GTC GLOBAL

The 6 leading themes on **International Tax Dilemmas and Complexities**

Based on the GTC Conference 2022

Contents

Preface

The Global Tax Controversy (GTC) network is a leading platform for sharing knowledge and experience in the area of international tax litigation and mediation. With an extensive list of senior tax litigators, arbitrators and mediators, the GTC team can help multinationals with a structured approach to global tax risk management, represent taxpayers in court, or support them in mediation and arbitration of international tax matters.

For GTC's annual conference in 2022, GTC specialists wrote and discussed 6 whitepapers that reflect the 6 current leading themes on international tax dilemmas and complexities:

1. "Ethics of Tax Planning"

How do morality and ethics play an important role in today's international tax arena?

The practice of tax planning has lately come under fire, lawful tax planning and aggressive even immoral avoidance, and whether the rule of law should be the only line that matters. One unanswered question that remains is what these implications mean for the tax planning sector.

The whitepaper discusses the various perspectives on how ethical tax planning is, including the role of the ethics of tax planning in the context of taxpayer rights.

2. "Code of Conduct: Principles for Tax Authorities"

Are the tax authorities treating multinationals in a fair and equitable manner?

Are tax authorities adhering to and upholding the principles of fairness and equitability in their public duties? Should we consider either a formal code of conduct or a general communication protocol that could ensure constructive and professional communication channels between tax authorities and taxpayers?

The whitepaper discusses the trends and concerns that arise from the behaviour of tax authorities, and whether tax administrations should be subjected to a universal code of conduct.

3. "Tax Footprint"

What do multinationals publish on their global tax footprint to society?

To be seen as "good taxpayers," businesses frequently volunteer to publicly share their tax impact in the form of a “tax footprint”. Therefore, their focus is shifted away from traditional tax planning and onto a tax compliance strategy, whose aim is to communicate tax compliance as a social responsibility. The advantage of such a strategy is that it can mitigate reputational damages emanating from potential tax audits and litigation.

The whitepaper discusses the considerations for tax footprint reporting, including drafting an MNE tax footprint, value chain and tax principles, and tax management and governance.

4. "Recent Experience on Onshoring of IP"

What is the tax impact and experience from onshoring of intangibles by multinationals?

The introduction of BEPS Action Plain 8-10 has significantly changed tax planning structures in relation to intellectual property (IP), and many companies are engaging in restructuring activities to meet the BEPS substance requirements.

The era of aggressive tax planning structures that involves the offshoring of IP to low-tax jurisdictions is over. Instead, the strategy should involve the redesign of structures to align economically significant decision-making and control functions with IP ownership. Many multinationals are converting their offshore structures to onshore structures, moving the IP back to the home jurisdiction where all economically significant activities take place.

The whitepaper discusses how MNEs will change their tax planning structures so that the IP is located where economically significant decision-making and control functions are aligned.

5. "How to Set Up a Tax Risk Committee"

What should your tax risk committee report to the audit committee or to the board?

Instead of having a reactive approach to tax monitoring, businesses should turn to more proactive tax risk management, as it would allow board members to react timely, and therefore avoid, potentially harmful tax risks.

It is vital that multinationals and medium to small businesses exercise control over this risk by establishing a tax risk management (TRM) framework. Some major questions surrounding this theme are:

- Should one have a tax risk committee as a subcommittee of the audit committee?
- Should a tax register be used to track all tax risks?

- • What are the ethical and legal implications of the latter two instruments, for example in light of the Whistleblowers Act?
- The whitepaper discusses the importance of effective management and proactive avoidance of tax risks and setting up a tax risk management structure.

6. "Anti-abuse Clauses - Interpretation Under Treaties"

How do multinationals deal with the tsunami of anti-abuse measures issued by tax authorities?

MNEs have increasing difficulty navigating through a web of complex anti-abuse provisions that have no natural hierarchy. One example is how the Principal Purpose Test contained in Article 29(9) of the OECD MTC rank against other anti-abuse provisions. In addition to a lack of hierarchy, the interpretation of the PPT remains controversial.

This white paper addresses the increasing difficulty MNEs face while navigating through a web of anti-abuse provisions some of them without a natural hierarchy.

Each section contains one whitepaper and 5 discussion statements that were discussed by the panel and the audience – including the percentage of the audience that agreed or disagreed with the statement.

To learn more about the GTC network, and past conferences, or to get in touch with our experts, please visit the GTC website: *[https://www.gtc-global.org/gtc-conference-2022.](https://www.gtc-global.org/gtc-conference-2022)*

WHITE PAPER 01

ETHICS OF **TAX PLANNING**

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2022

GTC CONFERENCE

"The art of taxation consists in so plucking the goose as to get the most feathers with the least hissing.[1]"

1. Introduction

The term 'tax' derives from the word 'taxare', which signifies an estimation.[2] The first record of taxation was found in ancient Egypt, which was almost 5,000 years ago.[3] These were occasionally collected in an unplanned way and charged either on the sale and purchase of goods or cattle. Taxes were imposed throughout the Greek, German, and Roman Empires as well, based on revenue or vocation.

Today, we are living in an era where "responsibly sourced" and "sustainably sourced" products are becoming fundamental to the ethos of businesses and consumers. Taxes are also inextricably linked to the 15 Sustainable Development Goals set out by the UN, which have been accepted by all member nations.

Given the fundamental shift in society and mindset, the debate on the tax liability of a business has also shifted gears - from determining the correct legally due amount of tax liability in a nation to responsible & ethical payment of taxes (in countries) where businesses operate or where economic value is generated. Further, the rollout of the ambitious OECD G-20 lead BEPS initiative signalled an end to stateless income or what is called 'double non-taxation.

Taxes to be paid are usually defined and definite, however, ethics and morality are not as cut and dry – they are relative to the belief of individuals, communities and societies. As we all know, perfectly legal acts may be immoral or unethical.

How does a business draw the balance between varying stakeholder expectations and its own set of guiding principles? Throw in the interplay of morals and ethics of individual decision-makers of a business to this mix, and it will be evident that there can be no clear answers to whether and to what extent is tax planning ethical or unethical.

Businesses are expected to be efficient about how they plan their taxes, however, the expectation is that this would still be in the contours of what is perceived as moral and ethical by society at large.

This brings to the fore a fundamental disconnect with long-standing principles and jurisprudence in

2 Directly from Latin Taxare, available at https://www.etymonline.com/word/tax#:-:text-and%directly%from%Latin%taxare, (accessed 12 July 2022).

3 'History of Taxes' (Tax Foundation) <https://taxfoundation.org/history-of-taxes/> accessed 18 July 2022."plainCitation":""History of Taxes' (Tax Foundation

tax. It has long been held in various cases that every person is entitled to arrange his affairs in a manner as to minimize taxes,[4] and that it is no one's patriotic duty to pay more taxes than what is warranted by law. Some famous quotes by Judge Learned Hand in this regard are:

Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes (Gregory v. Helvering, 69 F.2d 809, 810 (2d Cir. 1934))

Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant. (Commissioner v. Newman, 159 F.2d 848, 851 (2d Cir. 1947) - dissenting opinion)

This paper attempts to lay out changing approaches to this vexed topic. It doesn't attempt to reach a right or wrong conclusion on the ethics of tax planning; however, it attempts to highlight various perspectives that a business may consider while planning its tax affairs in light of the debate in the past decade, and how we foresee the future.

2. History And Evolution Of Tax Systems

Official records may trace the origin of taxes to almost 5,000 years ago in Egypt. Taxes, either in the form of tributes or contributions, have been present in human civilization for a long time now. Throughout history, paying taxes has been considered as a moral obligation to the country, kingdom, or community that one lives in.

An edict from Caesar Augustus ordering the taxation of everyone in the world was issued around 2,000 years ago.[5]

The Greeks inserted taxes into the ethical realm, arguing that a society's taxation system must indicate if it was free or despotic. The term liturgy, derived from the Greek '*leitourgia*', implies "public service" or "people's labour." The concept of generosity was ingrained in the mythological minds of the ancient Greeks.

The concept was established by the philosopher Aristotle. His "magnificent man" donated substantial money to the neighbourhood. However, because they lacked resources, the poor could never be 'magnificent'. In 'The Art of Rhetoric[6], Aristotle made the case that true prosperity comes from doing good: giving away money and gifts and assisting those in need to survive.

4 IRC v. Duke of Westminster (1936) AC 1 (HL).

5 'History of Direct Taxation' <https://www.incometaxindia.gov.in/pages/about-us/history-of-direct-taxation.aspx> accessed 18 July 2022.

6 JH Freese and Aristotle Aristotle, The Art of Rhetoric (1926).

In the Middle Ages, St. Thomas Aquinas[7], a thirteenth-century philosopher, and economist equated the collection of taxes with morals and ethics. According to him, the collection was justified if it was related to the safeguarding of the common good. He has also justified the use of violence for the collection of taxes if the above condition was satisfied. Hence, Aquinas focused more on natural law for the justification of imposing and collecting taxes. Accordingly, if these principles of taxes were held unjustly, such taxation was illegitimate.

With time, the concept of taxation evolved. Societies gradually started perceiving taxation as an 'obligation' and a 'responsibility'.

With the dawn of the industrial era, Adam Smith, an eighteenth-century philosopher outlined four fundamental tenets of sound taxation in his book, 'The Wealth of Nations[8]. These guidelines, namely, equity, certainty, convenience, and economy are also sometimes referred to as the four canons of taxation.

'Equity' is the idea that persons and organizations should pay taxes that are in proportion to their income. 'Certainty' is the notion that taxes need to be straightforward and easy to understand. 'Convenience' refers to how easy it is for taxpayers to pay their taxes, both in terms of timing and method. Finally, the term 'economy' relates to the notion that tax collection expenses should be kept to a minimum. These four canons of taxation are the pillars on which current tax systems in the world are based.

Tax treaties and the present movement to eliminate double non-taxation can trace their genesis back to the League of Nations. As income taxes gained prominence during World War I, the League of Nations was compelled to address the issue of double taxation and produced many models for use in the negotiation of bilateral tax treaties.[9] However, the end of World War II brought an end to all the efforts undertaken by the League of Nations. The League of Nations Model Conventions were rejected, and the OECD and later the UN took over the work. 1963 saw the first version of the OECD Model Convention. In 1992, it was transformed into a loose-leaf format to permit more frequent changes. Since then, nine changes, have been made. The most recent ones of 2014 & 2017 are however trying to change the narrative from avoidance of double taxation to prevention of double non-taxation – in alignment with the OECD's long-standing work on Base Erosion and Profit Shifting.

From its earliest known origins to Adam Smith's four canons, to established double tax avoidance treaties to the present thrust on the elimination of double non-taxation, the journey of tax, and the role of certainty & objectivity in the evolution of tax is an intriguing topic!

Conclusion

The history and evolution of taxation bear testimony to the unique relationship society have had with taxes even in today's modern era. As can be seen from its evolution, certainty is a fundamental tenet of the stabilization of tax systems which taxpayers

7 Konrad Edward Urban, Aquinas and the Welfare State, available at https://www.austriancenter.com/wp-content/uploads/2014/01/Aquinas-and-the-Welfare-State.pdf (accessed 12 July 2022).

8 Adam Smith, The Wealth of Nations (Fingerprint Publishing 2018).

9 Vann RJ, "Chapter 18: International Aspects of Income Tax" (IMF) <https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch18.pdf> accessed August 31, 2022.

are highlighting as an integral part of their rights. We discussed in the introduction, morality and ethics are relative and specific to both time and age, and the beliefs of society at large at any given point in time. Just as morality & ethics do not change the fundamental laws of physics, interposing morality & ethics in tax debate often vexes traditional tax planners who believe they are playing by the rules of the game, and prefer to work in objective contours rather than the vague contours of morality & ethics.

3. The Three Prisms

Despite the fact that the definition of ethics can be extremely broad and ambiguous, and the interplay between ethics and tax law is more complex, the application of ethical standards can help us draw some inferences regarding this unique interaction. Ethical standards or approaches could be utilized to distinguish between right and wrong behaviour.

There are three universal techniques that may be utilized to comprehend the interaction between ethics and tax law:

- **Utilitarianism:** It is an ethical theory that concentrates on the result of the act and disregards the means and reason behind the conduct. Utilitarianism is a 'utility-based theory, meaning that the most ethical action is the one that will benefit the greatest number of people. Bentham and Stuart Mill supported this theory.
- **Deontology:** This ethical philosophy emphasizes the application of a moral standard to differentiate between right and wrong. The adherents of this idea are concerned only with their purpose being in accordance with moral norms and are unconcerned with the consequence of their actions. Kant supported this hypothesis.
- **Virtue Ethics:** Aristotle and other ancient Greeks are given credit for developing this philosophy. This hypothesis is based on a person's character and inherent tendencies and is developed via practice and the environment in which a person lives.

Utilitarianism is about the 'utility' of an act. When approaching ethics in tax law, from a utilitarian lens, the means used to reduce tax liability will not be taken into consideration, instead, only the results would be investigated. The utility will be looked at from the perspective of the amount being saved, say through tax planning i.e., what is the greater benefit being generated from the use of tax planning strategies?

If a taxpayer uses tax avoidance to save more money in tax, then it will generate more utility for the taxpayer, and hence, from a utilitarian perspective, it will be an ethical thing to do. However, the use of tax avoidance strategies may result in a loss of revenues for the government and therefore, tax avoidance shall bring disutility from a government's perspective, including being viewed as a societal vice.

Deontology, unlike utilitarianism, is focused on moral norms and not on the outcome of the act. The intention, in line with moral norms governing society, is the relevant factor for the application of this approach. With the current framework, the government and society, in general, expect individuals to pay their 'fair share' of taxes for the betterment of society and hence, correlates with moral behaviour. Conversely, non-payment of pay their 'fair share' of taxes, under this approach shall be construed as an unethical action.

Virtue ethics, instead of being dependent on society or moral norms, is dependent on the individual itself. The approach is premised on the fact that people are born with a set of their own characteristics/values and cultivate them throughout their lifetime via their experiences and social constructs. Hence, vis-à-vis tax law, doing good for society by paying a 'fair share' of taxes would be considered a moral thing to do.

Contemporary understanding of tax

In today's world, at its most fundamental level, the concept of 'tax' may be seen as an agreement between the taxpayers and the government. The ability of a tax system to function effectively is the evidence of a notable commitment on part of various stakeholders in society. In essence, tax is an underlying factor that could be viewed by stakeholders of a business from three prisms:

1. Obligation
2. Cost
3. Responsibility

1.1. Tax as an Obligation

Defined as "a responsibility; the link of legal necessity which holds together two or more definite people[10]", it may be legal or moral in nature.[11] However, in terms of sovereign nations, where statutes, treaties, and court judgments regulate the tax system, the scope of such obligatory responsibility grows more.

The term "obligation" carries the connotation of positive law. This indicates a legal necessity that may be supported by law rather than moral responsibility. Hence, the 'obligation' of paying tax is not found on frivolous assumptions but derives its roots from domestic legislation, and bilateral agreements. For example, 'The Russian Tax Code', exclusively deals with the "fulfilment of obligations to pay taxes and levies", which touches the obligation aspect of taxation comprehensively.[12] Similar obligations can be found in laws of other jurisdictions[13] as well that are backed with deterrent statutory penalties. Hence, 'Legal Positivism' idealizes that taxes should be seen as obligations that come with predetermined penalties written down.

1.2. Tax as a Cost

Tax can also be construed as a cost for business. In generic terms, 'Cost' refers to the effort or loss necessary to accomplish something.[14] Stakeholders consider tax to be a cost to the business as it allows the business to carry on its operation, though tax paid in some circumstances is not allowed as a deductible expense in strict legal parlance. However, considering tax as a part of cost makes it possible for the company to implement cost-cutting and management strategies together taking into account tax planning considerations. Further, tax savings has

10 'Obligation', Osborn's Concise Law Dictionary (12th edn, Sweet & Maxwell 2013)

11 'Obligation', Black's Law Dictionary (10th edn, Thomson Reuters 2014)

12 Chapter 8, Russian Tax Code

13 Section 94v, Income Tax Assessment Act 1936 (Australia); Chapter 2C, Income Tax Act 2007 (United Kingdom)

14 'Cost', Concise Oxford English Dictionary (11th edn, OUP 2004)

also emerged as a tool for enhancing shareholder returns. Nevertheless, while going through the process of cost management, a particular focus is placed on accounting standards. The costs that are paid for the perpetuity of its operation in relation to the infrastructure (relating to Corporation, Financial, Social, and Regulatory) in some jurisdictions are also included in the costing component of the taxes that a business must pay. This is a linked type of taxation in which various members of an enterprise pay fairly for the services and operation of the enterprise. Thus, tax as cost for businesses can entail the characteristic of 'quid pro quo' i.e., tax in consideration for the sound infrastructure for businesses to function.

1.3. Tax as a Responsibility

'Responsibility' refers to the act of being responsible, blamed, or credited for something. [15] In addition, it also entails the moral implications that encompass it. In essence, 'Responsibility' means being morally accountable for one's behaviour.[16] With respect to tax, 'responsibility', like 'obligation', contains not just underlying features of a legal obligation to pay tax, however, it is a far broader term. Businesses must bear the responsibility of adhering to a fair tax policy. In the eyes of jurists, tax avoidance is equated to tax evasion, given a paradigm shift of accountability. In the same context, natural law jurisprudence provides for a solid foundation for the idea of taxation as a duty that must be repaid for every benefit received from the state. In addition, the Savigny Theory of Volkgeist holds that legislation embodies the collective desire of the people it was intended to serve. As a result, for a civilised state, there is a shared desire among all key members of society for a fair tax contribution and compliance.

Conclusion

How taxpayers view tax planning would largely be influenced by the prism from which taxes are viewed – those who view tax as an obligation would tend to comply with the letter of the law; those who view tax as a cost would naturally seek to minimize or optimise their costs; and those that view tax as a responsibility may be more inclined to pursue the path of the spirit and intent of the law. The prism from which a taxpayer would view taxes would certainly influence a person's view on whether their tax planning is ethical or unethical. In an independent unanimous survey conducted by the authors, 30% of the respondents viewed the tax as an obligation, 21% viewed the tax as a cost and about 49% viewed the tax as a responsibility. While the size of the sample is too small for the authors to reach a conclusion on the general view, it was an interesting perspective on the narrative which shapes tax debates.

15 'Responsibility', Concise Oxford English Dictionary (11th edn, OUP 2004).

16 'Responsible', Concise Oxford English Dictionary (11th edn, OUP 2004).

4. Interplay Of Ethics, Morals And Tax Planning: Similarities, Differences In Ethics And Tax Law

The Greek term 'èthos', which signifies custom, is the root of the English word 'ethics'. The English moral or morals are connected to the Latin term èthos, which is translated as mos, plural mores.[17] They both refer to the same meaning; that which is associated with acceptable behaviour. The notion of morality and ethics emanates from the changing dimensions of society. What is moral today may be deemed as immoral tomorrow, therefore, it is fundamental to construe a contemporary understanding of the aforesaid term. 'Morality' symbolises the principles pertaining to the underlining distinction between right and wrong[18] and 'Ethics' establishes the moral principles governing or influencing conduct.[19] Therefore, morality is a subset of ethics.

Since there is no moral need for citizens to pay taxes, states might reasonably predict that the factors that citizens would take into consideration are laws and penal consequences. Resulting, the state is practically obligated to enact tax regulations. Furthermore, the Court has ascertained the moral aspects of taxation by affirming the existence of moral duties to pay tax[20] and has equated the crime of tax evasion with that of moral turpitude.[21]

Associated with it is the issue of how far the responsibility to pay taxes would stretch. One might assess the bounds of the moral need to pay taxes by balancing the individual's self-interest in paying as little taxes as feasible with the social demands to contribute equitably to the common good. The objective is to offer a reasonable and equitable process that embraces the concept of fair share and achieves a balance. The notion of voluntary taxation (liturgy) practised in the Greek Empire, in which it was the responsibility of affluent people to pay the state's social programmes and military activities, is a sophisticated example of the connection between ethics and taxes.[22] It may be incorrect and unreasonable to presume that taxes (for the general good) are detrimental to the self-interest and materialism of individuals.

17 'Ethics' (LII / Legal Information Institute). <www.law.cornell.edu/wex/ethics#:~:text=The%20word%20"ethics"%20is%20derived,to%20interact%20with%20one%20another.> accessed 23 June 2022.

18 'Morality', Concise Oxford English Dictionary (11th edn, OUP 2004).

19 'Ethics', Concise Oxford English Dictionary (11th edn, OUP 2004).

20 Snyder v. Routzahn, 55 F.2d 396, 397 (N.D. Ohio 1931).

21 Jordan v. De George, 341 U.S. 223, 229 (1951).

22 'Voluntary Taxation: A Lesson from the Ancient Greeks | Aeon Ideas' (Aeon) <https://aeon.co/ideas/voluntary-taxation-a-lesson-from-the-ancient-greeks> accessed 17 July 2022.

Conclusion

Ethicists, philosophers, legal theorists and lawyers have all attempted to answer the perennial question; of whether the responsibility of paying taxes is dependent on the legislation that imposed such a liability.

The amount of taxes owed as a result of tax planning must be morally acceptable if it complies with the law. Can legislation be seen as the codified form of this normative notion and the reach of moral values beyond the codified version? This is an intriguing subject that courts may decide on in the future.

5. Notable Studies In The Field

While philosophers have laid down the moral need to pay taxes in the form of reciprocity to society, it has never been concrete. Attempts of philosophers like Rousseau and Hobbes can be of much significance here.

'Social Contract Theory' by Rousseau and Hobbes explains the moral responsibility to pay taxes. Hobbes assumes that individuals are free, intelligent creatures who are not subject to the law. Hobbes believes that individuals should be allowed to handle their finances as they see appropriate to maximise their wealth[23]. However, both Hobbes and Rousseau contend that rational human freedom is illusory and temporary.

Numerous studies have investigated and shown a clear correlation between taxpayers' ethics and morals and their degree of tax compliance. As an illustration, a research study undertaken[24] examined whether tax ethics and societal norms motivate tax compliance or just rationalize self-interested behaviour. Two-wave survey data from 1161 Australians were cross-legged. First, tax ethics affected tax compliance with varying levels of compliance. Second, perceived social norms influenced tax ethics, but only for group-identified respondents. Personal ethics were also placed onto social group norms. Third, perceived standards impacted tax compliance through personal ethics. Tax compliance altered norm perceptions. Overall, the study shows that individual ethics and societal norms influence taxpaying behaviour.[25]

Further, Alm and Torgler researched the relationship between tax compliance and ethics. The study argues that the issues related to tax compliance may be explained by "ethics". External and internal variables determine taxpayer behaviour. Ethics and morals are essential to understanding a person's tax compliance decisions. Morality and ethics are nebulous, abstract, and spectrum-based. Overall, the report advises combining ethics and morals with standard punishments to boost tax compliance.[26]

23 Yenni Mangoting , Eko Ganis Sukoharsonob, Rosidic, Nurkholis; 'Developing a Model of Tax Compliance from Social Contract Perspective: Mitigating the Tax Evasion', (2015) 966 – 971.

24 Professor (School of Psychology), Flinders University

25 Wenzel M, Motivation or Rationalization? Causal Relations Between Ethics, Norms and Tax Compliance, Australian National University Working Papers, No. 63 (2005).

26 J Alm & B Torgier, Do Ethics Matter? Tax Compliance and Morality, Journal of Business Ethics, 101(4), 635–51 (2011).

A 2017 Harvard study explored the role of moral appeals in reducing tax evasion.[27] HBR conducted an experiment with the Norwegian Tax Administration wherein almost 15,000 taxpayers participated to analyze the correlation between moral motivation and tax compliance. While the study concluded that moral appeals can often be cost-effective, it is important that they must be applied carefully. They seem to work best at the moment, without longer-lasting effects. By coupling moral appeals with other measures like the threat of detection, decision-makers can better ensure compliance, including limiting tax evasion.

Conclusion

Most studies above have concluded that morality and ethics influence the manner in which tax obligations are discharged.

6. Current Trends – The Debate Around Profit Shifting By Multinationals And Subsequent Developments [28]

Throughout most of the 20th century and early up to 2010 in the 21st century, while tax evasion and tax avoidance were debated, they were mostly in court cases and academic circles. The rest of the world carried on with business as usual and optimizing tax as long as it was in the letter of the law was a given for businesses. However, this changed in 2010, Mainstream media coverage from the year 2010 to 2012, such as Bloomberg's "The Great Corporate Tax Dodge"[29], the New York Times series "But Nobody Pays That" (David Kocieniewski of The New York Times won a Pulitzer for this)[30] and some articles in the Times and the Guardian, raised a growing concern worldwide of profit shifting using transfer pricing and double non-taxation of income. The debate reached

27 Kristina Bott et al., Research: Moral Appeals Can Help Reduce Tax Evasion, Harvard Business Review (July 20, 2017), https://hbr.org/2017/07/research-moral-appeals-can-help-reduce-tax-evasion#:~:text=However%2C%20if%20people%20are%20motivated,authorities%20substantially%20reduces%20tax%20evasion. The study provides some great insights for governments to enhance tax compliance from the taxpayers by appealing to their moral side. The field experiment was in collaboration with Norwegian government and involved 15,000 taxpayers that were selected based on the government's belief that they were more likely to underreport their income. The subjects were divided into two groups randomly. One group was presented with a "base letter" which entailed the detailed instructions regarding the procedure of paying taxes. The other group received two sets of letters, "moral letter" and "detection letter". The moral letter tapped onto the ethics and morality of the paying taxes and doing the right thing for general benefit. The detection letter was devoid of anything related to ethics or morality, it just indicated that the receiving taxpayer might get audited.

28 'A-New-Bar-for-Responsible-Tax.Pdf' <https://bteam.org/assets/reports/A-New-Bar-for-Responsible-Tax.pdf> accessed 31 August 2022.

29 http://taxjustice.blogspot.com/2011/12/great-corporate-tax-dodge-new-website.html

30 https://www.pulitzer.org/winners/david-kocieniewski

a political level and became an issue on the agenda of several OECD and non-OECD countries.[31]

While it culminated in the BEPS Inclusive Framework which has been discussed subsequently in this paper, it also led to introspection amongst corporates. Together with a crackdown (notably from the EU) on state aid and taxes paid by multinationals in EU countries which were their markets, and the UN Sustainable Development Goals, tax transparency and responsible tax practices started featuring prominently on the agenda of leading multinationals. One such initiative which has gained significant traction is discussed below.

In 2017, The B Team[32] (a global non-profit initiative), brought together heads of tax from multinationals[33] to address a critical opportunity for business and society: responsible tax practice. Facing an alarming decline in public trust, these MNEs were aware they had to take a bold step to restore corporate integrity while building a fairer, greener and more human world. Working with investors, international institutions and civil society, they developed a new framework for approaching tax with a set of Responsible Tax Principles.

In February 2018, at the Tax & SDG Conference at the United Nations Headquarters, The B Team launched 'Responsible' Tax Principles. The principles raise the bar on how business approaches to tax and transparency and help forge a new consensus around what responsible practice looks like. They articulate best practices in seven key areas from corporate governance to relationships with authorities to transparency. These are:

Principle 1:

Tax is a core part of corporate responsibility and governance and is overseen by the board of directors (the Board).

Principle 2:

We comply with the tax legislation of the countries in which we operate and pay the right amount of tax at the right time, in the countries where we create value.

Principle 3:

We will only use business structures that are driven by commercial considerations, are aligned with business activity and which have genuine substance. We do not seek abusive tax results.

Principle 4:

We seek, wherever possible, to develop cooperative relationships with tax authorities, based on mutual respect, transparency and trust.

Principle 5:

Where we claim tax incentives offered by government authorities, we seek to ensure that they are transparent and consistent with statutory or regulatory frameworks.

31 https://read.oecd-ilibrary.org/taxation/addressing-base-erosion-and-profit-shifting_9789264192744-en#page15
https://read.oecd-ilibrary.org/taxation/addressing-base-erosion-and-profit-shifting_9789264192744-en#page15
https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2019-july-2020.pdf

32 'The B Team | Our History' <https://bteam.org/who-we-are/our-history> accessed 31 August 2022.

33 The nine Founding companies are Allianz, BHP, A.P. Moller - Maersk, Natura Cosméticos, Repsol, Royal Dutch Shell Plc, Safaricom, Unilever and Vodafone Group Plc.

Principle 6:

We engage constructively in national and international dialogue with governments, business groups and civil society to support the development of effective tax systems, legislation and administration.

Principle 7:

We provide regular information to our stakeholders, including investors, policymakers, employees, civil society and the general public, about our approach to tax and taxes paid.

Conclusion

Several multinationals have now started reporting their tax facts/philosophy in their annual report to stakeholders.[34] This is an encouraging trend. Building trust between all stakeholders requires meaningful transparency: between businesses, revenue authorities, investors, citizens and governments. This approach should, in turn, help to rebuild trust in the tax system and enable a more informed public debate on the appropriate approach for a modern and inclusive economy.

7. The role of Government and Tax Administration

"No government can exist without taxation. This money must necessarily be levied on the people, and the grand art consists of levying so as not to oppress."[34]

The economic crisis of 2008 can be an example in point for the role that governments can play in the formation of a sound tax policy. Since the global financial crisis of 2008, a number of changes have been implemented that greatly improve the ability of the international tax regime to tax offshore earnings. To begin with, the G20 spearheaded the OECD Base Erosion and Profit Shifting (BEPS) project from 2013 to 2015, which yielded fifteen action measures to improve taxation on active income based on both the country of origin and the country of residency. The European Union (EU) implemented BEPS as part of its Anti-Tax Avoidance Directive (ATAD). The principal purpose test (PPT) is a key component of BEPS and ATAD, as it stipulates that all tax treaties must include wording stating that the treaty will not

34 Unilever, Shell, Vodafone, Allianz, Repsol to name a few.

apply to transactions if the major purpose of the transaction was to avoid tax.[35]

According to Avi-Yonah, taxation entails three goals for the government.[36] First, taxes fund vital government functions like public goods. Second, taxation redistributes wealth and income in a market-based economy to reduce inequality. Thirdly, taxation has a regulatory component that may guide private sector behaviour in the government's desired direction. These three principles illustrate how taxes and the government as a stakeholder interact. On close examination and study of Avi-Yonah principles, it may be deduced that taxation by the government is a channelled way of recouping money fairly.

Adam Smith demonstrated that justice in taxation is the fundamental tenet of tax collection. Tax compliance will increase as justice is perceived to be administered more fairly. It is rather straightforward to state that an increase in tax compliance will occur if people perceive tax as justified. Every advancement in how justice is perceived results in an expansion of tax compliance[37]. The taxpayer will be more compliant to furnish tax returns in accordance with the law if the tax system is fair and tax payment is rational.

Despite ethical considerations of governments being major stakeholders in taxation, yet some conundrums surround the applicability of the same. The most arduous amongst them is the evasion and avoidance of tax by the most affluent sections of society who find some loopholes in the existing law and end up reducing their tax liabilities ignoring the fact that taxation is not merely a legal obligation but also an ethical one.

Modes of punishment for non-compliance – retributive or reformWative?

Penalties for non-compliance with tax law in most countries are either monetary or in the form of criminal sanctions. Penal laws are guided by criminal jurisprudence, whereas monetary penalties are mostly determined by the amount at issue. Penal provisions can be of various types, including but not limited to, retribution, deterrence, rehabilitation, incapacitation, and restoration.[38]

Of these, the prominent theories for ensuring collective adherence to social norms are reformative and retributive modes of punishment.[39] Both philosophies influence how states deal with wrongdoings or violations of established rule of law. Establishing which of the two ways would assure effective tax compliance is a long-running argument. The first strategy advises gentle persuasion in case of non-compliance. The latter stems from the deterrence approach, which states that crimes must be punished harshly to dissuade repeat offences.

35 Reuven S Avi-Yonah, 'The Great Recession and the International Tax Regime' (Kluwer International Tax Blog, 23 April 2019) <http://kluwertaxblog.com/2019/04/23/the-great-recession-and-the-international-tax-regime/> accessed 31 August 2022.

36 Reuven Avi-Yonah, 'The Three Goals of Taxation' [2006] Articles <https://repository.law.umich.edu/articles/40>.

37 T. G. Brashear, C. Manolis, and C. M. Brooks, "The effects of control, trust, and justice on salesperson turnover," J. Bus. Res., vol. 58, no. 3 SPEC. ISS., pp. 241–249, 2005

38 Thomas Schueneman, 'Types of Crimes and Their Punishments | Learn Criminal Justice' (Point Park University Online, 26 May 2021) <https://online.pointpark.edu/criminal-justice/types-of-criminal-punishment/> accessed 20 July 2022.

39 Ezazul Karim, 'The Critical Evaluation of the different Theories of Punishment' (Oct, 2020) <https://www.researchgate.net/publication/350134502_The_Critical_Evaluation_of_the_Different_Theories_of_Punishment>

Economic offences undermine the economy by transferring financial advantages beyond developing nations' taxation net, yet retributive punishment alone may not be the answer. There are ethical nuances associated with taxpayers' thinking that leads to non-compliance. Discriminatory tax rates that impose a higher burden on common people, lack of transparency between taxpayers and their government, and lack of serious consequences in certain instances that shape the public belief system negatively are some of those ethical nuances. Simply put, if tax evasion isn't penalized, people will indulge in it.

It's common for fiscal legislation to discourage tax evasion by non-compliant parties. Where compliance isn't automated, easy, and clear, a responsive strategy with limited government interference is preferable. At the same time, retributive methods alone cannot secure tax compliance. This kind of punishment may erode trust in the authority and reduce cooperation. It may force taxpayers towards non-compliance or creative compliance/ tax avoidance schemes. Some scholars argue that regulations that relied less on coercion and more on education or persuasion generated a cooperative attitude in terms of compliance.[40]

In a case study involving Australia, New Zealand and East Timor, the tax authorities were, at some points in time, charged with continuous abuse of their position and undermining of the integrity of the tax system.[41] The first two jurisdictions relied on deterrence, while the East Timorese government was corrupt, eroding public trust in the system. Although each jurisdiction's approach was different, they all adopted retributive tax reform. Some of the approaches included taxpayer training, streamlining tax procedures, boosting staff efficiency via training, and developing a regulatory framework for resolving procedural unfairness.

Judge-made anti-avoidance theory and statutory principles like GAAR have helped tip the scales in favour of governments. Their effectiveness lies in their ability to see through the entire transaction and determine if the entire purpose of the transaction was to avoid taxes. Though the economic-rational framework is a driving factor, when it comes to the implementation of such policies, there is no denying the fact that the ethicalness of such transactions is also a main consideration. Further, the public and political reaction has also contributed to building a tax-avoidance immune environment.

While GAAR and PPT have been fairly successful measures, however, it is important to note that their formulation and implementation might be built on the political consequences following the public reaction to leaks like Panama and Pandora and the 2008 economic crisis. An example in point can be the shelving of the 'Double Irish with a Dutch Sandwich' structure. When this particular tax arrangement was bought into light and the revelation of how Facebook, Google and Apple had saved billions in taxes, the Irish Finance Minister was forced to abolish this controversial tax planning strategy and phase it out by 2020.[42] Similar is the British Parliament's questioning of MNCs on their innovative and yet,

40 Jenny Job et al., Culture Change in Three Taxation Administrations: From Command-and-Control to Responsive Regulation, Law & Policy (2007) 88, https://regnet.anu.edu.au/sites/default/files/publications/attachments/2015-05/Job-etal_CultureChange_0.pdf

41 Id.

42 'Irish Budget: Michael Noonan Is to Abolish "Double Irish" Tax Structure' BBC News (14 October 2014) <https://www.bbc.com/news/world-europe-29613065> accessed 25 August 2022.

aggressive tax planning strategies.[43] Such instances are a clear indication of the building political and public pressure against the strategies adopted by such MNCs.

Conclusion

The hard stance adopted by the governments is a clear indication that stakeholders in a tax system are beginning to realize that it is not just the legality of a transaction that will determine its validity but instead the ethicality of the transaction. All such measures are singularly focused on achieving an environment which is free of tax avoidance and requires the MNCs to contribute their fair share of taxes back to society. Since taxation entails the Governments to compulsorily collect revenues from their citizens, the question of the effects of tax laws on individuals' freedom and liberty is writ large.

8. International Tax Planning, BEPS & Sovereignty

Double Taxation Avoidance Agreements (DTAAs) have a two-fold purpose: first, they prevent double taxation of income; and second, they promote the flow of trade between countries with different taxing mechanisms.[44] They adjust the tax environment between countries so that pre-determined tax bases and withholding obligations are applied to non-residents. While it provides certainty to investors, it also opens avenues for MNEs to avoid taxation in high-tax jurisdictions and significantly lower their tax base in another jurisdiction through various strategies.

The problem arises due to inherent differences between the economies of developed and developing countries which makes their fiscal focus inconsistent with each other at times.[45] There has been significant debate on the allocation of taxing rights between developed and developing countries. Developing nations enter into DTAAs with the expectation that it would foster foreign investment in their jurisdiction

43 'British Parliament's Straight Shooter Taking on Big Business' (Los Angeles Times, 3 November 2013) <https://www.latimes.com/world/la-xpm-2013-nov-03-la-fg-hodge-qa-20131104-story.html> accessed 25 August 2022; 'MPs Challenge Google's "smoke and Mirrors" on Tax' Reuters (17 May 2013) <https://www.reuters.com/article/uk-google-britain-tax-idUKBRE94F0I920130517> accessed 25 August 2022..

44 Bruce A. Blonigen, Ronald B. Davies, Do Bilateral Tax Treaties Promote Foreign Direct Investment?, Working Paper 8834, National Bureau of Economic Research (2002) 2 & 4, https://www.nber.org/system/files/working_papers/w8834/w8834.pdf

45 Vogel, Klaus. Double Tax Treaties and Their Interpretation. International Tax & Business Lawyer, Vol 4, 1986

by laying down a uniform set of definitions and tax bases between the two countries.[46]

Relative to developed countries, developing countries typically rely more on corporate income tax as a percentage of all tax revenue and have fewer viable alternative sources of income.[47] This may suggest that developing nations may be more susceptible to the erosion of the corporate tax base. MNEs may strategize their transactions so as to avail benefits provided under the DTAA, thus costing developing countries their fair share of the revenue.

This inconsistency needs to be addressed since it could lead developing countries to impose strict liability on MNEs which could in turn disturb the economic balance globally. While a majority of developing nations exhibit immense potential in the area of capital and technology, regrettably, their export capability in these areas cannot be in comparison to those of developed nations because of the associated economic dissimilarities. While many developing nations have this characteristic, their economic policies, including their tax policies, should take this into consideration.

International tax policy currently concentrates on the developed nations which, with a few exceptions, have comparable trade and investment flows and that, as a result of the most recent economic crisis, require greater transparency. Despite efforts to include developing nations in the discussion of the OECD initiative on Base Erosion and Profit Shifting (the BEPS Report), there is no question that developed countries have dominated the process.[48]

BEPS Action Plans address the issue of taxation of businesses that follow the e-commerce model. Through digital means, MNEs no longer have to establish their presence in another jurisdiction so that they come within their tax jurisdiction. The riveting arguments by developing country for getting taxing rights over revenue generated through digital means in their jurisdiction is valid. They contest the allocation of taxing rights back to developed countries because revenue is generated in their jurisdiction by virtue of activity and user-base present there. The traditional model of DTAAs does not address this issue which has given to this controversy. This led to the evolution of BEPS Action Plan 1.[49]

Thus, developing countries have started to impose a domestic digital tax on MNEs that gain revenue through digital means. However, these unilateral sanctions have led to tension between developed and developing countries. For instance, the US announced the imposition of trade tariffs on developing countries that were imposing a digital tax on US corporations, since the US was losing revenue on said profits.[50] Pursuant to the inclusive framework, wherein Pillar one addresses this aim

46 Page 12, https://cris.maastrichtuniversity.nl/ws/portalfiles/portal/63620938/c7005.pdf

47 Crivelli, Ernesto; De Mooij, Ruud; and Keen, Michael. Base Erosion, Profit Shifting and Developing Countries. International Monetary Fund Working Paper (2015) 14, https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Base-Erosion-Profit-Shifting-and-DevelopingCountries-42973

48 Crivelli, Ernesto; De Mooij, Ruud; and Keen, Michael. Base Erosion, Profit Shifting and Developing Countries. International Monetary Fund Working Paper (2015) 14, https://www.imf.org/external/pubs/ft/wp/2015/wp15118.pdf

49 BEPS, Action 1 Tax Challenges arising from Digitalisation, OECD, https://www.oecd.org/tax/beps/beps-actions/action1/

50 USTR Announces, and Immediately Suspends, Tariffs in Section 301 Digital Services Taxes Investigations, Office of the US Trade Representatives, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/june/ustr-announces-and-immediately-suspends-tariffs-section-301-digital-services-taxes-investigations

to address the issue regarding the allocation of revenue between source and market jurisdiction, the US has suspended the tariff actions on developing countries after ensuring that the said revenue will be credited in the appropriate manner once Pillar one is implemented.

Fair Share Dilemma

A progressive tax system idealises payment of a fair share of taxation to the government. This principle has become even more prominent in recent times owing to revelations of MNCs and billionaires paying zero taxes by utilizing legal loopholes.[51] Such leaks strike right at the core of the idea that everyone pays taxes proportionally in a democratic setup with a progressive tax system. Nonetheless, they also put the spotlight back on the fair share debate.

While several attempts have been made to define fairness, the outcome has been varied and has resulted in a notion of fairness that is highly subjective and dependent on the perception of the individual. The task in itself is so mammoth that even philosophers[52] have been vexed by it.[53]

Black's Law Dictionary defines fairness as qualities of impartiality or treating people in a reasonable way[54] while the share is an allotted portion, owned by, contributed by, or due to someone.[55] When merged, a fair share can be understood as the total quantum that an individual deserves or is entitled to. When looked at from a tax perspective, a fair share would mean a fair distribution of taxes, reflecting a fair distribution of tax burden.[56] The concept of fair share rests on the anvils of equity, justice, a good conscience, and reciprocity. It is an implicit understanding that common citizens benefit when their fellow citizens pay taxes.[57] Moreover, the principle of fair share is also an extension of the duty of fair play and is an internationally recognized concept that binds the taxpayer to equitably contribute to his/her society via tax.

Nonetheless, loopholes in a legal system may allow a taxpayer to shift their taxes from a high-tax jurisdiction to a low-tax jurisdiction, thereby not effectively contributing their fair share of taxes. Hence, in a way, the fair share principle is at direct crossroads with tax planning. This is because while the fair share principle requires that a taxpayer contributes to the enrichment of society for the benefit accrued to him, tax planning intends to accrue the maximum benefit to the taxpayer and deprives society. Thus, to ensure compliance and resolve the conundrum of

51 Jesse Eisinger Kiel Jeff Ernsthausen,Paul, 'The Secret IRS Files: Trove of Never-Before-Seen Records Reveal How the Wealthiest Avoid Income Tax' (ProPublica) <https://www.propublica.org/article/the-secret-irs-files-trove-of-never-before-seen-records-reveal-how-the-wealthiest-avoid-income-tax> accessed 25 July 2022.

52 the likes of Rawls and Plato

53 Shiyan Koh, 'Paying Your "Fair Share" of Taxes: Prof Ho on What "Fair" Means' (NerdWallet) <https://www.nerdwallet.com/blog/finance/prof/paying-fair-share-taxes-prof-ho-fair-means/> accessed 24 July 2022.

54 'Fairness', Black's Law Dictionary (10th edn, Thomson Reuters 2014).

55 'Share', Black's Law Dictionary (10th edn, Thomson Reuters 2014).

56 Gribnau, Hans, Corporate Social Responsibility and Tax Planning: Not by Rules Alone (February 12, 2015). Social & Legal Studies 2015, Vol. 24(2) 225–250, Tilburg Law School Research Paper No. 09/2015, Available at SSRN: https://ssrn.com/abstract=2610090

57 Brookes Brown, 'Do You Have a Moral Duty to Pay Taxes?' (The Conversation) <http://theconversation.com/do-you-have-a-moral-duty-to-pay-taxes-114260> accessed 26 July 2022.

tax planning and fair share, it is important to address the ethical yardstick.

The authors believe that the argument for fair share covers two aspects within itself: tax treaties and taxpayers. Fairness in taxation covers the twin principles of economics, one being micro and the other being macro. The policy decision of a business entity to manage its tax determines the fair share commitment of the business which gives a micro picture. At a micro level, the focus is on efficient tax planning to maximize the net profit. Contrary to this, the formulation of laws, treaties and policies by the government to address taxation is an act at the macro level. A macro-level action plan is foremost to ensure the adaptation of a fair share.

Tax treaties must be consistent with our development goals to fulfil national interests. Due to their tax agreements with more developed nations, developing nations lose billions of dollars annually. In the case of Bangladesh, high-income nations like the UK, Italy, and the Netherlands have highly onerous tax treaties. A single provision in Bangladesh's tax treaties results in an annual loss of about US$85 million (£60 million).[58] Tax treaties between nations specify when and how to tax multinational firms. Lower-income countries are unfairly burdened by the taxation constraints contained in tax treaties as compared to wealthy nations. The need of the hour is to create a treaty for the commercial viability of capital-importing as well as a capital-exporting country.

The idea of fair share passes through crossroads where the equal share is equated to a fair share. This comparison is incorrect by its very nature since equity, not equality, constitutes the fair share. Giving every person or group the same resources or opportunities is referred to as equality. Recognizing that every person has unique circumstances, equity distributes the precise resources and opportunities required to get an equal result.[59] The main objective should be to prioritise equity in tax payment and collection over equality because there are inherent variations in the economic and social systems of the various treaty partners.

Admittedly, the fair share argument is strong and makes a fair case for progressive taxation, however, as is the case with every argument, the other side needs to be given due importance. While the idea of reciprocation is deeply ingrained in the fair share principle, nevertheless, one question that begs itself to ask is if paying taxes is the only way to reciprocate for fellow citizens.

Conclusion

Equitable distribution is a means to an end but not an end in itself. Global business has mostly made ethical contributions to host nations to improve their economic, social, and educational standing. The mere existence of a company in a nation is proof that respect for contribution exists. There are numerous ways for a corporation to fulfil its ethical duties. Everything, from foreign direct investment to creating jobs for locals, contributes directly or indirectly to the development of a country. The neighbourhood

58 Lovisa Moller, Why unfair tax treaties hold back developing countries, available at https://www.theguardian.com/global-development-professionals-network/2016/jun/15/why-unfair-tax-treaties-hold-back-developing-countries (accessed 15 July 2022).

59 Online Public Health, "Equity vs. Equality: What's the Difference? | Online Public Health" (GW-UMT, November 5, 2020) <https://onlinepublichealth.gwu.edu/resources/equity-vs-equality/> accessed July 22, 2022.

residents who work for the company are now liable for state taxes. This represents the company's basic contribution in itself. As a result, burdening the company more than necessary under the guise of a fair share may have unfavourable outcomes. It is paramount to reform the taxing mechanisms which are presently operating by balancing the power dynamics progressively to allow developing and underdeveloped countries to improve their participation in international trade, commerce and investment. This is not to imply that the company should think about dodging taxes, but rather that the government should analyse the company's obligation with a flexible and progressive mindset.

9. Concluding Remarks

'Nothing is certain but death and taxes, the famous quote has been attributed to various authors. However, what has not been attributed is that despite taxes being designated as certain, taxpayers have down the line, devised various ingenious approaches to reduce their unequivocal tax liability. Matching the same level of enthusiasm, Governments have also laser dedicated themselves towards countering such ingenious methods. On the same lines, Governments have been exploring the role of ethics and morality in substantial and better tax compliance.

The imposition of ethics-backed legal sanctions on one hand and morality on the other poses a fundamental question of whether morality and ethics are intertwined in tax law or are different unrelated concepts. And this serves as a breeding ground for the development of tax scholarship, fraught with morality and ethics. While trends do reveal that the use of ethics to increase tax compliance is increasingly being debated, however, the discussion can be traced to acclaimed philosophers like Adam Smith,[60] John Locke,[61] and[62] John Rawls[63]. Perhaps, it all boils down to the singularly focused and self-sufficient question – Why should one pay taxes?

While the question is straightforward, it still is the tip of the iceberg and is a representative of the eternal tussle between natural law and positive law. Philosophers stand on both sides of the debate; however, the likes of Panama and Pandora Paper leaks have tilted the debate more toward those who believe that it's unethical to indulge in tax planning.

The interplay of ethics and tax is centurial, nevertheless, with the rise of questionable tax planning strategies and the consequential public reaction, the debate has come to the spotlight and is gaining momentum. One long-standing question relating to tax and ethics that is if former is, 'Do we pay taxes because it is the legal duty or because it is illegal to not pay taxes?'

The authors, while attempting to answer this lofty question have analyzed different aspects of tax and ethical behaviour. While navigating through

60 Adam Smith, An Inquiry Into The Nature And Causes Of The Wealth Of Nations (5th ed., London, Strahan & Cadell 1789).

61 John Locke, Two Treatises Of Government (Peter Laslett ed., Cambridge Univ. Press 1988).

62 Bret N Bogenschneider, 'A Philosophy Toolkit for Tax Lawyers' (2017) 50 Akron Law Review 45.

63 John Rawls, A Theory of Justice (2nd ed., Harvard Univ. Press 1999).

questions of legal and ethical relevance, the authors, believe that it is the economic framework that drives people, rather than the ethical-legal framework.

Due to this, careful and conscientious ethical assessment of tax planning becomes necessary for the greater good of society. Therefore, the cynosure to be left by the government should be vis-à-vis the ethical consideration of statutes and relatively lesser towards an economic benefit. This begets the idea that laws should circumvent the ideas of generating revenues for the state conjointly keeping in mind the implications the laws will have on the minds of the taxpayers and how the same should not be regressive in nature.

Concurrently, taxpayers, while planning their taxes, should acknowledge the idea that taxes are collected for the greater good of societies and hence it becomes pertinent to make a careful ethical choice of tax planning strategies.

Easier said than done, to put such ideas to practicality, dissemination of awareness regarding ethics and tax is required and the importance of creating ethical tax planning as a norm within the legal system and moral fabric cannot be emphasized enough.

10. Five Statements For A Panel Discussion

Statement	Agree	Disagree
1. Morality and ethics get applied in a tax system that runs on a digital platform, i.e., the bias of algorithms.	40%	60%
2. Governments who use morality and ethics to introduce "anti-abuse measures" should be considered to uphold the morality and ethics standards by their behaviour.	96.88%	3.13%
3. Tax rules and regulations never address "morality and ethics".	40%	60%
4. Tax authorities treat "tax avoidance" the same way as "tax evasion".	50%	50%
5. Court verdicts help in determining what constitutes ethical behaviour in tax matters.	50%	50%

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WHITE PAPER 02

CODE OF CONDUCT **PRINCIPLES FOR TAX AUTHORITIES**

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1. Introduction

In the international tax world, the main talking point for decades has been and still is the unethical behaviour of multinationals (MNEs). Whether it is the media, governmental institutions or academic institutions, all have perpetuated the idea that MNEs are not paying their fair share of taxes.[64]

In this controversial and ground-breaking paper, the unethical and dishonest behaviour of tax authorities will be exposed and addressed through multiple examples. These show that, unfortunately, such behaviour is no longer an exception but is more and more becoming a trend. These concerns arise from tax professionals working in the field of international taxation who have observed disturbing developments in tax authorities' internal culture, which is reflected in their dealings with the taxpayers.

1.1. A Challenging Internal Culture

The internal culture of many tax authorities, both in developing and developed countries, rewards aggressive auditing and negotiations even where there is no basis and punishes reasonable and principle driven negotiations and assessments. Furthermore, the behaviour of tax authorities is often triggered by the wrong incentives such as maximizing the revenue ("cash justice" – government coffers are empty – squeeze the MNEs) even if there is no or little basis for this in tax law and regulations rather than principle driven – applying and interpreting the law in an objective way. For the tax authorities, the aim in negotiations seems to be not to find a reasonable conclusion but to intimidate and to "shake down" the taxpayer. The underlying motives of tax authorities should be questioned. For example, one of the intimidation tactics used is to play with the corporate reputation through leaking information, often wide-sided and incorrect, to the press or to issue highly inflated tax assessments (which tax authorities sometimes even openly admit) knowing that the multinational wants to avoid a very lengthy and costly (internal and external cost) appeals.

1.2. External Political Pressure

On top of that, the extreme positions taken by many tax authorities are justified in the public eye. This can be observed in the media and recent international tax publications. For example, some elements of the BEPS project are politically driven to address the perceived aggressive tax avoidance of all multinationals. In contrast, the vast majority of multinationals are paying their fair share of taxes. This stimulates and justifies the internal culture of tax authorities. As a side consequence, representatives

64 "Tax Morale II: Building Trust between Tax Administrations and Large Businesses" 2022 [hereinafter OECD Report 2022] available at https://www.oecdilibrary.org/sites/7587f25cen/1/3/2/index.html?itemId=/content/publication/7587f25cen&_csp_=ac409bfaa6c9ea20b305177e52b6da74&itemIGO=oecd&itemContentType=book#section-d1e1851

Where it reads in the Executive Summary: "In many countries, MNEs have been subject to increased public and media scrutiny concerning their tax practices…These results, together with the roundtable discussions between tax administrations and MNEs, highlight a lack of mutual trust and sub-optimal communication between tax administrations and businesses."

of tax authorities feel very uncomfortable in their negotiations with taxpayers. Sometimes even at the level that the communication between tax authorities and taxpayers is partially disrupted and non-functional. This is not to say there are no multinationals that are taking overly aggressive positions. This and this should be addressed through targeted changes in legislation that tax authorities can apply in an objective and principled manner.

Ultimately, there needs to be a counterbalance that protects the vast majority of open, honest and transparent multinational corporations that contribute to our society in a very positive manner and many ways. More and more multinationals are sharing their total tax contributions through various publications (such as tax footprints, tax contribution reports, public disclosure and country-by-country reports). From a legal perspective, this counterbalance could be achieved by creating a standard communication protocol. This protocol should contain a "Code of Conduct" – principles for tax authorities as well. Some countries have started defining a mutually respected written versions of such codes of conduct, like Switzerland.

Furthermore, this would call for the radical revision of the social contract into a new social contract 2.0, adapted to the modern era. Contrary to the non-constructive and sometimes even disruptive behaviour of tax authorities towards corporate taxpayers, the relationship needs to be one of transparency and mutual respect.

1.3. Taxpayer's Charter & Rights

The authors of this paper fully acknowledge the work of the IBFD, OECD and numerous countries' efforts to establish taxpayers' bill of rights, which intend to protect taxpayers against the excessive behaviour of tax authorities[65]. See below table 1, for an overview of the list of taxpayer rights in five leading countries[66]. However, we feel that due to political and societal pressures, some of the rights covered in those charters do not align with the actual behaviour of the tax inspector you are dealing with. This could be due to pressure on society to resolve more complex issues and the need for extra cash due to major events like flooding and Covid. We believe this does not warrant the categories of behaviour as outlined in footnote 7 and discussed in section 3.

65 7 International Bureau of Fiscal Documentation Observatory on the Protection of Taxpayer Rights, The IBFD's Yearbook on Taxpayers' Rights 2020 (2021); Taxpayers' rights and obligations – a survey of the legal situation in OECD countries Committee of Fiscal Affairs, OECD 27 April 1990. http://www.oecd.org/pdf/M00023000/M00023881.pdf; GAP001 Principles of Good Tax Administration Centre for Tax Policy and Administration, OECD 2001. http://www.oecd.org/pdf/M00017000/M00017627.pdf; GAP002 Principles of Good Tax Administration Centre for Tax Policy and Administration, OECD https://www.oecd.org/tax/administration/Taxpayers%27_Rights_and_Obligations-Practice_Note.pdf.

66 See also Butani, Mukesh, and Kinshuk Jha. "Taxpayer rights: Deciphering the Indian charter." (2021 for an overview of taxpayer rights in India.

With specific reference to the *Australian Taxpayer's Charter*[67], the full list of tax authorities' behaviours one should expect as a taxpayer is listed below:

- Treat you fairly and reasonably;
- Treat you as being honest unless you act otherwise;
- Offer you professional service and assistance;
- Accept you can be represented by a person of your choice and get advice;
- Respect your privacy;
- Keep the information we hold about you confidential;
- Give you access to the information we hold about you;
- Help you to get things right;
- Explain the decisions we make about you;
- Respect your right to a review;
- Respect your right to make a complaint;
- Make it easier for you to comply;
- Be accountable.

67 A brief history of the Taxpayers' Charter, Inspector- General of Taxation and Ombudsman of Australia p. 8 available at https://www.igt.gov.au/wp-content/uploads/2021/11/A-brief-history-of-the-taxpayers-charter-1.pdf.

Table 1: List of taxpayer rights of five leading countries.

	USA Taxpayer Bill of Rights: "Taxpayer Rights"	UK- HMRC Charter	Canada- Taxpayer Bill of Rights	New Zealand – Inland Revenue Charter	Malta: Taxpayers' Charter
1	The Right to be Informed	Working with you to get tax right	You have the right to receive entitle elements and to pay no more and no	We will be easy to deal with, prompt, courteous and professional	To be treated with fairness and impartiality
2	The right to Quality service	Getting things right	Less than what is required by law	We will follow through on what we say we will do	To be treated as honest and tax compliant unless there is evidence to the contrary
3	The right to pay no more than the correct amount of tax	Making things easy	You have the rights to service in both official languages	We will be responsive to individual, cultural and special needs. The person you are dealing with will give you their name	The right for certainty
4	The right to challenge the IRS's position and Be Heard	Being responsive	You have the right to privacy and confidentiality	We will value your feedback and use it to improve our services	For assistance and information from the Tax Departments
5	The rights to appeal and IRS Decision in an independent Forum	Treating you fairly	You have the right to review and a subsequent appeal	We will provide you with reliable and correct advice and information about your entitlements and obligations	To pay no more than the correct amount of tax
6	The right to finality	Being aware of your personal situation	You have the right to be treated professionally, courteously and fairly	We will assist you to get in touch with the right people for your needs	Not to be subject to retrospective taxation

	USA Taxpayer Bill of Rights: "Taxpayer Rights"	UK- HMRC Charter	Canada- Taxpayer Bill of Rights	New Zealand – Inland Revenue Charter	Malta: Taxpayers' Charter
7	The right to privacy	Recognizing that someone can represent you	You have the right to complete accurate, clear, and timely information	We will be well trained and competent	To minimize compliance costs
8	The right to confidentiality	Keeping your data secure	You have the rights, unless other wise provided by law, not to pay income	We will keep looking for better ways to provide you with advice and information	To be advised and represented by any person on taxation matters
9	The right to retain representation	Mutual respect	Tax amount in dispute before you have had an impartial review	We will treat all information about you as private and confidential, and keep it secure	To appeal
10	The right to a fair and just Tax system		You have the right to have the law applied consistently	We will only use or disclose it in accordance with the law	To privacy and confidentiality of information we hold about you

1.4. Code of Conduct: Principles For Tax Authorities

If we translate the last list of how in this charter list tax authorities should treat taxpayers – we believe that today's practice warrants a more explicit reading which we have tried to capture in the Code of Conduct for Tax Authorities – Communication Protocol as outlined below. A code of conduct regulating the conduct of the tax authorities may contain the following principles:

CODE OF CONDUCT FOR TAX AUTHORITIES (INITIAL LIST)

The tax authorities shall strive to:

I. Treat the taxpayer in a fair and equitable way;

II. Provide timely decisions;

III. Substantiate their decisions based on tax law and regulation principles in writing;

IV. Not to engage in fishing expeditions;

V. Not to presume abusive tax avoidance where a mere tax benefit is present;

VI. Collect the correct amount of taxes;

VII. Respect the privacy of the taxpayer and maintain confidentiality;

VIII. Only make enquiries about the taxpayer when required to check that you have complied with tax obligations;

   a. Only seek access to information relevant to our enquiries

   b. Treat any information obtained, received or held by the taxpayer as private;

   c. Ensure the safety of data against hacks or leaks

IX. Provide a toolbox to resolve and better to avoid disputes

X. Be principled and not result oriented in positions and decisions taken in tax audit and throughout the whole process.

XI. Be consistent in positions and decisions taken over time unless a change is warranted by relevant changes in facts or changes in law.

XII. Allow existing mechanisms, e.g. MAP, to operate to avoid double taxation on the same amount of income.

XIII. Allow and collaborate to avoid disputes e.g. (B)APA

XIV. Allow and collaborate on the use of Alternative Dispute Resolution (ADR) mechanisms in so far, the existing mechanisms prove to be dysfunctional.

XV. Create an independent panel (e.g., ombudsman or something similar) to handle excessive behaviour by tax authorities

A recent publication titled "*Tax Morale II: Building Trust between Tax Administrations and Large Businesses*" published by the OECD explicitly addresses the level of trust between tax authorities and taxpayers[68]. While these intentions by the OECD to create a higher level of trust between parties, almost the full 85 pages are putting the spotlight on the behaviour of taxpayers. We have to acknowledge in order to build a trustworthy relationship, the behavioural aspect of both parties needs to be analysed and addressed. In this publication, there is little to no room for self-reflection on the behaviour of the tax authorities themselves, although it is mentioned in the Executive Summary of the OECD Report 2022 it is stated that there is "a lack of ***mutual trust*** and ***sub-optimal communication*** between tax administrations and businesses" and a few times that instructive communication between parties should be the way forward.

2. Introduction: Time For A Universal Code Of Conduct Or Communication Protocol?

Are tax authorities adhering to and upholding the principles of fairness and objectivity in their public duties? The answer is no according to representatives of major global MNEs. It is reported that many tax administrations display acts of unprofessionalism, disregard for transparency and objective assessments, and behaviours that can only be seen as aggressive power plays (see section 3 for a full discussion).[69] Generally, not the behaviours one would expect from institutions

68 "Tax Morale II: Building Trust between Tax Administrations and Large Businesses" available at https://www.oecdilibrary.org/sites/7587f25cen/1/3/2/index.html?itemId=/content/publication/7587f25cen&_csp_=ac409bfaa6c9ea20b305177e52b6da74&itemIGO=oecd&itemContentType=book#section-d1e1851.

69 The categories of "bad behavior by tax authorities" from our practice can be listed as follows:

a. non-transparent behaviour - e.g., tax authorities requesting transparency from taxpayers, but keep all their arguments and back up materials, e.g., benchmarks and secret comparables;

b. non-treaty compliance behaviour - e.g., tax authorities when closing a deal with taxpayers, legally require taxpayers to sign not enter into a MAP procedure for claiming relief from double taxation. Another example is where tax authorities threaten taxpayers to 'double the taxable income assessment', if and insofar taxpayers under tax treaties wants to obtain a 'relief from double taxation.

c. non-treaty compliance behaviour - e.g., tax authorities with a taxpayer under audit and a higher taxable income being assessed, actively block the taxpayers' access to the MAP under the treaty with the argument that 'not all information has been provided by the taxpayer' to satisfy the MAP requirements.

d. Behaviour where the administrative overlaps with a criminal procedure - e.g., tax authorities propose a tax adjustment to taxpayer, with the notification - given the size of the adjustment - that criminal charge towards professionals on taxpayers' payroll will be seriously considered, if the proposes is not being honoured. In quite a few cases, the initial tax adjustment proposed did not have a fact based 'audit trail' in the first place.

that are responsible for upholding the principles of fairness and equitableness.

Whether or not these accusations ring true, it is important to question whether tax administrations should be subjected to universal standards and norms as is the case for most civil servants. In line with the OECD, it is of the utmost importance to protect the tax bases of countries but the collection of tax should still be enforced in a manner that complies with principles of fairness and equitableness. Once tax administrations start to target MNEs, just in order to collect more revenue or because MNEs are already suspected of abusive tax avoidance, it turns into a practice called "cash justice".[70] It is important that tax authorities protect the tax bases of our countries but in the process, we may not lose sight of the principles of fairness and justice. Our tax administrations should at all times act with professionalism, objectivity and fairness. Also, in an increasingly global and competitive world, we cannot afford to be an unattractive investment or business destination just because of the unfair treatment of MNEs. Then we destroy the object and purpose of tax treaties in the first place – the protection of tax bases.

In light of this, one should consider either a formal code of conduct or a general communication protocol which could ensure constructive and professional communication channels between tax authorities and taxpayers.[71] Some countries have already drafted

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e. Behaviour where the administrative overlaps with a criminal procedure - e.g., tax authorities start an audit and put at the same time pressure on the legal representative of the taxpayer with criminal charges.

f. Behaviour where taxpayers' homework is not being taken into account, but replaced by a negotiation strategy – e.g., quite often transfer pricing documentation is being ignored and considered irrelevant – which opens the road to free flow negotiations and in almost all cases a higher tax bill.

g. Abuse of tax instruments behaviour - e.g., under the label of ICAP a full fishing expedition is being organized, which is equal to a 'heavy audit process', but is not necessarly offering any security to taxpayers given the nature of the notification letters from governments.

h. Active leaking of private information behaviour - e.g., tax authorities in certain countries are known to leak information to the press as a strategy to put pressure on the proposed taxable income adjustment for example in the case of a business restructuring.

i. False incentives behaviour - e.g., tax authorities get a bonus for tax adjustment, irrespective whether the final position is being honoured and/or being supportable in courts. We do believe the above list is illustrative, and while most tax authorities do adhere to the fair and equitable treatment of taxpayers, the 'bad behaviour' is spreading and is even being supported in a few cases by the leadership teams at tax authorities.

70 Moreno, Andrés Báez. "GAARs and Treaties: From the Guiding Principle to the Principal Purpose Test. What Have We Gained from BEPS Action 6?." Intertax 45.6/7 (2017).

71 See "Tax Morale II: Building Trust between Tax Administrations and Large Businesses" available at https://www.oecd-ilibrary.org/sites/7587f25c-en/1/3/2/index.html?itemId=/content/publication/7587f25c-en&_csp_=ac409bfaa6c9ea20b305177e52b6da74&itemIGO=oecd&itemContentType=book#section-d1e1851 at section 2.3: "Guidelines may be a useful tool to build trust. Where they exist, most tax officials think that large businesses/MNEs follow them. Guidelines can help clarify requirements and frame the relationship between taxpayers and tax administrations in a transparent and open manner. The surveys provide a range of evidence to support the use of guidelines. In Africa, Asia and the OECD, around 75% of tax officials see most large businesses/MNEs as following the existing guidelines/guidance/procedures for managing the relationship between tax authorities and taxpayers. This proportion drops to 58% in LAC.

There is also a correlation between respondents identifying the existence of specific procedures/guidelines to deal with MNEs and perceiving higher levels of trust in MNEs. Respondents who said that guidelines/procedures existed in their jurisdiction were more likely to perceive that all/most MNEs/large businesses were open and transparent, suggesting that there could be a link between codes of conduct or communication protocols regulating the negotiations between taxpayers and tax authorities. For example, Switzerland and Italy have both drafted a form of code of conduct or communication protocol.

2.1. Swiss Code of Conduct

The Swiss code of conduct "*Verhaltenskodex für Steuerbehörden, Steuerzahler und Steuerberater*" provides the following general guidelines[72]:

- "Separate personal from factual and legal issues
- Focus on interests rather than taking positions
- Be independent as far as judgment and actions are concerned
- Aim at an open and unbiased dialogue"

It then proceeds to prescribe general guidelines (dos and don'ts) with respect to communication channels between tax advisors and the tax administration. To name a few selected examples:

"Maintain a climate of trust between the tax administration and the tax advisors, thus avoiding arrogant or antagonistic behaviour on either side; avoid any favouritism"

Or;

"Do not misstate the facts, and duly consider that the presentation of the relevant facts should be accurate, true and complete; there should be no voluntary omissions; anything that has no proper bearing on the final determination should be omitted"

Or;

"The tax administration should not refer taxpayers or their advisors to judicial proceedings as long an efficient and timely solution can still be reached".

2.2. Draft Italian Code of Conduct[73]

The code of conduct intends to govern and regulate the relationship between the Tax authorities and the Companies admitted to the Cooperative Compliance program (hereinafter also "the taxpayer") in order to ensure a relationship based on principles of collaboration and transparency.

See below some of the points in the draft code of conduct:

a. Right to adversarial procedure

The need for an adequate right to adversarial procedure, as provided for by the Law, should be effectively carried out not only with the Cooperative Office but also with any competent offices of Tax authorities technically involved

guidelines and improved relationships between taxpayers and tax administrations. More than half (57%) of respondents that said that detailed procedures existed in their jurisdiction also perceived that all/most MNEs/large businesses are open and transparent."

72 Available at Verhaltenskodex Steuern 2021 (admin.ch).

73 Informal source: draft version of code of conduct received through email communications dated 30/06/2022. See also, L. 27.7.2000 n. 212 (G.U. 31.7.2000 n. 177) Provisions on the Statuto dei diritti del contribuente (Law No. 212 of 2000 known as the Taxpayer's Code).

in the preliminary investigation, in that way ensuring an adequate "right of reply" before the formal response of Tax authorities.

b. Shared consultation

Importance of a "structured" prior consultation on drafts of Tax authorities' rulings: the prior consultations of 26 May 2021, regarding Resolution No. 49/E, and of 9 November 2021, regarding the Circular on Revaluation and Realignment, undoubtedly show massive room for improvement.

The companies consider it important that Tax authorities provide for prior consultation in the drafting and publication of Circulars, Measures, Practice Documents and any other type of documentation/communication concerning the Collaborative Compliance regime in the same way as it does for other measures and practice documents subject to public consultation for the generality of taxpayers (e.g. Circular DAC 6, Circular CFC, Circular on Hybrids, Circular on Documentary Burdens). This consultation should be structured through the prior sharing of the document with the Companies participating in the Collaborative Compliance regime to allow them to analyze it, elaborate proposals and/or comments, and submit them to Tax authorities within a congruous time limit with the objective of making the document in line with the actual needs of the taxpayer and capable of capturing the expectations and requests of the Companies themselves. It would also be desirable for prior sharing with the Cooperative Societies to also take place on practice documents that deal with issues that are particularly important for the country.

"The companies would also appreciate a "fast track" that would allow them to ask questions of an urgent nature to which Tax authorities would undertake to reply as quickly as possible and, in any case, not later than 45 days (as provided for e.g. for the so-called abbreviated questioning pursuant to Article 7 co 1 of Decree-Law of 15/06/2016). "

2.3. Time for a universal code of conduct or communication protocol?

The conduct of most civil servants is regulated or controlled through a universal set of norms or standards issued usually in a code of conduct or practice manual. See for example the "*Model Code of Ethics and Conduct"* issued by the World Customs Organization (WCO).[74]

See Model Code of Ethics on page 1:

"Public service is a public trust. Therefore, Customs employees have a responsibility to their government and its citizens to place loyalty to the Government, laws and ethical principles above private gain. The public is entitled to have complete confidence, trust and respect in the integrity of its Customs administrations and to expect all Customs employees to be honest, impartial and professional in the manner in which they employ their skills, knowledge, experience and official authorities. To maintain public confidence, it is important that Customs employees maintain the highest standards of integrity in their dealings with members of the public, the business

74 *Model Code of Ethics and Conduct"* World Customs Organization (WCO) available at.

community and other Government officials, and maintain the same standards in their personal lives."[75]

"The Code of Ethics and Conduct describes, in very practical and clear terms, the minimum standards of behaviour required of all Customs employees. These standards of behaviour shall be demonstrated by all Customs employees and are to serve as a guide when making decisions and taking action."[76]

See on page 2 some of the duties of care a customs officer is obliged to adhere to:

"...perform duties with honesty, care, diligence, professionalism, impartiality and integrity; strive for the highest ethical standards to sustain the trust and confidence of the public they serve, not just the minimum required to meet legal or procedural requirements; take the time to read and understand the Code of Ethics and Conduct and the implications of non-compliance; not hold financial interests that conflict with the conscientious performance of duty; not engage in financial transactions using nonpublic Government information or allow the improper use of such information to further any private interest."[77]

What should be noted is that most branches of civil servants issued a code of conduct or practice manual which sets out minimum standards of behaviour except for tax administrations.

2.4. BEPS Action Plan: External Political Pressure

In recent decades, MNEs have attracted much public and media attention regarding their tax affairs.78 Many MNEs, particularly tech giants, have been put under the spotlight and had their ethics and reputations tested.79 It is vital and necessary to question the tax ethics of MNEs but the authors of this paper are of the view that the balance has shifted too far to one side. The tax scandals of a handful of MNEs should not taint the reputation of all MNEs who are tax compliant although it appears that this assumption has already to a large extent been accepted by the public and to some extent by the OECD/G20. It is essential to find a middle ground, where MNEs are not merely scapegoated but also included in the discussion. It is vital that we do not alienate the vast majority of open, honest and transparent multinational corporations that provide society with employment opportunities, innovation and other positive contributions.

The introduction of BEPS may have sent out a clear signal to MNEs that abusive tax avoidance will not be tolerated! As stated in the revised preamble; the prevention of tax avoidance now forms one of the objects and purposes of tax treaties. [80] When we apply pressure on MNEs to pay their "fair share of tax", we should do so in a manner that is in line with principles

75 Ibid p.1.

76 Ibid p.2.

77 Ibid p.6.

78 J.L.M. Gribnau, A-G. Jallai & A.J. Bakker, Good Tax Governance and Transparency: A Matter of Reputation or Ethical Motivation?, 18 Fin. & Cap. Mkts 1 (2016), Journal Articles & Opinion Pieces IBFD (accessed 18 July 2022).

79 Ibid.

80 BEPS Project Executive Summary: "Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions),".

of fairness and objectivity – not arbitrarily assume abusive avoidance. Also, we need to acknowledge that in a rapidly global and technologically advanced world, the historically applicable "social contract theory" is outdated. In the reconstruction of a social contract 2.0, the main taxpayers (MNEs) should have a voice.

Furthermore, is it not the fiduciary duty of the CFO to arrange the companies' tax affairs in an efficient way? From a business perspective, one needs to take into account that the average businessman would arrange his tax affairs to be efficient. MNEs are not just considering the letter of the law but when available also take into account the intention of the tax law. And tax affairs are firstly driven by how the business operates or wants to operate and only then tax comes in to find a tax-efficient way how the business wants to operate. These principles (and many more) are already captured in the code of good conduct or principles of good tax governance adopted by many MNEs.81

These principles are also stipulated in (*IRC v Duke of Westminster [1936] AC1 (HL)), where it was confirmed "Every man is entitled if he can to arrange his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure that result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax".*[82]

See also a similar opinion held in academic writing:

> *"Consequently, the concepts of "aggressive tax planning", "tax evasion" and "tax avoidance" express different relationships between law and morality.*
>
> *Notwithstanding their moral character, taxes are a cost item, Moreover, taxpayers have a right to structure their affairs to achieve favourable tax treatment within the limits set by law. Thus, (corporate) taxpayers should balance this right with the duty of fair play towards society and thus impose restraints on themselves in taking advantage of the inevitable imperfections of the legal system."*[83]

Although the author(s) of this paper disagree with the last sentence of the above quote. Who determines what is fair and how does one determine what is fair (right and wrong)? This grey area is to be determined by philosophers, politicians (public opinion) and lawmakers.

81 See Best Practices for Good Tax Governance available at: Best Practices for Good Tax Governance (https://conference-board.org).

82 IRC v Duke of Westminster [1936] AC1 (HL).

83 J.L.M. Gribnau, A-G. Jallai & A.J. Bakker, Good Tax Governance and Transparency: A Matter of Reputation or Ethical Motivation?, 18 Fin. & Cap. Mkts 1 (2016), Journal Articles & Opinion Pieces IBFD (accessed 18 July 2022) chapter 10.

3. Taxpayers' Rights: Behavioural Aspects

3.1. Culture of distrust – does the principle of fair and equitableness still applies?

As referred to above, in this paper the aim is to establish whether tax administration does conform to the principles of fairness and equitableness. The authors of this paper do acknowledge that it is of the utmost importance to protect the tax bases of countries but the collection of tax should still be enforced in a manner that complies with principles of fairness and equitableness. Once tax administrations start to target MNEs, just in order to collect more revenue or because MNEs are already suspected of abusive tax avoidance, it turns into a practice called "cash justice".[84] Many of the discussed behavioural elements are contrary to the principles of fairness and equitableness.

3.2. Lack of diversity – elements of institutionalized discrimination

Before one begins to talk about the discriminatory treatment MNEs face in their dealings with the tax authorities, we need to address the fact that average people/minorities may also face discriminatory treatment in their dealings with the tax authorities. For example, recently the Dutch Tax and Customs Administration (de Belastingdienst) came under scrutiny for being guilty of ethnic profiling and institutionalized racism. This case involved the targeting of (on the basis of their second nationality) and were falsely labelled as fraudsters.[85] See below the following media experts:

> *"Last month, Prime Minister of the Netherlands Mark Rutte—along with his entire cabinet—resigned after a year and a half of investigations revealed that since 2013, 26,000 innocent families were wrongly accused of social benefits fraud partially due to a discriminatory algorithm."*[86]

84 Moreno, Andrés Báez. "GAARs and Treaties: From the Guiding Principle to the Principal Purpose Test. What Have We Gained from BEPS Action 6?." *Intertax* 45.6/7 (2017).

85 See footnote 16 & 17.

86 How a Discriminatory Algorithm Wrongly Accused Thousands of Families of Fraud (https://vice.com).

"The Dutch Data Protection Authority (DPA) has imposed a €2.75 million fine on the Dutch Tax Administration. The fine was imposed because for many years the Tax Administration processed data on the (dual) nationality of childcare benefit applicants in an unlawful, discriminatory and therefore improper manner. This constituted serious violations of the General Data Protection Regulation (GDPR), the law governing privacy."[87]

3.3. Lack of transparency

The current international taxation regime puts tremendous pressure on MNEs to share tax-related financial data and subjects MNEs to strict exchange of information procedures and reporting obligations. Yet, in practice, it often happens that tax authorities refuse to objectively assess all transfer pricing documentation filed by the taxpayer.[88] For example, the taxpayer may expend resources to submit fully compliant transfer pricing documentation including benchmarking studies and value chain analysis to the tax authorities. In turn, the tax authorities dismiss the fully prepared transfer pricing documentation and prepare their benchmark based on "secret comparable". Instead of fundamentally arguing on the critical assumptions and search criteria used as parameters, a taxation office constructs its benchmark search on doubtful criteria. Also, in practice, carefully considered value chain analysis is often not consulted and reviewed. One would expect that the relevant taxation officer would provide substantiated arguments on the merits of all submitted transfer pricing documentation. Yet, it is not uncommon for the relevant taxation office to resort to subjective argumentation to claim a position that would lead to a higher end-of-the-range outcome.

Although extensive literature covers the obligation of the taxpayer to comply with the principle of transparency, it is still unclear to what extent tax administrations have to comply with this principle.89 Nevertheless, the pertinent question is why tax authorities disregard the benchmark studies that have been provided. The transparency that is (rightfully) required by MNCs / taxpayers is often met with a complete lack of transparency by tax authorities. Examples of this are: not providing any reason or rationale to disregard certain facts or certain positions and or no rational / reason that supports the position taken by tax authorities. Another example of the lack of transparency is that some tax authorities are using "secret comparables" in Transfer Pricing matters/benchmark studies.

87 Tax Administration fined for discriminatory and unlawful data processing | Autoriteit Persoonsgegevens.

88 On the list of information provided are: financial statements that are audited and approved by (reputable) audit firms, statutory accounts, Country by country information already provided for a number of years to tax authorities. Furthermore, Transfer Pricing – Master File and country specific transfer pricing documentation. And then there are many country or regional (EU) specific requirements: DAC 6, APB 28 etc.

89 E. Poelmann, Chapter 30: The Netherlands in Tax Transparency (F. Başaran Yavaşlar & J. Hey eds., IBFD 2020), Books IBFD (accessed 17 July 2022). Would the tax administration, in line with the principle of transparency, be obliged to substantiate why they drafted an alternative benchmark (see example above), instead of testing a benchmark filed by the taxpayer? Would a tax administration be obliged to provide substantiated reasoning, referencing all transfer pricing documentation provided by the taxpayer to form an objectively reasoned counter argument?

3.4. A challenging internal culture: culture of distrust

The internal culture of many tax authorities, both in developing and developed countries, rewards aggressive auditing and negotiations even where there is no basis and punishes reasonable and principle driven negotiations and assessments. Furthermore, the behaviour of tax authorities is often triggered by the wrong incentives such as maximizing the revenue even if there is no or little basis for this in tax law and regulations rather than principle has driven – applying and interpreting the law in an objective way. For the tax authorities, the aim in negotiations seems to be not to find a reasonable conclusion but to intimidate and to “shake down” the taxpayer. The underlying motives of tax authorities should be questioned. For example, one of the intimidation tactics used is to play with the corporate reputation through leaking information, often wide-sided and incorrect, to the press or just to issue highly inflated tax assessments (which tax authorities sometimes even openly admit) knowing that the multinationals want to avoid very lengthy appeals and court procedures that can take many years. Tax auditors sometimes are (partially) rewarded by the number of tax adjustments they issue. This results often in “result-driven” behaviour of the auditor/tax authorities.

3.5. Elements of Arbitrary Decisions

Although much of what has been discussed above could also fall under this category. The refusal to base arguments on drafted and submitted transfer pricing documentation is arbitrary in itself. Furthermore, tax authorities are not accepting the audited (by a reputable audit firm and a favourable opinion) statutory accounts of a company. In these scenarios, there is often no rational given and seems often just based on a desire to achieve a certain result. What is even more concerning is that Tax Audit adjustments often lack even the basic reasons or rational for it and even when the facts and circumstances are exactly the same tax auditors deviate from the previous tax audit results without giving appropriate notice or any rationale. It has also been noted that certain taxation officers have a very specific and biased way of looking at terminology used while analyzing the importance of functions whether or not that arrives through on-site interviews or other kinds of surveys when it comes to FAR functions and risk analysis. Less importance is put on the absolute salary levels and possibly the company’s internal salary scheme, robber social media information is used to their advantage to prove that there is an element of significant people presence such in combination with the internal language used by colleagues, such as “I am responsible for” or “I initiate” etc which oftentimes is language more for I feel responsible than that responsibility is formalized in salary levels job descriptions.

All the above factors; the external political elements, lack of transparency and internal turmoil of the tax authorities reflect outwards in their dealings with MNEs. For the tax authorities, the aim in negotiations seems to be not to find a reasonable conclusion but to intimidate and to “shake down” the taxpayer. The underlying motives of tax authorities should be questioned.

3.6. Elements of Power Play

Again, much of what falls into this category has already been discussed above. However, in this section elements closer to the negotiations are discussed.

Tax audit adjustments are often intentionally inflated (sometimes even explicitly admitted) to put (undue) pressure onto the taxpayer and or have a better "negotiation position". Tax authorities are taking many months to respond or to come up with a position for the taxpayers whereas tax authorities give taxpayers just a few weeks to respond

Tax settlements often come under the condition that the taxpayer is not allowed to go to Court or even not allowed to start a MAP procedure resulting in double taxation. Especially concerning are the tax settlements that are reached after exercising undue pressure onto the taxpayer by the tax authorities by either inflating the initial tax adjustment or threatening to refer the case to the criminal prosecutor (knowing the criminal prosecutor has no knowledge about tax issues, often causing reputational damage to the company and officials involved and are often decided well before the regular court proceedings are completed).

As discussed above one of the intimidation tactics used is to play with the corporate reputation through leaking information, often wide-sided and incorrect, to the press or just to issue highly inflated tax assessments (which tax authorities sometimes even openly admit) knowing that the multinationals want to avoid very lengthy appeals and court procedures that can take many years.

3.7. Elements of Digital Discrimination (Algorithms)

With reference to point 3.2. above, it should be avoided that MNEs receive the same "digital discrimination", considering the backdrop of this paper.

See the opinions of D. Hadwick & S. Lan:

> *"In addition, taxpayers selected by the risk management systems (RMS) cannot properly prepare arguments against tax authorities without a thorough understanding of the reasoning of the selection. Accordingly, there is a risk that taxpayers may already be unknowingly suffering from discriminatory treatment during the assessment process and are deprived of any possibility to defend themselves. The principle of non-disclosure also applies in court proceedings out of fear that taxpayers can recognize or estimate concrete risk indicators applied to them by the RMS. However, taxpayers can hardly protect their right to defence if they are not able to understand how the tax administration reached its conclusions."*[90]

90 D. Hadwick & S. Lan, Lessons to Be Learned from the Dutch Childcare Allowance Scandal: A Comparative Review of Algorithmic Governance by Tax Administrations in the Netherlands, France and Germany, 13 World Tax J. 4 (2021), Journal Articles & Opinion Pieces IBFD par.4. See also in par 3.4 where the author states: "In the authors' opinion, given the risks of discrimination identified in literature and case law, such an omission should be cause for concern. In Germany, the two safeguards to protect against biases are the random selection and the periodic review, mentioned in section, yet the modalities of the random selection are unknown and the findings of the reviews are not publicly disclosed. Both in Germany and France, the legislators expect taxpayers to have blind faith and trust in the administration, resources that can be dangerously limited in times of pandemic or economic crises. In addition, the lack of transparency, identified in section, inhibits the ability of the public to supervise the functioning of the RMS and to protect themselves against biases and discrimination."

4. Social Contract 2.0

In light of all the above, the authors of this paper argue for the revision of the traditional social contract theory to adapt to the modern era. MNEs have traditionally contributed to society in the form of innovation, creation of employment and donations. In today's modern world, many MNEs are responsible for extrinsically valuable research, disruptive innovation and not to mention job creation. It is also true that some of these MNEs have been involved in unethical tax avoidance. It is also true and unfair that in some platform economy multinationals – it is quite unclear how to treat the participants to such platforms, i.e., does for example the platform control the taxi drivers or the ones who deliver food?

However, is it constructive to scapegoat all MNEs instead of finding a solution that is fair and equitable for everyone? Under social contract 2.0, one has to go back to the drawing board and envision the obligations of the state in a modern technology and interconnected multicultural world. Does the state fulfil its obligations in such a world? And of course, the rules for MNEs in a technology-driven world have to be redefined. Is it not time to treat the MNEs as part of the solution rather than being part of the "tax leakage" problem?

5. Five Statements For A Panel Discussion

Statement	Agree	Disagree
1. There should be a code of conduct introduced for tax authorities.	100%	0%
2. The code of conduct should be structured as a communication protocol i.e., reflects soft law standards.	53.57%	46.43%
3. Such a body should be independent and impartial, or should one escalate such complaints to a higher level within the tax authorities?	96.88%	3.13%
4. The rules of transparency applicable to MNEs on their tax affairs, should also be applicable to the case handling process and positions taken by the tax authorities.	90%	10%
5. The rules of transparency applicable to MNEs on their tax affairs, should also be applicable to the case handling process and positions taken by the tax authorities.	100%	0%

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WHITE PAPER 03

TAX FOOTPRINTS

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2022 GTC CONFERENCE

1. Introduction

One must be aware that "Tax Footprint Reports" are not usually a legal obligation. They are being produced by companies in a Post BEPS Era as a reaction to discussions about abuse, ethics, and transparency. With these public reports, companies are explaining their business structures, choices, strategies, the co-related impacts on taxation, and how they contribute to value creation (including revenue) for different countries. They are exploring topics that used to be private. Why? To recapture the narrative, after mainstream media has painted MNE as globalization villains? Already manage possible reputational damages? Showing to society the complex interaction between value creation, society benefits, and taxation? A pure marketing strategy? An ethical duty that should become legally binding? Dealing with different stakeholders' expectations about a company's behaviour? Or a risk option that puts under public scrutiny relevant information that can be used against the company? Maybe, all that together.

Under this White Paper, we intend to understand better what this kind of report is about, and access the main topics companies are including in their reports, without ignoring how strategic they are.

2. Definition Of A Tax Footprint Report

Companies have a "footprint": a proper identity that affects the market/society where they operate, and it is closely related to their business model. On the other hand, the footprint is also influenced by the market, society, and legal environment. Then, any footprint is closely related to the value chain a company integrates and its capacity for value creation.

Considering corporate social responsibility issues and fiscal ethics discussions, the concept of value creation has been also under change, and new stakeholders, besides shareholders, are under consideration. Companies are dealing with the question: what do we give in return to employees, communities, and governments? After many scandals, such as Starbucks, Amazon, etc., taxation also got over the table.

A **Tax Footprint** is a company or a group's "personality" towards taxation in its most relevant aspects: revenue raised, type of taxes paid, split between countries, risk management, compliance and disputes, etc. Some MNEs would also show that taxation is one part of the value creation delivery by a company. [91]

In this perspective, the **"tax footprint report"** is a mechanism through which a company defines and explains details about its "tax life", showing how its taxation is managed and accrues to society. In fact, with the gradual demand for transparency,

91 VTT description of a Tax Footprint: "A company's Tax Footprint illustrates the extent to which the company's activities generate tax revenues for society and the distribution of the tax effect between countries." Source VTT Tax Footprint

some MNEs voluntarily choose to publish their tax footprint. 92 Therefore, there is no formal requirement, structure, or model to be met by an MNE. But – one way or another – they address the consequences of business activities and how they are distributed across many nations. If the Tax Footprint is a consequence of a business model, the decision of creating a report is dearly connected with a strategic point of view: the implicit or explicit purposes of setting the narrative in front of public opinion.

There are two organizations which have been publishing standards for such tax footprint reports, being The B team and the Fair tax mark. The B team has been set up by large corporate taxpayers in close corporation with the other stakeholders in society, while the Fair Tax mark is a foundation with an accreditation system. Both organizations do define the minimum level of communication on an organization's tax profile to society. For a detailed summary see Appendix A.

3. Purpose Of A Tax Footprint Report.

Abusive tax planning started to be persecuted not only by tax authorities or the prosecution officer (with criminal charges) but also by society. On one side, many legal obligations were created to prevent abuse and guarantee the exchange of information between countries as we can see by the CbC reporting required by the updated EU Accounting Directive. Besides that, to be seen as "good taxpayers," businesses frequently volunteer to share their tax impact in the form of a "Tax Footprint Report" making their business and taxation more transparent.

The advantage of such a strategy is that it can mitigate reputational damages emanating from potential tax audits and litigation. In this perspective, public opinion is more - or as - important as the legal and financial impacts derived from litigation.

The aim of the tax footprint report could include the following objectives:

- Avoid the accusation of aggressive tax planning and disconnection with society's needs (with the possible consequences in terms of profitability, clients' riot etc.);
- Explain the business model, its value chain and value creation[93], as necessary elements to explain profitability and related taxation (including transfer pricing choices); [94]

92 Certain industries like the financial institution have already been provided with regulatory framework on what to publish on their websites related to taxes. Participants from other industries much more follow the non-regulated proactive approach to sharing their tax contribution to society. Examples include RELX, Nestle, Coca Cola Euro pacific, Lego, Ikea, Novartis, Accenture.

93 Kemira in this excerpt clearly tries to show that tax incentives and exemptions application is part of its value creation: "We create value to our stakeholders by optimizing the tax efficiency of business operations, including applying tax incentives and exemptions. This is always aligned with our commercial objectives as taxation is a consequence of business operations and is, therefore, based on business decisions and needs. We do not operate in tax haven countries for tax reasons. Source:Kemira tax footprint.

94 An example of this report can be seen at Kemira report: "Chemical industry is a capital-intensive sector and, therefore, it is important that our business operations, structures and financing are organized in the most tax effective way (i.e. corporate income tax, VAT, property tax, customs duties, energy tax, waste tax, withholding tax etc.). Kemira operates in over 100 countries

- Describe the fiscal consequences of business activities, inclusive revenue generation and how they are distributed across many nations and different types of taxes (consumption, social security, income);
- Manage reputation by providing different stakeholders[95] related information and describing the Tax footprint in an accessible way;
- Choose and set the narrative about the relevance of the business model and structure to the value creation and tax choices;96
- Provoke the audience about the need for improvements in the tax policy, discussing government behaviour[97];
- Explain the complexity of tax management and interpretation, justifying possible legal court cases.

Obviously, MNES will differ in how they approach it; local culture and the relationship between taxpayers and tax authorities might have a big impact on whether the company makes public its Tax Footprint or which of the points above they take into consideration. In fact, a company might be concerned about how to publish this kind of information, because it can be sharing information that might be on the interest of its competitors or be used against them, both by journalists and tax authorities.

and has subsidiaries globally. Our business is built upon a combination of centralized business processes and local performance. Consequently, our profits are generated both in Finland, our headquarter jurisdiction, and locally according to arm's length transfer pricing principles." Source: Kemira tax footprint.

95 For example, Fortum report even describe "How to read Fortum's Tax Footprint" considering different stakeholders' expectations: "This report is primarily intended to benefit shareholders, investors, and governments. Source: Fortum. Tax Footprint2021.

96 About this, pay attention on how Fortum explains the relationship between Taxation and Business needs: "Taxation is always a consequence of business; therefore, our approach to tax strategy and planning is based on business needs. Taxes are one factor that we need to take into consideration. Our business solutions are not driven by tax considerations, but supported by the Fortum Group Tax Team. Taking into account multiple stakeholders ensures that we have a license to operate, our businesses can continue to invest, our operations are efficient, and it safeguards returns to stakeholders." Source: Fortum. Tax Footprint 2021.

97 Fortum after explaining its market peculiarities, demands suitable tax laws. This can be considered a strategic movement for future justification in face of the public about law application: "Fortum operates in the energy sector, which is characterised by long-term, capital-intensive investments. Our climate commitment to drive the clean energy transition means that our business is changing. The tax system is also undergoing material changes. To reach our targets and to drive investments in clean energy, we believe that future tax legislation needs to be clear, predictable, and simple." Source: Fortum. Tax Footprint 2021.

4. Creating A Tax Footprint Report Guide

After defining its strategy (and purposes) with a Tax Footprint Report, a company will usually formalize it and publish it on its website. There are no clear guidelines for establishing the report structure. From the reading of some Tax Footprint Reports, we concluded that the following aspects are usually addressed (in different dispositions or with different names):

- The MNE's tax principles
- Business Model and Value chain presentation
- Tax and operating environment
- The revenue generated (per type of tax, country, and region)
- The MNE's tax management, risk, and compliance strategy.
- Non-abusive practices
- Litigation cases

Those topics are addressed in deeper detail in the sections that follow.

4.1. The MNE's Tax Principles

Tax principles are included in a footprint to describe the general approach of a company regarding its taxes' moral and legal obligations, and how the tax choices are made considering possible interpretations of the law and different business structures. Somehow, they try to explain how a company deals with the inherent risk of applying tax law.Therefore, tax principles define the undertone of tax footprint reports. The principles may vary from industry to industry and may depend on the business strategy. Usually, companies would include between their tax principles the following:

- Tax governance principle (defining how tax accountabilities, responsibilities, and delegation of authority within the MNE, such as the RACE model for the central tax department);
- Tax planning principle, (e.g., a low or nil tax jurisdiction is to be banned);
- Compliance principle (e.g., tax returns must be supported by relevant tax law, open and transparent communications shall be organized for different interpretations of the law);
- Stakeholder reporting principle (e.g., mandatory disclosure on important tax matters in the annual reports);
- Tax risk management principle (e.g., tax risk committee and tax risk register processes), etc.

The following sections will give you other ingredients of the global footprint publications, where each section will be illustrated by a practical example from one of the companies already involved in the global footprint movement.

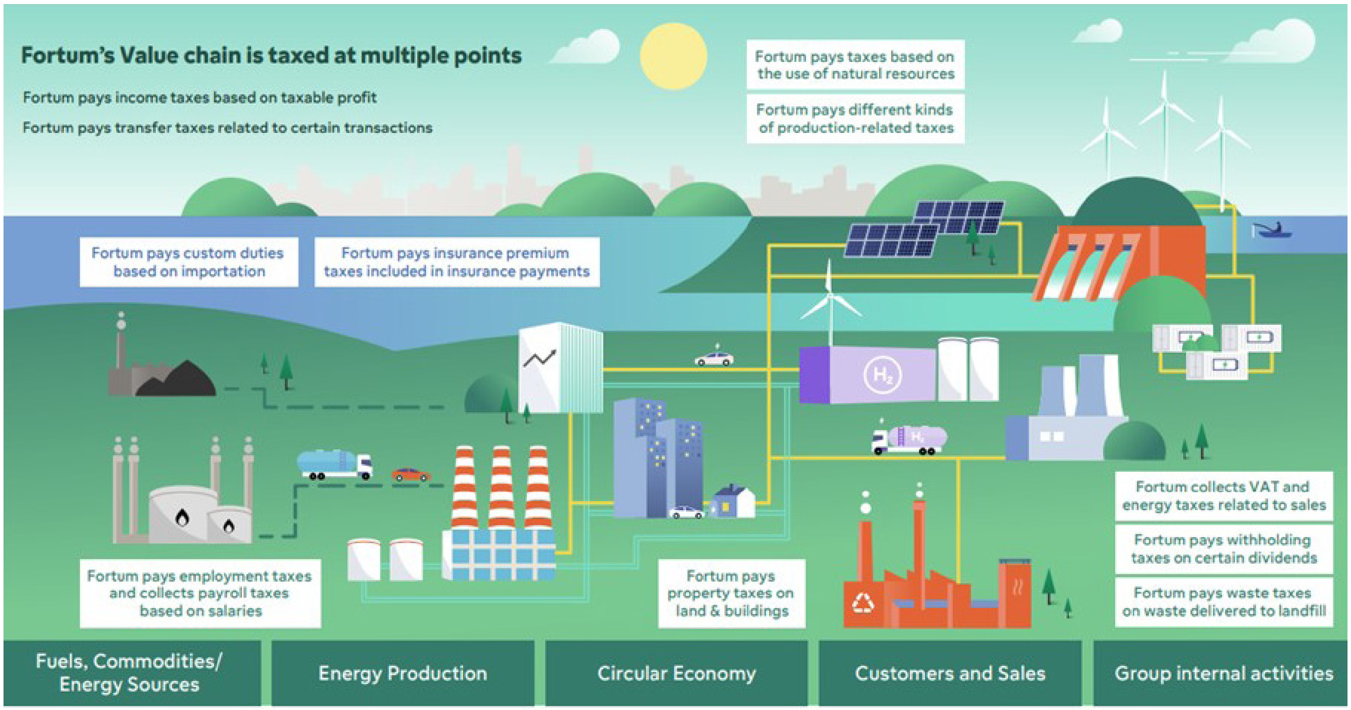
4.2. Business Model And Value Chain Presentation

For international business, one of the tax questions is how tax payments are split between different countries.[98] For most types of taxes borne, it is obvious to which country the tax is to be paid (e.g., Property taxes). In other case like corporate income tax, it is harder to define it. The corporate income tax is dependent on profitability and profitability derives from where a company creates value. Therefore, it is crucial to properly recognize the MNE structure and operations to define where profits are generated.

Exploring the business model also gives to the MNE's the possibility to explain the different types of wealth and value created, to describe the stakeholders related to the value chain, and relate those elements to the taxation creation (including and beyond corporate income tax – the core of abuse discussion).

In addition, other taxes such as VAT, energy taxes, people-related taxes, property taxes, withholding taxes, etc., are other illustrations of how taxes in the value chain are being identified, levied, and paid. The below value chain visualization is taken from one of the front runners in the area of global tax footprint publications, a company called Fortum. This company is a Finnish state-owned company which also holds a variety of investments in other corporates like Uniper.

Example 1. Fortum as a taxpayer – Value Chain Analysis

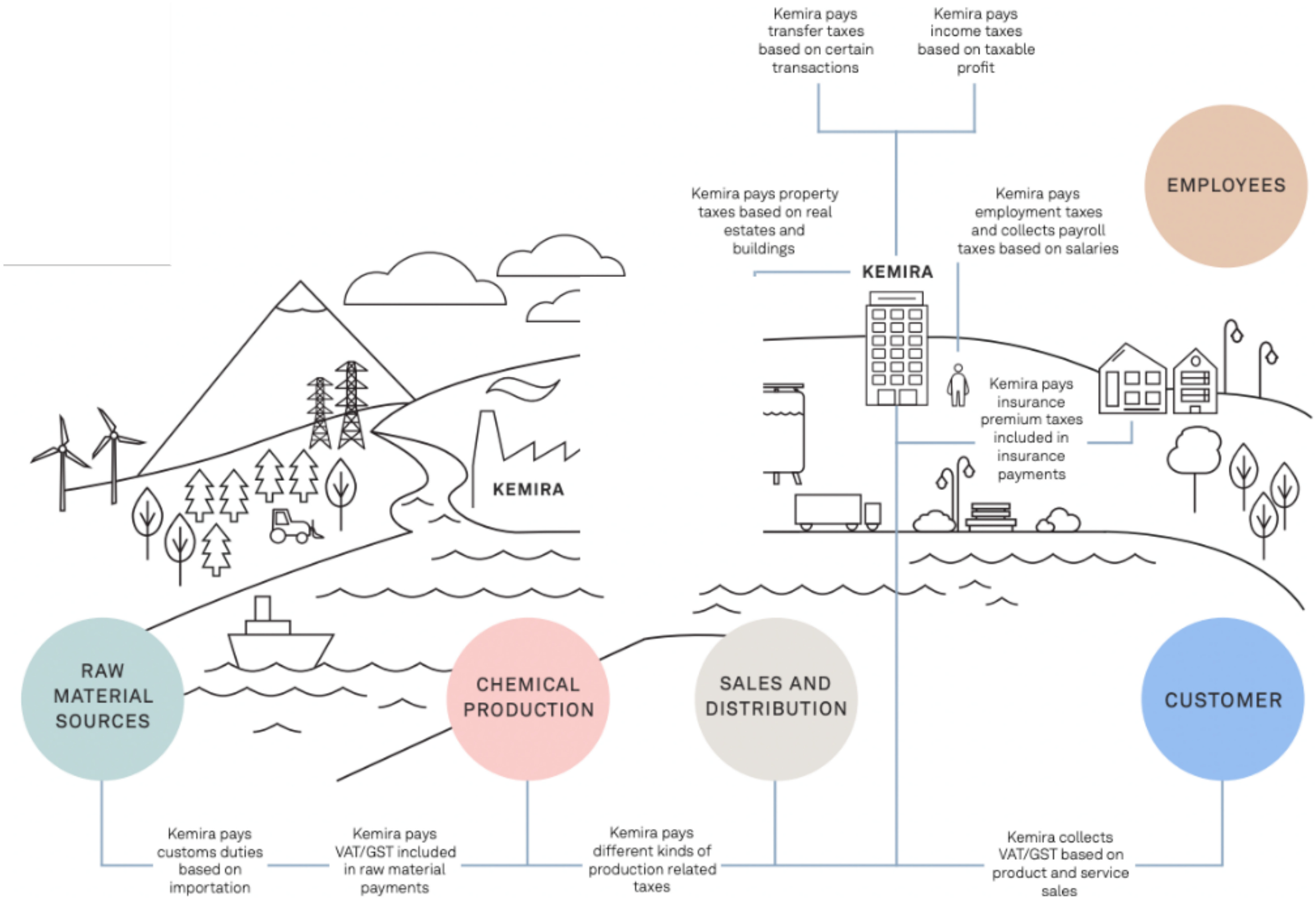


Source: Tax Footprint (Fortum, 2021)

98 It is widely recognized that taxes rights as well as tax base shall be fair for both small and large consumer countries as well as for developed and developing countries. (European economic and social committee, 2019). However, naturally, the allocation will depend on the business structure and the domestic law.

The visualization of this value chain and the way all steps in the value chain are contributing their fair share of taxes is a great way of communicating tax positions in a transparent manner.

Example 2. Kemira's description of "Taxes through the full value chain from raw material supply to finished goods deliveries to customers."



Source: Kemira Tax Footprint 2021.

As one can see, value chain descriptions are built to make the information easily understandable to readers.

4.3. Revenue/Profit Generated Per Country/Type Of Tax

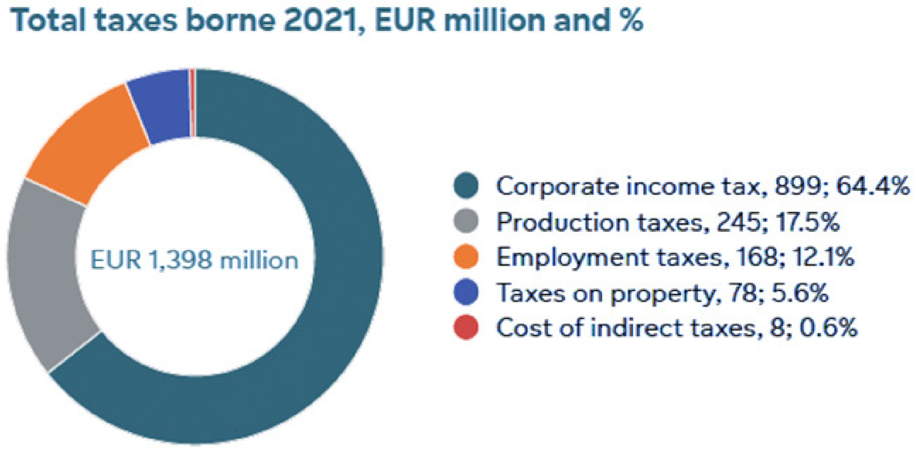
On the Tax Footprint Reports, MNEs might show their vision about the relationship between their business model, value chain, and value creation, to justify the allocation of various tax payments between countries/regions and taxes. The following 3 visuals show 3 comparable explaining in different formulas where revenue, profit, and/or taxes are being reported and paid. The latter means that both the taxes borne by the corporate as well as the taxes collected by the corporate and on-paid to tax authorities once covered.

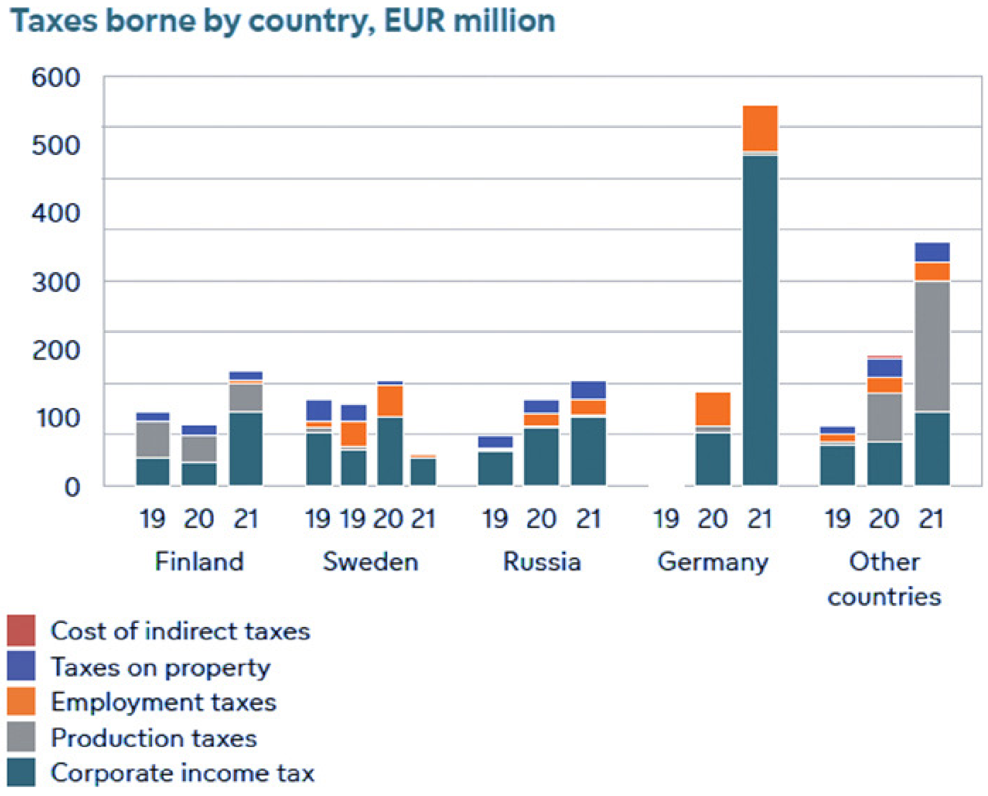
Example 1. Nestle Tax Figures.

	2021	2021	2021	2021	2021	2021
TAX FIGURES	Finland	Sweden	Switzerland	United States	Other Countries	Group in total
Revenue, MEUR	7 999	1 207	1 840	2 911	1 192	15 148
Earnings before taxes, MEUR	595	19	40	63	1245	1 962
Taxes borne, MEUR						
Corporate income tax	52	3	6	15	19	94
Real estate tax	1	0	0	0	5	7
Employer's charges	53	0	2	2	7	64
Environmental taxes	0	0	0	0	0	0
Custom duty	16	0	0	0	2	17
Total taxes borne, MEUR	**122**	**4**	**7**	**17**	**33**	**183**
Taxes collected, MEUR						
VAT/GST, remitted	953	59	0	69	17	1 099
Excise taxes	2 038	2	0	116	295	2 451
Withholding taxes	156	0	1	5	16	179
Employee's social security	22	0	1	0	4	28
Total taxes collected, MEUR	**3169**	**63**	**2**	**191**	**331**	**3756**
Total taxes borne and collected, MEUR	**3291**	**66**	**10**	**208**	**364**	**3939**

Source: Neste's tax footprint

Example 2. Fortum Total Taxes Borne 2021.





Source: Fortum. Tax Footprint 2021

They can even be used to explain how an MNE might not have to pay some kinds of taxes, depending on its functions, assets, staff, and risks[99]. It can be seen in Example 3:

Example 3. VTT Total Taxation

	VTT Group		Parent Company		Subsidiaries	
M€	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**
Taxes borne						
Income taxes	0	0	0	0	0	0
Taxes on property	0	0	0	0	0	0
	0	0	0	0	0	0
Taxes collected						
Payroll taxes	28.7	28.0	28.5	27.9	0.2	0.1
Social security contributions	1.5	0.9	1.5	0.8	0.0	0.0
Value-added taxes	9.1	7.8	9.0	8.0	0.0	-0.2
Asset transfer taxes	0.0	0.0	0.0	0.0	0.0	0.0
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0
Total taxes	**2 038**	**2**	**0**	**116**	**295**	**2 451**
%-shares	100%	100%	100%	100%	100%	100%

Source: VTT. Tax footprint, management, and control in 2020.

It is clear from the level of detail that a high standard of transparency has been applied.

99 See VTT explanation: "The parent company did not generate any taxable income. The parent company has confirmed losses as well as statutory provisions entered in its opening balance sheet. The use of these statutory provisions against realized costs does not constitute taxable income. The statutory provisions have not been recognized as deferred tax assets in the parent company's financial statements. However, deferred tax assets have been accounted for in the consolidated financial statements in accordance with the prudence principle, by recording EUR 2.1 million in deferred tax assets. The Group's subsidiaries also have confirmed losses, but in accordance with the prudence principle, no deferred tax assets were recognized in the consolidated financial statement. "Source: VTT Tax footprint

4.4. Tax & Operating Environment

Under this topic, companies are explaining the interaction between taxation with their operation environment, meaning the complex factors that establish the playing field around their business and taxation (economy, government, society, climate change, regulations100 etc.). The operating environment can explain the overall performance of the whole MNE and specificities in certain regions countries and times. 101 The tax environment includes the level of simplicity of tax administration, the relationship between MNEs with policymakers, tax administrators and courts, and obviously the quality of the legislation. [102]

Changes in the Operating Environment can affect business planning and, consequently, taxation. Changes in the Tax Environment can affect, for example, the cash flow, the efficiency of MNES or the tax certainty. When governments play too hard around these elements, they can increase the challenges of tax management and compliance, increasing the tax risk. Addressing these issues in a report also shows the readers how applying tax might be hard, even for taxpayers in good faith·

In this topic, companies might also explain their attitudes against or in favour of some specific tax policy, reporting how it can affect the business model and its value creation. 103 Or even consider how changes in the world itself should impact taxes, demanding for changes in the policy. [104]

100 The tax environment has been driven by several new rules and regulations. We see that the OECD, the EU, and governments are continuing this work and making progress in reforming the international tax system to reflect changing business operations. For specific industries, especially the highly regulated ones, there are analyst reports and independent statistic reports, which should be a reference point for MNEs when describing their operating environments (e.g., Bank Operating Environment Scores published by Fitch). Source: Bank Operating Environment Scores (July 2022), Fitch, website: https://www.fitchratings.com/research/non-bank-financial-institutions/bank-operating-environment-scores-july-2022-11-07-2022.

101 The operating environment is important because it helps to understand a business allocation of income and profitability, especially in crucial times like COVID pandemic. Although it is believed that most of society suffered from the pandemic and economic weakness, certain industries may have experienced a blooming opportunity, such as food delivery, online streaming, etc.

102 For illustrations, please find behavioral guidance between taxpayer and tax authorities in the White Paper-Code of Conduct Principles for Tax Authorities. It is often seen in tax footprint reports that MNEs describe their principles for communications with tax authorities, ongoing tax disputes, however, not the potential challenges from less business-friendly jurisdictions.

103 "Deciding on capital-intensive, long-term investments is challenging without clarity of the future tax framework and tax consequences. For that reason, we have been actively involved in the discussion over the new tax proposal for Pillar II (minimum taxation) and changes to the OECD Model Tax Convention's Article 9 on deductibility of arm's length payments, the shape and structure of which are crucial to supporting industries at the centre of the energy transition towards carbon neutrality. "Source: Fortum. Tax Footprint 2021.

104 "A future angle is that the tax revenues for value chain in energy taxation of utilities are currently based mainly on the use of fossil fuels. As the world becomes more decarbonized, these tax bases will disappear, impacting also our contribution to our stakeholders. While the current rules are welcome to support the current transition to carbon neutral operations, we need to always be ready for when this will change." Source: Fortum. Tax Footprint 2021.

4.5. Tax (Risk) Management Strategy and Governance

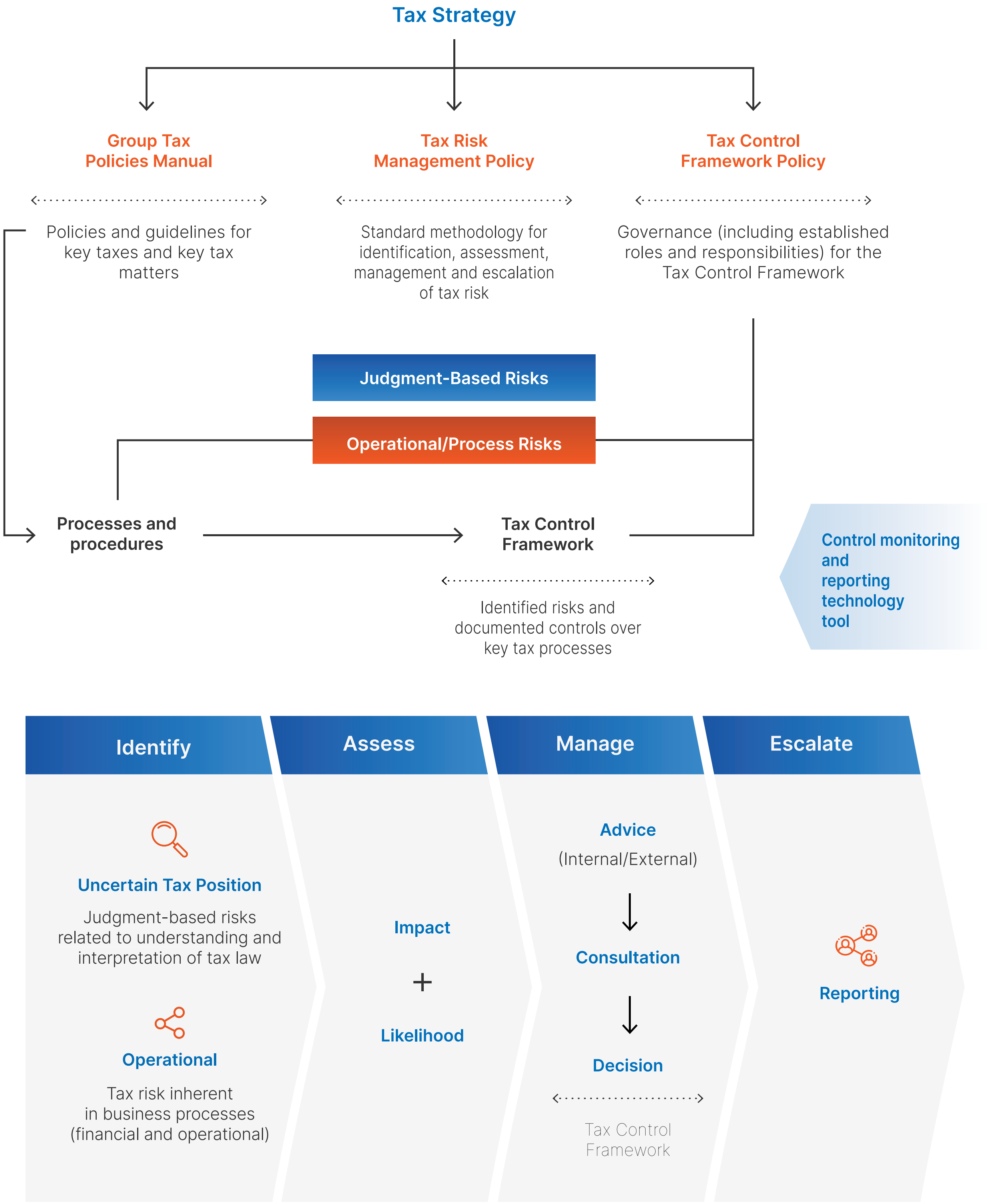
Tax management strategy commonly describes *how* the company manage tax risks and choices, with the description of the decision process. [105] There are different tax management models according to the company's vision and objectives.[106] A company might use the Tax Footprint Report to share this model and strategy with their stakeholders. In this context, tax management strategy describes:

- The set-up of the operational tax organization, (e.g., many MNEs have set up a centralized tax operational model where a center of excellence provides instructions and supports to local tax departments).
- Reporting line, Board reporting mechanism, (e.g., some MNEs have chosen to create a tax risk register which is being managed by a tax risk committee. This committee reports either to the audit committee or directly to the Board).
- Cooperation with key stakeholders (e.g., tax advisors, legal process, and communication with tax authorities).

The below graph sets an example of the tax management strategy with a tax governance and risk management framework.

105 "**Fortum's tax management** (...) For tax management, this means that all operations report and comply with operational authorities reviewing tax matters, for example in investment proposals or changes in operations. Tax contributions are made by legal entities.Legal entities, i.e.companies therefore have a key role in complying with tax rules and regulations. The Fortum Group Tax Team supports business operations by planning and advising the businesses and steering through operative and legal level guidelines, instructions, advice, and controls to ensure that we are in compliance with tax regulations. **Tax governance** The Chief Financial Officer is accountable for tax governance and strategy. The Vice President of Taxation implements our tax principles and is responsible for ensuring that principles, and the procedures that support them, are in place, maintained, and implemented in the same manner in all countries." Fortum. Tax Footprint2021.

106 *Tax Risk Management South Africa, Prof. Dr Daniel N. Erasmus, 2021*



Source: Tax and Economic Contribution Report (AngloAmerican, 2021)

It shows that beyond the duty to pay tax most of the complexities can only be managed when working with professional governance, i.e., which gives a clear view of people, processes, and technology. In absence of a good governance model, managing your tax risks in today's complex world is impossible, i.e., therefore a pre-requisite.

4.6. Non-Abusive Practices

One cannot forget the context of Tax Footprint Reports: MNE groups under accusation of tax avoidance and even sometimes evasion. Then, usually, this document will point to the absence of subsidiaries in a tax haven, or explain its presence, relating how taxation follows business, or even explain the business reasons for some specific operations and business that could be considered abusive. The description related to the whole document intends to show that sound business reasonings subsidize tax choices. [107]

4.7. Litigation Cases

After so many scandals, companies might be worried about how a litigation case can affect their reputation. Stakeholders might consider that a litigation case might mean abusive practice and huge economic and legal risks. In this topic of Tax Footprint Reports, companies can explain why they are in court and locate the possible contingencies and consequences derived from the litigation case.[108 109]

107 Neste denies conducting a list of typical abusive behavior: "As we do not conduct aggressive tax planning, we do not use tax havens, low tax jurisdictions nor artificial arrangements, which are ambiguous or against the spirit of the law, for the purpose of avoiding taxes.(https://www.neste.com/sites/neste.com/files/tax_footprint_2021_0.pdf) We are scaling up our sustainable business areas organically and by acquiring new companies in our existing and new geographical regions. We are not acquiring companies or businesses purely for the purpose of benefiting from the tax losses of the company or for any other tax benefit. If we acquire or are about to acquire a company or a group of companies with losses, the use of tax losses will be conducted based on the normal business practices. Also, structuring a new business acquisition is driven by operational needs, not by tax benefits. ". Source: Neste Tax Footprint.

108 "Fortum had ongoing tax audits during 2021. Based on earlier audits, Fortum has received income tax assessments in Belgium for the years 2008–2012. In previous years, Fortum has appealed all assessments received. Based on legal analysis, no provision has been accounted for in the financial statements related to the Belgium 2008–2012 tax audits.In Sweden, Fortum filed a summons application to the District Court of Stockholm in 2018 in which damages are claimed from the Swedish State.Secondly, Fortum has had ongoing tax appeals in Swedish courts and EU Commission relating to the hydro property tax.In February 2022, Fortum did not get leave to appeal to the Supreme Administrative Court in Sweden." Source: Fortum. Tax Footprint2021.

109 "TAX APPEALS Due to Kemira's extensive international operations, the Group is involved in a number of tax related legal proceedings incidental to these operations and it does not expect the outcome of these currently pending legal proceedings to have a materially adverse effect upon its consolidated results or financial position." Source: Kemira Tax Footprint2021.

5. Value Chain And Tax Contribution: Measuring The Light, Medium Or Heavy Tax Footprint?

A Tax Footprint Report refers to tax paid by MNEs and tax collected on behalf of tax authorities in certain jurisdictions. Value creation by the group entity of the MNE is the basis for paying taxes and the ability to pay taxes in such jurisdiction. Any excessive contribution to any stakeholder will weaken the financial position to invest.

Taxes are paid on the value creation during operations; correspondingly, the cost of dismantling will impact value creation at the end of the lifetime through the ability to pay tax as tax bases will be depleted. As business is the origin of the tax contribution, poorly designed taxes may negatively impact value creation. It is widely believed that the design of tax rules should always be balanced with business interests to allow for optimal value creation for all stakeholders.

Countries have at some level agreed that taxes must be levied in the country where you have the value creation, so describing the relationship between the MNE group companies and how it relates to the value chain is fundamental to legitimatizing the tax allocation. However, it might not be as simple as it looks.

To correctly recognize the value generated for tax reasons resulting in tax contributions, it is essential to understand the current value chains. The operational footprint determines the kind and extent of our tax footprint, whereas the scale of our activities determines the size of our tax footprint.

In general, the bigger the operative footprint we have in a country, the more we rely on the infrastructure and regulations of that country. Consequently, operations that do not require heavy assets and not a lot of personnel have a **lighter operative footprint.** The tax footprint of these operations is not comparable to that found in countries with production and thus they may only be paying income tax on their profits.

Businesses with a **heavy footprint** typically have production operations, which results in the collection of taxes on production, property, profit, and other taxes.

With a larger client base, service, sales, and trading operations make up a **medium** footprint. Along with corporate income tax and wage withholding duties, a medium business footprint also generates VAT liabilities.

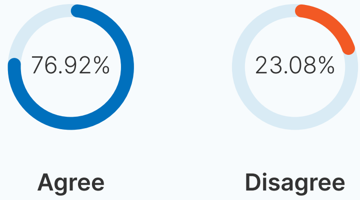
If a company has a small client base and its activities are not always obvious from the outside, we consider it to have a **light footprint**. These low-impact enterprises typically result in responsibilities for corporate income tax and salary withholding taxes.

The 3-scale measuring approach comes with the following observations:

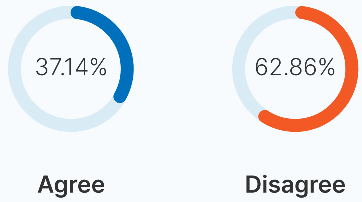
- It communicates very well to a wider audience to explain the relationship of the level of activities with tax paid/collected.
- In combination with the visual of the value chain, this adds another layer of communication easy to understand.
- If and insofar an easy definition of light, medium, and heavy footprint can be established across the industry, this could well become a superior way to communicate to society your total tax contribution.

6. Five Statements For A Panel Discussion

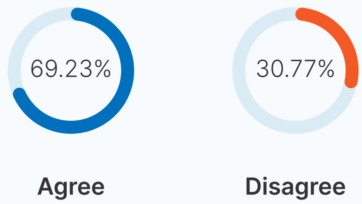
1. A global Tax footprint publication can be considered a communication tool for taxpayers.



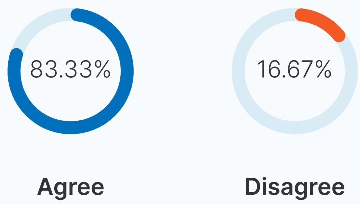
2. A global Tax footprint publication makes any disconnect between taxes paid and local operations very transparent.



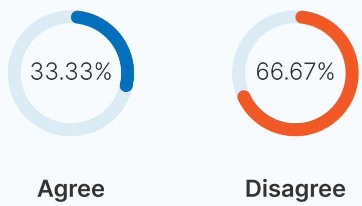
3. If you consider yourself a good corporate citizen, you could consider a global tax footprint publication.



4. The two standard models leave MNE's a lot of freedom on what to publish and what not.



5. It should be fairly easy for MNEs to identify the "Profit to revenue ratio" outliers with a tax footprint published.



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- Tax Risk Management South Africa, Prof. Dr Daniel N. Erasmus, 2021

Appendix A

Fair Tax Mark-B team
Principle.pdf

Please click on the image above to open the PDF.

WHITE PAPER 04

RECENT EXPERIENCE **ON ONSHORING OF IP**

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2022 GTC CONFERENCE

1. Introduction

The introduction of BEPS Action Plan 8-10 have significantly changed tax planning structures in relation to intellectual property (IP) and many companies are engaging in restructuring activities to meet the BEPS substance requirements. The era of aggressive tax planning structures that involves the offshoring of IP to low-tax jurisdictions is over. Instead, the strategy should involve the redesign of structures to align economically significant decision-making and control functions with IP ownership. Many multinationals are converting their offshore structures to onshore structures, moving the IP back to the jurisdiction where relevant economically significant activities take place.

2. BEPS Guidelines

The following is a brief summary of the new guidance dealing with intangibles:

1. Legal ownership of intangibles by an associated enterprise alone does not determine entitlement to returns from the exploitations of intangibles;
2. Associated enterprises performing important value-creating functions related to the development, enhancement, maintenance, protection, and exploitation ("**DEMPE**") of the intangibles can expect appropriate remuneration;
3. An associated enterprise assuming risk in relation to DEMPE of the intangibles must exercise control over the risks and have the financial capacity to assume risks including the very specific and meaningful control requirement;
4. Entitlement of any member of the MNE group to profit or loss relating to differences between actual and expected profits will depend on which entity or entities are performing the important functions in relation to the DEMPE of the intangibles;
5. An associated enterprise providing funding assuming the related financial risks, but not performing any functions relating to the intangible, could generally only expect a risk-adjusted return on its funding;
6. If the associated enterprise providing funding does not exercise control over the financial risks associated with the funding, then it is entitled to no more than a risk-free return.

The major challenges of any onshoring of intangibles are:

- What is the fair market value of the intangibles transferred?
- What is the DEMPE profile of the intangibles receiving entity?
- What if the functional profile of the intangible's receiving entity if it is performing little or no DEMPE functions?
- What are some of the structuring-specific elements to take into account?

3. The Irish Perspective

Offshoring structures – The past

Relevant to past and current IP structures using Irish companies is the relatively low tax rate that should apply to the Irish operating company (the entity exploiting the IP concerned) used in the structure. The Irish corporation tax rate of 12.5% applies in respect of income from an Irish trade; that is a trade which is at least partly carried on in Ireland. All other corporate income is taxed at a higher rate of 25%. Broadly, in order for income to be trading income it needs to be generated by activity rather than arising from the mere ownership of an asset, and thus the rate is aimed at encouraging and facilitating the carrying out of economic activity in Ireland.[110]

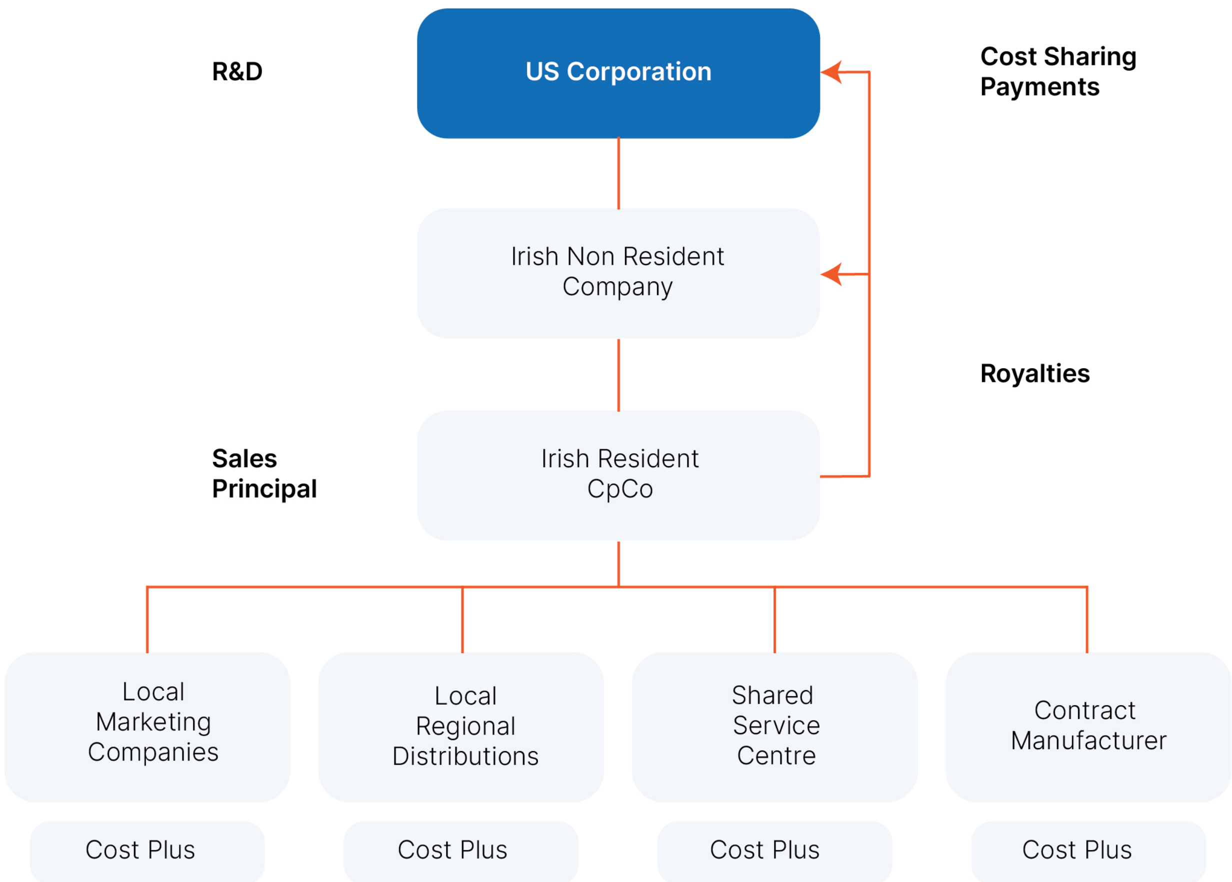
For a trade to be considered to be at least partly carried on in Ireland, some activities need to be carried on in Ireland by employees or officers of the company concerned that are physically present in Ireland. Outsourcing is possible but there needs to be sufficient and appropriate oversight of the outsourced activities, again by employees or officers that are physically located in Ireland.

110 Relevant aspects of the Irish tax code are discussed further in Outbound Acquisitions: Tax Planning for European Expansion in a Changing Landscape (2020), Chapter 8, James Somerville of A&L Goodbody.

4. License Of IP To The Operating Company

There are two types of structures which have commonly been used by multinational groups in order to achieve effective rates of tax that are less than the statutory rate of 12.5%. The first type involved the holding of IP outside of Ireland by an Irish non-resident group company while another Irish resident group company was used to actively exploit IP. Changes to both Irish and foreign tax laws now negate the previous benefits that were achievable with this structure.

The so-called "Double Irish" structure is an example of this arrangement. In that structure the IP was owned by an Irish incorporated but non-tax resident company, resident in an appropriate low, or no tax jurisdiction. The IP was licensed to an Irish-incorporated and Irish tax resident company, in return for which an arm's length royalty was paid. The taxable profits in Ireland were reduced by way of the royalty payment made by the Irish resident company to the IP owner.



This structure allowed the IP to be exploited by an active trading company with substance in Ireland, a country with a wide tax treaty network. Often this was of relevance where the income was generated by way of royalty income, as opposed to being used to create a product to sell, as the relevant Irish tax treaty reduced or avoided taxes arising in the foreign customer jurisdiction and paid to the Irish trading company.

Where the structure was used by a US multinational group, typically both the IP holding company and the Irish operating company were Irish incorporated (hence the description "Double Irish") so as to allow the royalty payment from the operating company to the IP holder to be disregarded for US tax purposes. While the operating company was Irish tax-resident, the IP holding company, although Irish incorporated, was arranged so as not to be Irish tax-resident.

The structure was used by many multinational groups for many years. As far back as 2005, the Wall Street Journal reported on Microsoft's use of the structure. Following the economic pressures on jurisdictions after the economic crash at the end of the last decade, the structure came under the spotlight of media attention and was the subject to harsh criticism from certain politicians in the United States.

In the face of criticism levelled at Ireland in respect of the Double Irish structure and certain aspects of the Irish tax code generally, especially that in 2013 from US senators at the US senate hearings, and from UK members of parliament at parliamentary hearings, the Irish legislature responded by amending the rules relating to the Irish tax residence of a company.

While there was certain grandfathering until the end of 2020, essentially the change to the Irish corporate tax residence rules prevented achieving non-residence of an Irish incorporated company in a non-tax treaty country and negated the benefits that arise for both Irish and foreign tax purposes where the IP holding company in the structure is Irish incorporated but not Irish tax-resident.

The structure has not just been affected by Irish tax residency changes and subsequent BEPS project measures. Various low or no-tax jurisdictions have had to implement economic substance rules requiring income-generating activity to be carried out in the jurisdiction concerned and also requiring adequate employees and assets to be located in the jurisdiction. Additionally, since 2017 the OECD Transfer Pricing Guidelines (the "Guidelines") require that for the legal owner of IP to be entitled to the returns from the exploitation of intangible assets, it must perform certain key functions in its own jurisdiction (the so-called "DEMPE" rules discussed below).

As a result of these, and other factors, multinational groups may look to move their IP "on shore", in many cases for US groups to the US but there is also a movement to jurisdictions such as Ireland (particularly where there are existing operations carried on by the group in the jurisdiction concerned).[111,112] Information from tax authority statistics, and company office and SEC filing disclosures, all go to suggest the such movement of IP to "onshore" jurisdictions as Ireland, the Netherlands, Switzerland, the United Kingdom and certain unidentified jurisdictions by various US multinational groups.[113]

111 Irish Tax Policy in Perspective, Irish Tax Institute, Chapter 6.

112 Ireland Rivals United States for Onshoring IP, Martin Sullivan, Tax Notes International, 31 January 2022. Martin A. Sullivan, "Big Tech Is Moving Profit to the United States," Tax Notes International, 23 August 2021, and Daniel Bunn, "New Research Shows Major Changes for US Companies Earning Profits From Ireland" Tax Foundation, 16 June 2021.

113 Martin A. Sullivan, "Big Tech Is Moving Profit to the United States," Tax Notes International, 23 August 2021, and Daniel Bunn, "New Research Shows Major Changes for US Companies Earning Profits From Ireland" Tax Foundation, 16 June 2021.

While Ireland has been one of the jurisdictions of choice for IP onshoring, for the initial periods following any such onshoring the income generated from the IP exploited by the Irish company should be expected to be substantially sheltered by tax depreciation allowances. Nevertheless, a portion of the income should be taxable, and the onshoring trend may have a part to play in the substantial increase in Irish corporation tax taken in recent years. The Annual Taxation Report published on 1 September 2022 by the Irish Department of Finance[114] indicates Irish corporation tax receipts last year were €4.4 billion (41%) higher than pre-pandemic, mainly reflecting the contributions from pharma, med-tech, and ICT sectors. The Financial Times reported that "so great was the impact from multinationals that Ireland's numbers distorted EU figures, despite the nation of 5.1mn making up less than 3 per cent of the region's economy".[115] The overreliance on corporate income tax may leave the exchequer vulnerable. The report indicates that half of the Irish corporation tax receipts of €15.3bn last year came from just ten groups, including Apple, Google, Intel, Meta, Amazon and Pfizer.

5. Onshoring Structures – The Present

Operating a company as an IP owner

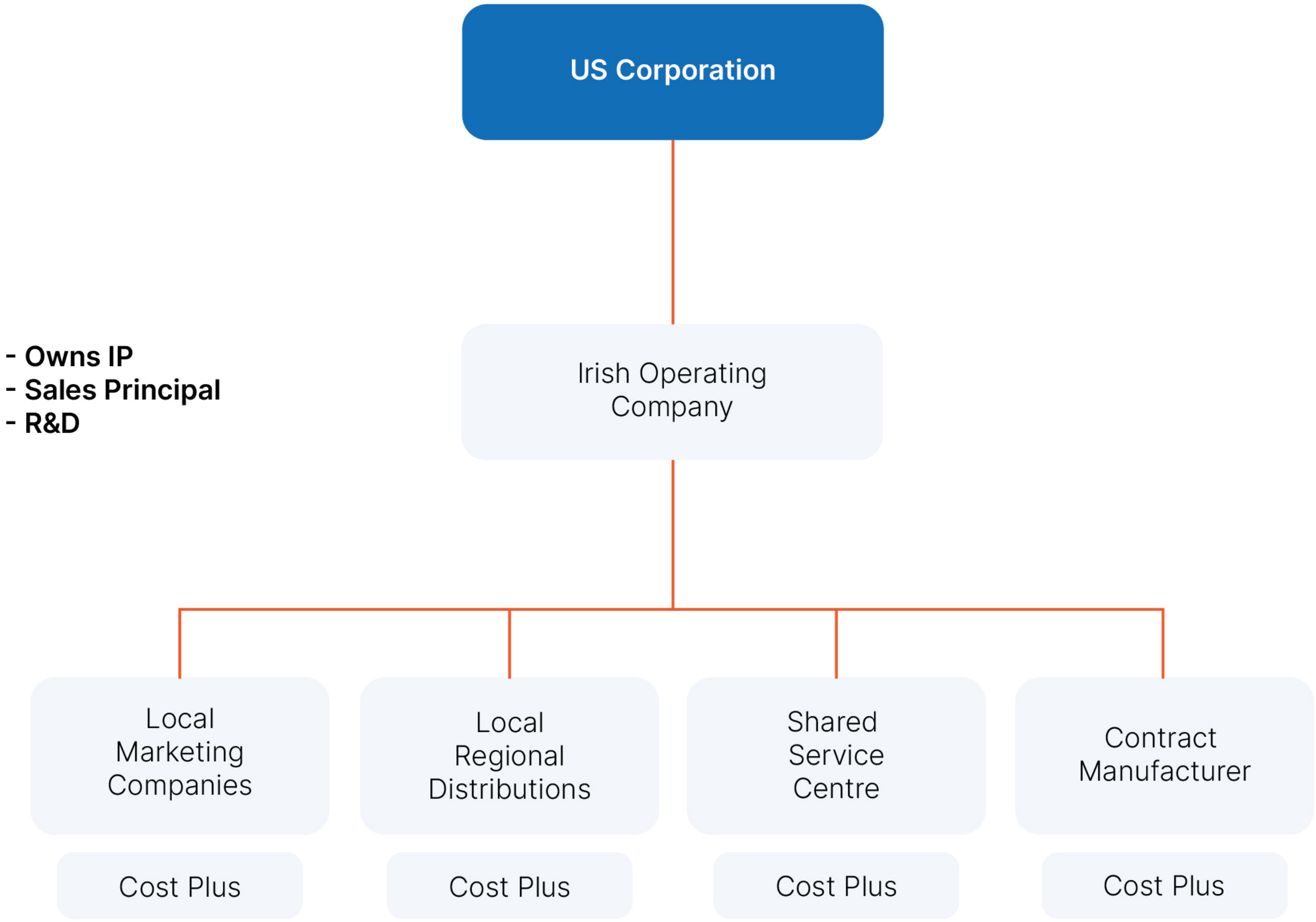
Irish tax law allows for beneficial tax treatment to be achieved in the case of the second type of common structure, being one where the Irish resident operating company is also the holder of the IP. An "onshore" structuring option is for the relevant IP to be acquired by an Irish operating company.

The Irish tax code provides an incentive for onshoring of IP to Ireland by way of tax depreciation allowances, described as "capital allowances" in Irish tax law. Those allowances provide for a tax deduction in respect of the capital expenditure on the acquisition of a wide variety of intangible assets which can shelter income arising from the exploitation of the IP.

The deduction either follows the relevant accounting depreciation of the IP concerned or alternatively follows a 15-year write-down (that is, seven per cent over 14 years, and two per cent in year 15). This tax depreciation is available in respect of capital expenditure incurred on assets that are "intangible assets" under IFRS or Irish GAAP and come within certain stated categories of IP such as patents, trademarks, brand names, know-how, domain names, scientific processes and goodwill directly relating to such. There are certain limits to the tax deduction available in that only 80% of the profits of the business exploiting the IP rights can be reduced by capital allowances and related interest expenses (but with any excess being carried forward indefinitely). This allows for an effective Irish tax rate of 2.5% to be possibly achieved on income arising from the exploitation of IP where tax depreciation for the capital spend on the acquisition of the IP is fully utilised (the 2.5% effective rate is arrived at where there is full utilisation by applying the 12.5% tax rate to the 20% of income left after the 80% deduction was been taken).

114 https://www.gov.ie/en/publication/a6312-annual-taxation-report-september-2022/`

115 "Tech sector tax windfall shores up Ireland's economy against recession", Financial Times, 8 August 2022.



In addition to the 12.5% tax rate, in order to encourage activities in Ireland at the earlier stage of the IP lifecycle, when the IP is actually being developed through the carrying on of R&D activities, there is a generous tax credit system which is available at the rate of 25% of the qualifying expenditure. The tax credit can result in an effective 37.5% deduction, taking into account the normal corporation tax deduction, for revenue expenditure on certain R&D activities and the plant and machinery for such activities.[116]

The application of OECD Pillar 2 rules, should they come to pass, should have a bearing on the benefits that may be achieved as a result of incentives such as tax depreciation allowances and R&D tax credits.[117]

116 For detailed commentary on Irish tax incentives see Maguire, The Taxation of Companies 2022, Chapter 7.

117 The Irish Department of Finance is carrying out a consultation process in respect of relevant Irish incentives in light of the potential impact of Pillar 2 rules; Irish Department of Finance, Tax Strategy Group paper, Corporation Tax, July 2022.

6. Tax Incentives Relevant To Onshoring Of IP In Switzerland

On 1 January 2020, the Swiss Federal Act on Tax Reform and AHV Financing ("TRAF") came into force. The reforms provided for by the TRAF aimed to guarantee legal certainty and preserve Switzerland's attractive tax law regime while being in line with the OECD standards. A 'patent box' provision that relates to the taxation of income arising from IP, licenses and other comparable rights was implemented. Accordingly, companies that move to and/or maintain their principal structure in Switzerland will have a clear legal basis to step up (to fair market value) the tax base of their assets and goodwill tax-free effective from 1 January 2020. They can then depreciate their stepped-up basis over a 10-year period with a tax-effective deduction. The entire built-in gain including goodwill ("BIG") of multinationals reflects its people and assets, as well as its functions as a global materials solution supplier, including all patents and brands. Essentially, this provision allows for a portion of profits from IP rights to be tax at a deductible tax rate, when they are OECD-compliant. The TRAF also implemented a Limitation of the Aggregate Relief. This entails that the total tax benefit from a patent box and from extra R&D deductions cannot exceed 70% of income before these deductions.

7. Tax Incentives Relevant To Onshoring Of IP In The Netherlands

The Netherlands instituted new legislative transfer pricing measures that came into force on 1 January 2022. These are aimed at preventing non-taxation based on the previous Dutch TP legislation. These measures stipulate that a downward adjustment to the Dutch tax base will be permitted only if an equivalent upward adjustment is incorporated in the taxable basis of a profit tax in the other nation in current or future years.

To secure the recognition of an arm's-length profit for Dutch tax purposes, the Netherlands' transfer pricing regulations now demand a downward correction of commercially applied transfer prices between related parties. If a transaction between a Dutch corporate taxpayer and a foreign related party is not at arm's length, the legislation denies a downward adjustment of the Dutch taxpayer's taxable income (either as a payor or payee) to the extent that a corresponding upward adjustment is not included in the taxable basis of a profit tax in the foreign counterparty's country.

Several case-specific examples of interconnection with other Dutch tax provisions are provided, including certain interest deduction limitation rules, the controlled foreign company (CFC) rules, the Innovation box regime, the Dutch dividend withholding tax, and the Dutch conditional withholding tax regime applicable to low-taxed/EU-blacklisted tax jurisdictions.

8. Example of Jurisdiction Specific Tax Measures Relevant To IP onshoring

In Germany, withholding tax may be triggered in transactions involving IP registered on a German IP register, regardless of whether the IP holder has [any taxable presence in] [Note to draft – please confirm that this is correct] Germany. This is based on section 49 of the German Tax law act according to which withholding tax implications can arise if certain conditions are met.

On 28 June 2022, the German Federal Ministry of Finance ("BMF") published an evaluation report. The BMF maintains its (as yet untested) view of the law but recommends legislative changes to abolish the non-resident taxation of German-registered IP with effect for future tax periods (except for transactions that involve parties resident in tax havens). The BMF maintains its view that a German tax liability arises in respect of royalties or capital gains arising from the licence or sale of German-registered IP even though both parties to the transaction are resident in a foreign jurisdiction and the sole nexus to Germany is the registration of the underlying IP in Germany. In its reasoning, the BMF does, however, acknowledge that its interpretation of the law regarding the tax liability per se and the determination of the tax base has not yet been tested in the German tax courts. All assessment notices issued so far have been challenged by the taxpayer and appeal proceedings are currently pending on an administrative level.

The applicability of section 49 of the German Tax act depends on whether the following conditions are satisfied:

- the IP must be registered in Germany, and Income related to the IP shall arise in Germany and;
- a royalty must be paid on this income or there must be a capital gain related to the sale of the IP and;
- the limitation period of 7 years must have not yet passed.

These conditions can be applied to both related and third-party transactions. In principle, there are only two major circumstances that can give rise to such German withholding tax. These are when a royalty paid on sales income is derived in Germany (even if the royalty is paid between two other countries), and/or for capital gains related to the on-shoring of IP.

9. OECD Transfer Pricing Guidelines And DEMPE

The Guidelines affect the efficiency of structures in which the IP owner is an entity separate from that carrying out the operating activity. The Guidelines contain (amongst other changes) material changes to the methodology for how income from intra-group arrangements should be allocated. The starting premise of the approach contained in the Guidelines is that all members of a multinational company should receive an arm's length compensation for (i) the functions that they perform, (ii) the assets that they contribute and (iii) the risks that they assume in connection with the exploitation of intangible assets .Under the Guidelines, there is a switch from a methodology where the group entity, which is the legal owner of a relevant intangible asset, has a right to the returns from the exploitation of that asset, to a differing methodology, providing that, for the legal owner to be entitled to the returns from the exploitation of intangible assets, it must perform key functions in the development, enhancement, maintenance, protection and exploitation ("DEMPE") of the relevant intangible assets.[118]

10. Identification Of DEMPE

There is a need to identify the key DEMPE functions, so as to ensure that the company concerned is exercising proper control over those functions and associated risks and that the control is clearly evidenced. The matter as to what the relevant DEMPE functions are for a particular company depends upon the particular circumstances concerned. Functional analysis and risk assessment are required to identify the key DEMPE functions. To be entitled to the full IP profits it is not sufficient that an entity holds the IP rights and bears the funding costs. The entity must also perform and control DEMPE functions in relation to that IP.

The identification of relevant DEMPE functions should be very much fact dependent with the relative importance of each DEMPE function differing depending on the facts.[119] For example, in the case of acquired IP, it is likely that more importance will attach to functions such as maintenance and protection, whereas in the case of self-developed IP the more important functions may be development and related R&D activities such as design and control of R&D and marketing programmes and budgets. Differences in relative importance may also arise due to the nature of the IP concerned, the particular stage in the life cycle of the IP, or the particular IP strategy of the business concerned.

Additionally, there may be variation between cases as to what is encompassed in each relevant DEMPE function. For example in the case of protection, for some groups that would entail relevant IP registration, identification of infringement and taking appropriate infringement action, while others may

118 OECD Guidelines Para 6.48.

119 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, Chapter VI

avoid registration and the consequent publication of certain details concerning the IP and use strategies such as disaggregation of essential information.

A challenge with DEMPE analysis is the matter of the level of detail at which the analysis is carried out. Carrying out the analysis in too much granular detail has the potential to give rise to an adverse outcome.[120] Relevant in this regard is having the DEMPE analysis appropriately focused on activities that are aligned to key value drivers, and at the appropriate strategic level, rather than at the operational level. Contemporaneous documentation of the reason behind the adoption of the particular level of detail for the analysis undertaken should be helpful in the event of subsequent queries or challenges.

Practical difficulties in carrying out the DEMPE analysis may arise due to cross-functional organization in the group concerned, which may be exacerbated by the digitalization of function or remote or hybrid working arrangements. In addition to the identification of relevant contributors, the matter of assets and risk needs to be addressed in the analysis. Assistance in the analysis may be obtained from enterprise risk management or compliance frameworks which may point to key functions and risks related to relevant assets and IP and where control, management and responsibility lie in respect of such.

11. Establishing DEMPE Control

In order to establish DEMPE control by a company owning IP, it is often necessary to enhance the composition of the board of directors and to ensure strong corporate governance including the appropriate holding and documenting of meetings. It may also be necessary to establish a specialized IP committee having as its primary responsibility the control and strategic management of the IP owned by the relevant company.

Good practice should require that a long-term plan is put in place to seek to appropriately align the allocation of IP profits and DEMPE control. An aim of that should be to have the senior executives, who are responsible for controlling and making strategic decisions in relation to the company's DEMPE functions, physically based in the operating company jurisdiction. Often this may require the relocation of executives from elsewhere in the business or through new hires.

Where an IP committee is to be established, the composition of that committee should be driven by what constitutes DEMPE for the company concerned, relevant to which should be the functions that contribute the most IP value, and identification of who in the group controls the decisions and risks relating to those functions.

120 Neil Pereira, "Intangibles: The New Frontier", International Tax Review, 3 January 2022; Philippe Paumier, "TP Aspects of Intangibles: How Deep Should DEMPE Be?" International Tax Review, 17 February 2020.

Committee members should possess the necessary expertise and experience in the area of particular risk for which they are responsible. From a governance perspective, there should be certain common members of the board. In order to facilitate the implementation of the relevant arrangement parameters and appropriate delegation should be set out, often in the form of approved guidelines to identify functions, responsibilities, and decision-making powers, to provide for a schedule for meetings with all members in physical attendance, and appropriate feedback and reporting to the board.

12. Structuring Issues

Acquisition of the IP

In the case of structuring in the usual form of IP onshoring to Ireland, the upfront payment for the acquisition of the IP is funded by cash or a loan note and should be expected to be regarded as "capital" for Irish tax purposes. IP tax depreciation should be available, provided that the cost of the IP relating to the upfront payment made is capitalised and treated as an intangible asset for accounting purposes in the Irish statutory financial statements of the acquiring company, and that the Irish IP tax depreciation regime conditions are satisfied. In the view of the Irish tax authority, the acquisition of IP in return for the issue of equity/shares should not be regarded as "incurring" capital expenditure for the purposes of qualifying for the IP tax depreciation regime.

The acquisition of IP by way of debt may be achieved by the Irish buyer (i) issuing a promissory note as consideration, or (ii) assuming existing debt owed by the seller. Interest on the borrowings used to fund the IP acquisition should be expected to be tax deductible and interest withholding tax should not apply subject to certain considerations, specifically including that the loan note must have an arm's length interest rate.

For transfer pricing purposes, the interest rate applied to the loan should be comparable with third-party interest rates for similar transactions in the market, i.e. the interest rate to be paid by the Irish acquiring company to the IP seller should be comparable to interest rates that the Irish acquiring company would pay to a third party bank for similar transactions under comparable terms.

A transfer pricing report should be required providing for the details of the intra-group loan arrangements entered into by the Irish acquiring company, the credit rating assessment of the borrower and the bond benchmarking exercises performed, including the arm's length interest rate range derived. In addition, a debt-equity analysis may also be required to ensure that the interest rate applied reflects an arm's length rate.

The acquisition of the IP may involve contingent milestone payments linked to the success of the product (e.g. net revenue) and may be tiered (i.e. increase with success), to allow the seller to share in the risk of failure/upside of success. From a tax and accounting perspective, it should need to be determined whether such future milestone/contingency/instalment payment (a) forms part of the initial cost of the asset and is therefore to be capitalised (in which case Irish IP tax depreciation may be available), or (b) is akin to a royalty payment and is to be expensed as incurred (in which case a tax deduction may be available when paid). Where a milestone payment is capitalised upfront, together with the initial payment, tax depreciation for Irish tax purposes would not be claimed on the milestone/contingency/instalment payment until such time as it has been incurred.

The structuring transaction may be affected by tax arising in a jurisdiction other than that of the parties involved, for example, transfer or stamp duty taxes. A particular issue of focus in relation to IP that is the potential for German tax to arise on the licensing or disposal of IP (generally trademarks and patents) recorded in a German register. A report issued by the German tax authority ("BMF") on 28 June 2022, confirms that the BMF intends to tax transactions entered into since 2013 but may seek to abolish the tax in the future.[121]

The matter of the German IP tax conflicting with EU law (free movement of capital, Article 63 of the Treaty on the Functioning of the European Union) and also German tax treaties have been raised by commentators.[122] The OECD model treaty provides that only the residence state should have a right to tax royalties and disposals of IP. The model rules article 12 concerning royalties do not distinguish between registered and unregistered rights. Additionally, neither the OECD model treaty nor the BEPs reports identifying registration of IP as a sufficient (or even relevant) nexus for taxing the disposal of or granting of rights in IP.

Various other tax matters should need to be considered, including avoiding the realization of any gain within the on the transfer of the IP, VAT on the supply of the IP and related recovery of any VAT arising, matters relating to financing such as interest withholding tax and exemption for such, reporting obligations (such as under the EU DAC6 measures), and anti-avoidance measures (such as the recently introduced Dutch measures described above).

13. Standards For Transfer Pricing Valuation

With effect from accounting periods beginning on or after 1 January 2020, valuation should be in line with 2017 OECD guidelines. Ireland adopted the 2017 OECD guidelines (replacing the 2010 OECD guidelines), as well as, supplemental OECD guidance on hard-to-value intangibles and the transactional profit split method ("TPSM"). Further, from 1 January 2020, the Irish transfer pricing provisions were extended to capture capital transactions (e.g. an IP transfer). Therefore, the arm's length value of any IP transferred to the Irish operating company should be determined with regard to the 2017 OECD guidelines.

Broadly, the 2017 OECD guidelines set out five methods for determining arm's length price but point out that a number of the methods would rarely be

121 An English version of the report is available online. Johannes Frey and Florian Schmid, "'Catch-56': Germany's Proposed Extraterritorial IP Tax", Tax Notes International 25 July 2022. See also William Hoke, "German MOF Proposes Revisions to Extraterritorial IP Taxation," Tax Notes International , 27June, 2022.

122 Johannes Frey and Florian Schmid, "Nexus Limitations on German-Source IP Taxation," Tax Notes International, 23 November 2020.

appropriate for IP (due to lack of comparables and the lack of relationship between cost and value etc.). The guidelines indicate that a discounted cash flow valuation may be appropriate for hard-to-value intangibles where no reliable uncontrolled transaction exists (see 6.153 in Chapter IV) and this methodology has been adopted in certain IP acquisitions by Irish companies.

The discount rate takes into account the time value of money and the risk or uncertainty of the anticipated cash flows. The discount factor is often the Weighted Average Cost of Capital ("WACC"), being the average cost of equity (common and preferred) and the post-tax cost of debt, weighted by capital structure (debt to equity ratio). The higher the WACC, the greater the degree of discount.

The DCF method also takes into account tax savings resulting from tax depreciation deductions. The DCF approach can be used for both on-market and pre-commercialised IPs (usually apply a lower discount rate for on-market – reflecting more certain returns). Elements of the consideration may also require different discount factors. The DCF method is a valuation based on management forecasts (estimates) and the choice of the discount rate.

The OECD issued the report[123] Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles ("HTVI") under BEPS Action 8, with the intent of identifying what is covered as HTVI, as well as clarifying for tax authorities how to go about analyzing these types of intangibles, given they have asymmetrical information as compared to taxpayers. The term HTVI covers intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (i) no reliable comparables exist, and (ii) at the time the transactions were entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of the ultimate success of the intangible at the time of the transfer.

To address the HTVI guidance, the relevant analysis carried out may recount how the valuation was performed, and what information was considered and the process undertaken to assess what information would be relied on for the ex-ante analysis. As the key model variables are the reasonableness of the forecasts used and the discount rate, the analysis may include a discussion of how those variables were derived, considered and used.

There is the risk of contention that IP value is inflated giving rise to additional tax deductions and thus reducing tax receipts in the onshoring jurisdiction. Tax authority audits may query IP valuations in certain instances taking an approach that challenges positions taken relating to future matters applying the benefit of hindsight.[124]

123 OECD (2018), Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles - BEPS Actions 8-10, OECD/G20 Base Erosion and Profit Shifting Project, OECD, Paris. http://www.oecd.org/tax/transfer-pricing/guidance-for-tax-administrations-on-the-application-of-the-approach-to-hard-to-value-intangibles-beps-action-8.htm , now reflected in the OECD Guidelines (2022).

124 OECD (2018), Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles, for example: "In the case of intangibles which fall within the definition of HTVI found in paragraph 6.189, and under certain conditions, tax administrations are entitled to consider ex post outcomes as presumptive evidence about the appropriateness of the ex ante pricing arrangements... However, it would be incorrect to base the revised valuation on the actual income or cash flows without also taking into account the probability, at the time of the transaction, of the income or cash flows being achieved".

In that regard, contemporaneous detailed documentation may assist in defending such after-the-fact contentions. It is important to have relevant contemporaneous documentation that records the thought process and analysis used that resulted in the particular valuation arrived. Examples are detailed board minutes and cross-referencing to detailed and substantive valuation workings. As a practical matter, it should be helpful to approach such contemporaneous record-keeping with a mindset that assumes possible future litigation concerns the matter and to draft contemporaneous minutes and documents accordingly.

14. Conclusion

Various measures have negated the benefits of splitting IP ownership and exploitation within a group structure and have changed significantly tax planning structures. These include the OECD DEMPE rules requiring income to be taxed in jurisdictions with real economic activity related to that income, changes to domestic laws like the Irish and Dutch examples discussed above and also US tax reform neutralizing certain benefits of utilizing low tax jurisdictions, reputation issues with tax issues being considered as part of a group's corporate and social responsibility considerations[125] and also the threat of political criticism.

Publicly available information indicates a move of IP not only to the US but also to jurisdictions such as Ireland, the Netherlands, the United Kingdom, and Switzerland.[126] Tax alone may not of itself explain the reason for certain jurisdictions being chosen as the location for a group IP holder but a competitive taxation regime is likely to be a necessary condition to attract such onshoring and investment.

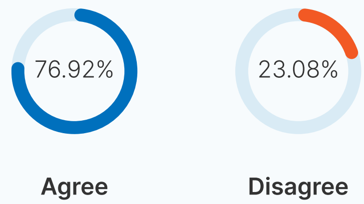
The tax issues to be considered in an on-shoring of IP remain volatile, including if anyhow the two-pillar rules will be implemented and their impact on the tax benefits that may be obtained from the use of certain jurisdictions and the particular tax incentives that they may offer. Additionally, there are various practical issues to be faced with the approach which may be informed by challenges seen not only in the jurisdiction concerned but in others, especially in respect of the application of rules common to various jurisdictions such as the OECD DEMPE guidelines.

125 Criticism may arise even where there is an onshoring of IP from a low or no tax jurisdiction, see for example the BEPS Monitoring Group Comments on the Model Rules for a Global Anti-Base-Erosion Minimum Corporate Tax, Tax Notes International, 21 March 2022 (The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations that research and campaign for tax justice)

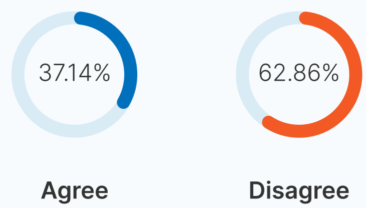
126 Martin A Sullivan, "Irish Data Confirm Tech IP Shift From Havens to the United States", Tax Notes International 17 January 2022, see also Seamus Coffey, "The Changing Nature of Outbound Royalties From Ireland and Their Impact on Taxation of Profits of U.S. Multinationals," Irish Ministry of Finance (May 2021).

15. Five Statements For A Panel Discussion

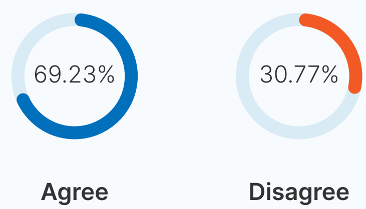
1. The onshoring of IP requires a good governance policy, either strategic or operational, to be put in place.



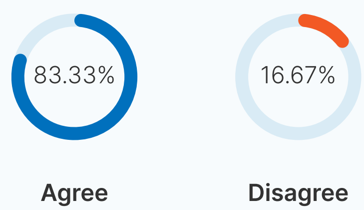
2. When IP onshoring happens without DEMPE functions being performed by the receiving entity, a risk-free return may only be charged to the licensees.



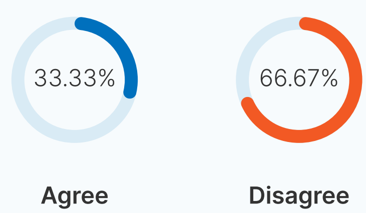
3. The receiving countries will have to fully share the received royalties with other group entities involved in DEMPE activities.



4. The fact that countries like Germany might apply a withholding tax on IP being onshored, is a clear case of treaty override.



5. IP onshoring will drive continued tax competition among countries to attract FDI, and success in attracting IP onshoring is not without its economic risks.



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WHITE PAPER 05

HOW TO SET UP **A TAX RISK COMMITTEE**

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2022

GTC CONFERENCE

1. Introduction

The aim of this paper is to consider the effective management and proactive avoidance of tax risks. It is vital that multinationals and medium to small businesses exercise control over this risk by means of a tax risk management (TRM) framework. Some major questions surrounding this theme are:

- Should one have a tax risk committee as a subcommittee of the audit committee?
- Should a tax register be used to track all tax risks?
- What are the ethical and legal implications of the latter two instruments, for example in light of the Whistleblowers Act?
- What is the importance of the "attorney/client" privilege, and how can this be implemented in a tax risk committee?

2. Tax Risks

Identifying the tax risks that exist in a particular business environment is a critical first step toward a TRM framework. The identification process should be both forward-looking *and* backwards-looking (to anticipate adverse consequences post-audit).

A business might potentially be exposed to the following tax risks:

- Transactional tax risk, operational tax risk;
- Compliance tax risk;
- Financial accounting tax risk;
- Portfolio tax risk;
- Management tax risk; and
- Reputational risk.

The outcome TRM seeks to avoid, from a 'bottom-line' perspective, is a liquidity threat resulting from either under-accounting future tax liabilities (including increased assessments from past transactions) or over-estimating deferred tax assets or refunds that will become due. In all these instances, the appropriate monetary provisions might not have been made and as such, there is a threat to liquidity.

Furthermore, one needs to consider that the effective management of tax risks would most likely mitigate future legal costs. The process of litigation surrounding transfer pricing cases is usually protracted and costly. There is also the added cost of reputational damage that comes with these high-profile cases (which the media often makes a meal of).

Insurance coverage of tax risks (or at least the legal costs of any tax dispute representation) is being addressed as a topic for further discussion.

3. Tax Risk Management (TRM) Model

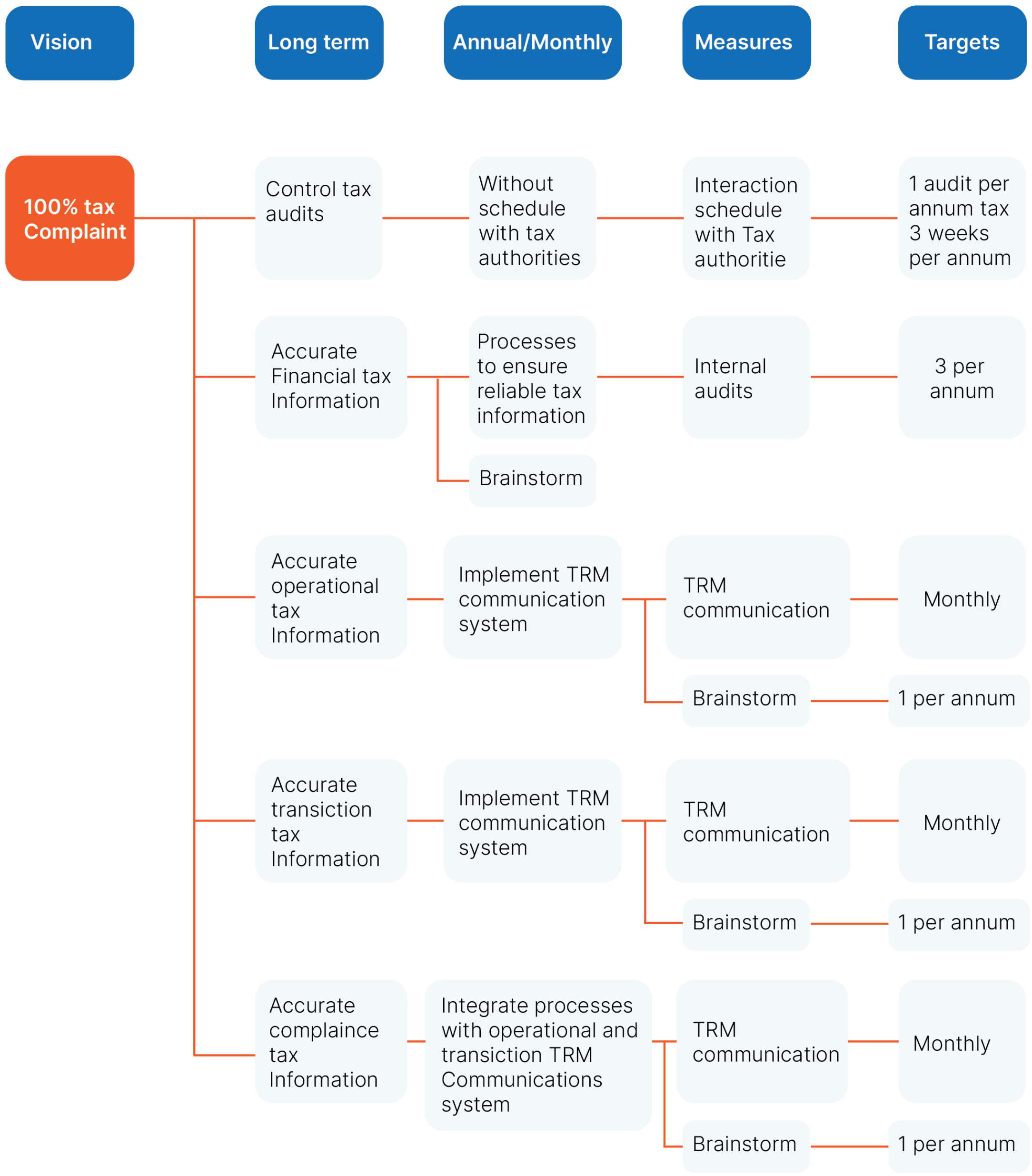
Instead of reactive tax monitoring, more proactive tax risk management is recommended. Considering risk management would allow board members to prevent tax risks and react in time, as suggested by multiple guidelines, e.g., King IV Report issued by the King Committee in South Africa. (South Africa, 2016). A tax risk control system is urged to be in place and appropriate by Global Corporate Governance Principles, as part of the Board's role and responsibilities. (International Corporate Governance Network (ICGN), 2021)

Following the guidance provided by various authorities and associations, significant progress by large MNEs in developing and implementing general and tax risk management policies is shown in Haroldene F. Wunder's research of the survey responses from Chief Financial Officers of MNEs. (Wunder, 2009)

In order to develop a comprehensive, easy-to-integrate, and easy-to-implement TRM Model, the Board of the MNEs shall design the vision of the project for the short and long term. The measures should:

- Involve all the stakeholders who are expected to take an action;
- The facilitating tools and technologies; and
- Periodical targets, etc.

The following illustration demonstrates a tax risk management model:



Source: Tax Risk Management South Africa, Prof. Dr Daniel N. Erasmus, 2021

With developments in Data Analytics and Information Technology, tax risks can be monitored, predicted, and managed in a straightforward visualized manner. (W. Didimo, 2020). The study was performed with the intention to support Italian tax administrations in tax risk assessment for discovering tax evasion and avoidance. The built-up and technical approach set examples for MNEs to design their self-assessment TRM Models to stay compliant.

4. Setting Up The Tax Risk Management (TRM) Strategy

Tax risk management strategy should be set up with a clear vision to achieve downward exposure to any negative tax consequences, and it shall not be isolated from other risk management strategies. The implementation of a TRM strategy entails the following:

- Appointing the tax risk management (TRM) strategy participants, including a tax specialist attorney as chairperson to ensure "attorney/ client" privilege;
- Planning the tax risk management (TRM) strategy sessions;
- Setting the specific tax risk objectives;
- Planning the risk reduction strategy;
- Planning the factual gathering process;
- Planning the analytical and solution process;
- Determining the closure date;
- Setting the parameters for the future maintenance process.

A TRM strategy within the context of the integrated risk control system of the MNEs shall take into consideration whether the existing employees engaged in risk control can perform control function for tax risks as well, as what level of additional costs should be invested to build the TRM system, and what resources shall be acquired and allocated to the TRM system.

EXAMPLES OF THE PARAMETERS

- Submit all tax returns on time and provide accurate information and full disclosure
- Pay all tax liabilities on time
- Maintain low risk status with tax authorities
- Where appropriate, respond to queries, information and clearance requests in a timely manner and provide updates on how issues progress
- No engagement in tax avoidance schemes
- No engagement in aggressive tax planning

Tax risk traditionally is delegated to external accounting firm tax consultants. This trend is changing as more businesses are hiring tax personnel to deal with tax risks internally. This is being combined with the participation of outside tax advisors at tax steering committee meetings, assisting in formulating and implementing effective management strategies.

With the set-up of internal tax divisions involving the expertise input of outside tax specialists in the tax risk steering committees, the potential costs of tax disputes will taper down. However, consideration should be given to implementing tax risk representation insurance policies, to cover professional fees should tax disputes elevate to tax audit, objection and appeal stages.

5. Tax Risk Committee Vs. Tax Risk Register

Once an effective tax risk management (TRM) framework and strategy have been implemented, a tax risk steering committee should oversee the process. The tax team together with a tax risk steering committee should be set up. Having outside tax specialists participate, under the chairmanship of a specialist tax attorney (to ensure "attorney/client" privilege) should reduce tax risks significantly. The "attorney/client" privilege will help manage any emerging ethical dilemmas and the possibility of revenue authorities seizing confidential tax-related information. The functions of the tax risk steering committee will include reviewing tax risks and making tax risk recommendations. Accordingly, the tax risk management strategy should be updated regularly based on these recommendations.

A tax risk register is comprised of an ongoing documentary record of all transactions/ items that pose risks of tax exposure such as under-accounting for future liability, potentially incorrect tax positions or failing to identify a past, present or future tax event that results in liability.

The following table sets out some of the advantages and challenges of having a tax risk committee and tax risk register:

	ADVANTAGES	CHALLENGES
1.	Prompt identification of any potential issues in the tax structure of an organization.	Internal meetings with a tax risk committee may be time-consuming.
2.	The tax risk committee will ensure that the taxpayer retains the required documentation. For example, what transfer pricing documentation is required under what jurisdiction?	Setting up a tax risk committee may be expensive.
3.	A tax risk committee can save a taxpayer unnecessary legal costs by resolving disputes with a revenue authority out of court.	Finding the right tax risk committee may be difficult, as there is always the risk of placing a taxpayer's financial affairs in the wrong hands.
4.	A tax committee's knowledge of administrative and substantive law applicable to revenue authorities in conducting audits, issuing assessments and the entire dispute resolution proceedings, thereby ensuring that revenue authorities act within the scope of their duties, within the specified time periods. This furthermore ensures that any potential issues between a taxpayer and revenue authority are resolved without delay.	

MNEs should implement both a tax risk steering committee and a tax risk register, taking into consideration their administration capacity in implementing these processes, and taking advantage of any computer programs to assist them in the execution thereof. The choice of a tax risk register may provide a company with a broader overview and the ability to keep track of changes to ensure that any risk is aligned with the business's risk appetite. Furthermore, the risk information is often stored in the minds of the committee members and as such this information could easily be lost should they leave. If the risks are documented, they can be communicated to the Board more digestibly and allow for more informed prophylactic measures to be approved expediently. A register could also assist in proving to a revenue authority that efforts were made to adopt a reasonable tax position, which is often a basis for reducing penalties following an understatement in a return. Again, attention should be paid to "attorney/client" privileged information.

In the absence of "attorney/client" privileged documentation management, having the documentation available to members of the tax team could expose the business to 'whistleblowing' if a member perceives the manner in which risks are managed is illegal. Obviously, this would be less of a threat without the tax risk register as intentional knowledge-driveniven conduct would be more difficult to prove in the absence of a properly regulated "attorney/client" privileged environment, provided that any discovered illegal processes discovered are ceased and corrected in the appropriate manner.

Having a tax register could prove problematic from a reporting and transparency perspective. For example, to what extent should uncertain liabilities be factored into a solvency and liquidity test when dividends are declared? To what extent should these uncertain liabilities be factored into a share valuation?

Therefore, questions will be raised by the Board in implementing tax risk steering committees and a tax risk register:

- Do businesses want to have all of their tax risks documented on paper?
- Does this expose the head of tax to an ethical dilemma?
- To what extent is the head of tax under an obligation to disclose the tax risks?
- Would the register be considered as 'relevant material' for the purposes of a request for documentation during an audit? If a risk was identified in the register and, for whatever reason, steps were not taken – to what extent would this expose financial management/ directors to civil liability (such as from a derivative action taken by shareholders) or to personal liability for the tax debt?[127]
- To what extent does an "attorney/client" privileged environment contain these issues of disclosure whilst the imposing tax risks are resolved

127 In some jurisdictions, financial management can be held personally liable for a tax debt if their negligence resulted in the company's failure to settle that debt. See Section 180 of the Tax Administration Act 28 of 2011, the Republic of South Africa.

6. Five Statements For A Panel Discussion

Statement	Agree	Disagree
1. MNEs want to have all their tax risk documents on paper.	45.45%	54.55%
2. Tax risk register exposes the head of tax to an ethical dilemma.	38.1%	61.9%
3. The head of tax of the MNE is under an obligation to disclose the tax risk.	88.89%	11.11%
4. Tax risk register would be considered as 'relevant material' or the purposes of a request for documentation during an audit.	71.19%	23.81%
5. The 'attorney/client' privileged environment contains these issues of disclosure, whilst the imposing tax risk is being resolved.	80%	20%

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WHITE PAPER 06

ANTI-ABUSE CLAUSES **– INTERPRETATION UNDER TREATIES**

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1. Introduction

1.1. Statement Of Problem: Anti-Abuse Measures And Their Hierarchy

There are three underlying issues:

1. There is a natural hierarchy in the various form of anti-abuse rules. One rule does overrule the other and may or may not apply simultaneously.
2. The various rules are not orchestrated by a centralized organization such as the OECD. That leads to various measures from different organizations (e.g EU and UN) which may conflict with each other or measures that are similar but published by different organizations and countries. For example, the ATAD GAAR and Principal Purpose Test are fairly similar but still subject to different interpretations due to the mere fact that different organizations implemented them.
3. On top of that, one needs to consider that these anti-abuse measures are interpreted and applied differently by different stakeholders.

1.2. Brief Outline And Summary Of The Solution

Considering that anti-abuse measures do not have a perfect hierarchy, it will first be considered whether these various anti-abuse provisions have overlapping thresholds or attributes which can be ranked. See specifically table 1. Based on these attributes or thresholds, a brief interpretational analysis of the various anti-abuse measures will be provided.

Following a discussion, in table 2, the definitions together with thresholds or attributes will be described.

2. Nature Of Anti-Abuse Provisions

Anti-abuse measures have underlying thresholds, elements or attributes on which they are built. In the table below these (often overlapping) thresholds or attributes are outlined.

Table 1: Thresholds, elements and attributes for anti-abuse measures.

	Anti-abuse provisions	Mechanical	Motives	Economic reality
1.	PPT[128]		X	x
2.	Beneficial ownership[129]	X		x[130]
3.	LOB[131]	X		x[132]
4.	ATAD GAAR[133]		X	x
5.	Domestic GAAR[134]		X	x

128 The Principal Purpose Test is a treaty GAAR contained in Article 29(9) of the OECD MTC 2017.

129 Although the term "beneficial owner" is widely known and included in the OECD MTC since 1977, it does not have an official definition. The beneficial ownership "doctrine" is applicable in terms of Article 10 of the OECD MTC and the OECD Commentary in paragraph 12.4. See also the OECD paper CTPA/CFA/WP1/NOE2(2008)18/REV2/CONF on the meaning of beneficial ownership and the UN paper E/C.18/2008/CRP.2/Add.1 which introduced a paper by Phillip Baker QC titled "Possible Extension of the Beneficial Ownership Concept" for consideration at the 4th Session of the Committee available at https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-04/18STM_CRP10-Update-UN-Model-Double-Taxation_Beneficial-Ownership.pdf.

130 S.H. Bærentzen, The Danish Beneficial Ownership Cases – Is the European Union Becoming a Common Law Jurisdiction? 5 (2021), Journal Articles & Opinion Pieces IBFD.

131 Anti-abuse rule stemming from US legislation now contained in Article 29 of the OECD MTC 2017.

132 LOB and motives depend on whether you apply the US provision or Article 29 of the OECD MTC. The LOB is a "extended" LOB provision whereas the LOB under the PPT refers to both a "simplified" or "extended" LOB.

133 The Anti-Tax Avoidance Directive (2016/1164) (the ATAD or Directive). See C. Valério, Applying the OECD Principal Purpose Test in Accordance with EU Law: An Analysis of the Scope, Burden of Proof and Effects, 61 Eur. Taxn. 11 (2021), Journal Articles & Opinion Pieces IBFD (accessed 27 July 2022) for a full analysis on the differences between the PPT and ATAD.

134 The definitions of domestic GAAR's vary from country to country.

3. In Search For Hierarchy: The Interaction between the PPT, Beneficial Ownership, LOB, ATAD GAAR And Domestic GAARS

3.1. The Principal Purpose Test

Motives

The PPT has been criticized for having a low threshold of application, clearly favouring the tax authorities. In terms of the PPT, the tax authorities may challenge any transaction that indicates that there is a tax benefit present – see the wording of the PPT; where obtaining a tax benefit was one of the principal purposes of any arrangements or transaction (see footnotes for limitations)[135]. If one looks at the wording of the PPT according to a strict interpretation, it is noted that the wording does not read "the principal purpose was to obtain the benefit" (in the singular) but specifically refers to "one of the principal purposes" (in the plural). This would mean that according to a strict interpretation, the non-tax benefit has to outweigh the tax benefit. The consequence of such an interpretation would be that the onus is on the taxpayer to prove that the non-tax benefits outweigh the tax benefits and the tax authorities can easily invoke the PPT in most scenarios. This is of course if the courts follow a strict interpretation of the wording and disregard the commentaries. In line with this reasoning, numerous academics have expressed their concern about the low threshold of the PPT which might lead to the presumption of tax avoidance where there is a mere tax benefit.[136]

Paragraph 182 of the OECD MTC, in the form of examples, lays out non-tax-related motives (business reasons). The broadly summarized factors can be seen as non-tax motivated motives (business reasons) for choosing a specific jurisdiction[137]

- Skilled labour force;
- Reliable legal system;
- Business-friendly environment;
- Political stability;
- Sophisticated banking industry.

135 Relief to the taxpayer is provided in the OECD Commentaries in paragraph 178 where it is stated that the obtaining of a tax benefit "should not be lightly assumed". Meaning, there should not be a presumption of tax avoidance where there is a treaty benefit. Yet, this is not supported by a strict interpretation of the wording and academics have still expressed their concerns regarding the burden of proof and low threshold of the PPT.

136 See Kuzniacki, B, "The principal purpose test (PPT) in BEPS action 6 and the MLI: Exploring challenges arising from its legal implementation and practical application." World Tax Journal: WTJ 10.2 (2018): 233-294 where he states: The standard of one of the principal purposes gives rise to serious concerns. The wording of the PPT delivers a clear message to its addressees. If you have two equally important reasons to establish an arrangement or carry out a transaction, one being a tax related (such as expanding one's business into new markets where there is a high demand for the business's services), you may lose treaty benefits under the PPT because, in this scenario, one of the two principal purposes is to obtain treaty benefits" at 255.

137 See paragraph 182 of the OECD Commentaries –factors cited from example G.

In terms of the PPT, there is a subjective and an objective test where motive forms part of the subjective test. Here one should note that some authors argue that under the PPT the motive attribute also has an objective element to it or is entirely objective.[138] It is not a mere subjective exercise as is the case with GAARs in applying a motive attribute. On the other hand, in many states, we see the subjective criterion filled in with objective approaches, e.g., the Dutch dividend withholding tax. Thus, under the PPT, motives and economic reality overlap to some extent. Please be aware that the above-mentioned list with non-tax-motivated motives is followed in the OECD MTC with the words but if you have a tax reason this addition makes it unclear whether the non-tax-related motives are sufficient to get out of the PPT application by tax authorities.

Economic Reality

The tax authorities merely have to establish that there was an intention/motive to obtain a tax benefit.[139] In response, the taxpayer has to prove that the exception applies: namely that the non-tax benefits outweigh the tax benefits and that the arrangement in question is "*inextricably linked to a core commercial activity"*.

Paragraph 181 of the OECD Commentaries, sets out a defence or exception for the taxpayer based on the attributes of "economic reality". In terms of paragraph 181, the taxpayer may prove that the arrangement in question is "*inextricably linked to a core commercial activity*". This is a purely objective exercise based on the facts and circumstances of each case. The non-tax-motivated reasons should reflect the economic reality, which triggers the exception. [140]

See for an example of testing "real economic activity" in van den Hurk's "Tax Treaties and Abuse: The Effectiveness of the Principal Purpose Test and Some of Its Shortcomings" in paragraph 3.4.

3.2. Beneficial Ownership

Mechanical

The beneficial ownership doctrine is nothing more than a mechanical distributive rule which also serves as an anti-abuse measure. There are two difficulties in applying this anti-abuse measure; first, there is no definition of beneficial ownership although it was formally included in the OECD MTC of 1977. The most important clarifications of the terms beneficial ownership were provided in the OECD MTC 2014. The interpretation of beneficial ownership various from country to country and also depends on whether the relevant tax treaty contains such a clause. Second, it is hard to predict how the courts will interpret and reconcile the beneficial ownership provision with the above-mentioned PPT.

One might argue that the interaction between the beneficial ownership and PPT are provisions of the OECD MTC with the same policy aim of tackling treaty shopping might be problematic. However, the PPT has a wider scope of application and therefore it is clear that the usual distributive rules in tax treaties would

138 M. Lang, The Signalling Function of Article 29(9) of the OECD Model – The "Principal Purpose Test", 74 Bull. Intl. Taxn. 4/5 (2020), Journal Articles & Opinion Pieces IBFD. D. Weber, The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principal of Legal Certainty and the EU Abuse of Law Case Law, ELR 1 (2017).

139 As previously stated, the motive element is not regarded by all academics as being a fully subjective assessment but also partially objective.

140 Duff, David G. "Tax treaty abuse and the principal purpose test-part 2." Can. Tax J. 66 (2018).

apply. The most logical application would be that Article 12 is applied first and thereafter Article 29(9) according to the normal rules of treaty interpretation.

3.3. LOB regime

In terms of BEPS Action Plan 6, a bundle of a simplified LOB rule (limitations on benefits) and the PPT is set as a minimum standard for OECD Member and the inclusive framework countries. This anti-abuse provision has its origin in US legislation and merely is mechanical in its application. Although it is unlikely to conflict with other anti-abuse measures, one still needs to assess whether a relevant treaty has this mechanical anti-abuse provision. Most states either use the LOB or the PPT in their tax treaties, some have actually both. In that last situation even if a company fulfils the LOB test, applying the PPT can still mean that the treaty benefits will be ignored, either totally or partially.

3.4. ATAD And Domestic GAARS

On top of the already discussed anti-abuse measures, one has to take into consideration regional and domestic GAARs. Two problems immediately arise from this – there is a complete lack of hierarchy when it comes to GAARs and since they are all orchestrated by different institutions with different rules of interpretation or precedents. For example, the US applies the prevailing law being equal to the latest legislation, irrespective of whether it is a treaty or national tax instrument.

Regional GAARs (for example Nordic treaty models) are usually found in tax treaties and theoretically, therefore, are on the same level as the PPT. How does the regional GAAR relate to the PPT, for example when a Dutch group entity enters into a "tainted" transaction with its US parent?

Starting with a specific GAAR, ATAD GAAR is also referred to as the "EU PPT" due to its similarity to the PPT of the OECD. This result is a logical consequence of the fact that the European Union has a deviating legal structure with a major role for an independent court, the European Court of Justice.

Now, this is only one example, but there are more regional (Nordic treaty models) GAARs or anti-abuse measures contained in regional tax treaties. The ATAD GAAR – EU PPT, will ultimately differ from the OECD PPT, in that it has to comply with the case law and verdicts by the EU court of justice. We expect the ATAD GAAR – EU PPT therefore to be much more subject to boundaries in its interpretation than the OECD GAAR.

Lastly, one has to face domestic GAARs. There is no consensus or solution as to whether a treaty GAAR (regional or domestic) will take precedent over a domestic GAAR. This has all to deal with the fact that in some states a treaty result which is not in line with the intention of that state, is considered to be also infringing on the domestic GAAR. From the perspective that a treaty has to be ratified in order to be applied in the legal system of that state, this is not illogical. Nevertheless, it will be a difficult question in practice. From this one can conclude that there is a clear hierarchy in that the EU GAAR would take precedent over the PPT as applying the PPT within the EU can only happen if EU-law is not applicable in a certain situation.[141]

141 In one of my recent opinions for an EU MNE, that country actually applied a domestic GAAR in order to not test a GAAR which is in the domain of the ECJ. This can certainly be challenged but then still this will be a long journey around courts.

4. Establishing A Hierarchy Based On The Attributes Underlying The Anti-Abuse Measures

4.1. Ranking The Attributes: The Economic Reality Exception

Although one cannot establish a fixed hierarchy in terms of the various anti-abuse measures, one may argue that from an analysis of the various attribute of anti-abuse measure, one can establish a hierarchy. The hierarchy would look as follows:

Table 2: Ranking of attributes

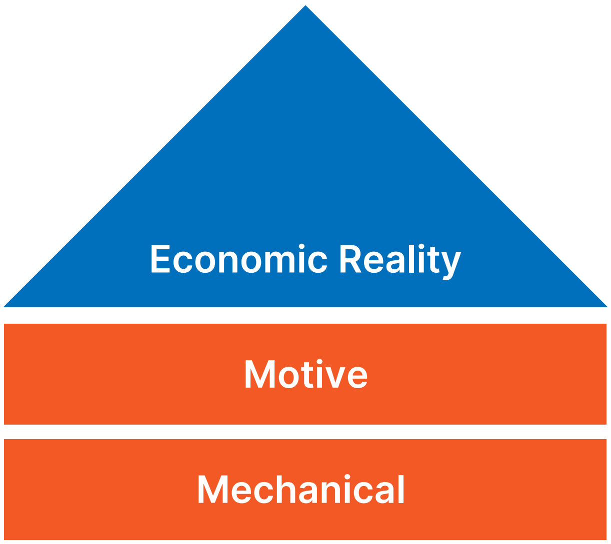

Table 3: Ranking reasoning

	Attribute (ranking)	Definition	Advantage	Disadvantage
1	**Economic reality**	This attribute essential refers to a business substance test. Do the motive for entering into the arrangement and the economic reality on paper reflect the economic reality in the real world? This is an objective assessment.	Reflects the true objective intention of the taxpayer.	Sometimes entities have a valid reason for lacking economic substance. See Alta Energy where a conduit-holding entity was seen as appropriate in light of the whole tax structure.142
2	**Motive**	This attribute refers to tax-motivated tax structures. What is the motive behind arrangements or tax structures? It refers to the weighting of non-tax motives (business reasons) versus tax motives when entering into arrangements or implementing tax structures. This assessment is usually subjective in nature or has a subjective element to it.	1. Motive can be derived from what the company is doing. 2. One can always identify a tax benefit in an arrangement but the motive test is mostly in favour of the taxpayer 3. In clearly defined business models, the heavy footprint of business activities will be a clear-cut case that non-tax motives prevail.	1. Tax authorities might presume a tax avoidance motive based on the mere presence of a tax benefit.
3	**Mechanical**	This threshold is determined once a certain requirement is met. There are no other considerations except for the underlying policy considerations of the relevant mechanical anti-avoidance provision which operates akin to a normal distributive rule in a tax treaty.	1. Relatively easy to apply (not controversial) – mere mechanical distributive rule 2. Limited to specific situations	Beneficial ownership regimes are different from country to country/ tax treaty to tax treaty – lack of a universal definition

142 Alta Energy Luxembourg SARL v The Queen 2018 TCC see at par 91 “There is nothing in the Treaty that suggests that a single purpose holding corporation, resident in Luxembourg, cannot avail itself of the benefits of the Treaty. There is also nothing in the Treaty that suggests that a holding corporation, resident in Luxembourg, should be denied the benefit of the Treaty because its shareholders are not themselves residents of Luxembourg.”

5. Five Statements For A Panel Discussion

Statement	Agree	Disagree
1. The PPT is also applicable in cases where a specific tax treaty has no PPT and the MLI is not applicable in relation to both states.	11.11%	88.89%
2. The anti-avoidance measures targeting the same abuse structures create enormous uncertainty for taxpayers.	90%	10%
3. There is an increase in more and more vague anti-abuse provisions, which undermines the certainty of the law.	94.44%	5.56%
4. Is it acceptable/suitable that a state used a domestic GAAR instead of a ATAD GAAR in order to stay away from the European Court of Justice?	12.5%	87.5%
5. PPT can be used under all circumstances by the tax authorities i.e., it does not have a threshold of application in practice.	22.22%	77.78%

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