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BUSINESS ADMINISTRATION: ACCOUNTING AND FINANCE

TESI DI LAUREA

"TOWARDS AN HARMONISED EU ANTI-TAX AVOIDANCE LEGISLATION: THREATS AND OPPORTUNITIES FOR THE INTERNAL MARKET"

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Firma dello studente

ABBREVATIONS AND ACRONYMS:

Art: Article

ATAD: Anti-Tax Avoidance Directive

BEPS: Base Erosion Profit Shifting

CFC: Controlled Foreign Company

CIT: Corporate Income Tax

CJEU: Court of Justice European Union

COGS: Costs of good sold

Commission: European Commission

Court: Court of Justice European Union

DST: Digital Services Tax

EBIT: Earnings before interests and taxes

EBT: Earnings before taxes

ECOFIN: Council Economics and Finance

ECSC: European Coal and Steel Community

EEC: European Economic Community

EESC: European Economic and Social Committee

EU: European Union

FDI: Foreign Direct Investment

GAAR: General Anti Avoidance Rules

GDP: Gross domestic product

LLC: Limited liability company

LOB: limitation on benefits

MNE: Multinational enterprises

OECD: Organization Economic Community Development

Par: paragraph

PE: Permanent Establishment

TAAR: Targeted Anti Avoidance Rules

TEC: Treaty Establishing the European Community

TFEU: Treaty of Functioning of European Union

TEU: Treaty of European Union

UCC: Union Custom Code

UNCTAD: United Nations Conference on Trade and Development

VAT: Value Added Tax

WHT: Withholding taxes

Introduction:

Tax evasion and tax avoidance is a current topic characterized by a continuing evolution and discussion around the possibility to cover grey areas with new laws or international treaties which provide anti-avoidance measures and anti-evasion measures. They represent a real threat, because they contribute to increase the tax gap between what collectable theoretically and what actually is obtainable.

Tax evasion can be defined as "an illegal activity in which a person or entity deliberately avoids paying a true tax liability".[1]

The penalties regarded to the missing payment are subjected to criminal charges and substantial penalties. To determine it, it's fundamental the agency shows the wilful on the part of taxpayer to avoid the payment and normally it involves a fraud or the international non-disclosure.

When a taxpayer commits a tax evasion his or her actions are against the text and spirit of law, while when there is tax avoidance the taxpayer is not contrary on the text of law, but only in the spirit. Doing so, he/she knows is going against rules, he/she does voluntary.

Tax avoidance is defined as the legal method used by taxpayers to exploit jurisdiction for paying the lowest tax burden, going against the true spirit of law.

Normally, it happens trough a strategy able to exploit the treaty agreements between countries or through the movement of taxable income in countries which present low-tax jurisdiction.

In the first chapter it will be described the idea of how EU wants to ensure the Pareto-efficiency of its Internal Market and what are the current measures provided before the introduction of Anti-Tax Avoidance Directive (ATAD).

An accurate description of the current integration of EU will be dedicated, describing the current tax categories harmonised completely, and which tax categories are only approximated as harmonisation across Member States.

Some data across the evolution of the different categories of taxes will be provided, described in an economic perspective the trend over the years, representing also the current problems developed from tax avoidance and tax evasion activity for public finances.

Then a description of the role of CJEU will be underlined, demonstrating the action played in the negative integration field.

In the final part of first chapter an overview of the current tax policies across Member States will be included, describing also the possible threat represented by external and internal tax havens.

[1] KAGAN J., 2022, *Tax Evasion: Meaning, Definition, and Penalties*, Investopedia.
The author provides a theoretical definition of tax evasion, describing also potential penalties.

In the second Chapter there will be focus on the alignment of EU with OECD measures and topic to be beaten (BEPS) to ensure the correct functioning of trade with third countries and how the taxpayer could make aggressive tax planning, especially for MNEs.

After that, an introduction of active policies issued by EU will be provided, introducing the Anti-Tax-Avoidance Directive 2016/1164. ATAD will be the main character of this part.

It will be developed the main points provided by EU with this Directive.

The elaborate will be more dedicated on tax avoidance, seeing what happened about the abuse of tax treaties and the abuse of EU's law.

A deep analysis will be dedicated in second chapter to the concept of CFC and shell companies, which are negative actors in conducting strategies for aggressive tax planning in order to reduce tax burden for "personal interests".

It will be described the possible theoretical strategies, supporting by some historical sentences made by CJEU, in order to see the possible methods implemented to pay low tax burden, explaining how the directives present some weaknesses, due to different policies implemented by Member States. An example, of course, will be the thin capitalisation and the Cadbury Schweppes case.

In the last chapter it will be described which are the new challenges of EU for digitalisation issue and which is the content of ATAD 3 regarded the shell companies. The desire is to make it part of EU legal system from 2023.

In this part it will be included some criticism about the operate of EU by EESC, based on this slow trend to introduce measures to follow by Member States. A comparison on digital policies by Member States will be included, in order to highlight the weakness of EU to provide uniformity.

The missing uniformity, plays a key role, transforming the Member States in "active actors" in developing tax avoidance phenomenon. Google case and Amazon case will support it.

The scope of the thesis is to demonstrating how tax activity is a sort of poison for common Internal Market of EU, if it is not issued in the right manner, in the right contest and with uniformity in a common area for Member States because it could provide loopholes, loopholes which can create a spiral effect due to capital movement, illegal activities and aggressive strategies. The goal is to demonstrate how the companies and firms could avoid taxation in their countries, without making an illegal activity, contrary only to the spirit of law.

The will is to demonstrate that EU must increase its active role in fighting the tax avoidance and tax evasion activity, becoming a leader and not a follower, through proposals to implement in short times and with uniformity among Member States.

Chapter 1: Tax avoidance in the perspective of EU's legal system.

1.1 The two faces of tax burden

Tax burden is always an actual topic of discussion subjected to detailed analysis by global experts as it concerns that every company and every citizen try to decrease it as much as possible. Other aspect that tax burden must consider is the evolution of the world due to phenomenon of globalization and internationalization, which it has developed international institutions aimed to provide a sort of uniformity for taxation issues for its Member States.
In economic theory there are two basic opinions about tax burden, one defined "positive" which emphasizes the concept of tax game and the other defined "negative" which is focused on the harmful tax competition because it reduces revenues provided for domestic governments.[2]
About the first trend, one of the main exponents was Tiebout, who said tax competition is optimal for organizations able to guide to an increase of welfare for all actors inside the society and it contributes on favouring the economic growth due to more allocation of resources, more efficiency of governments activities and more accuracy of public expenditure, thanks to a more effective use of public resources.[3]
Contrary on this theory was the economist Stiglitz, in 1997, who said that the main reason, the fiscal competition is limited from factors such as language barriers, family and administrative. He said also that the collected taxes make distortion effects, conducting in externalities leading to inefficiencies in allocating decisions.[4]
Agreeing with Stiglitz, was Oates in 1973, who said that tax competition could provide a negative result due to low tax burden provided by a State in order to attract more capitals and more companies, but this leads to an outcome under the "socially optimal level". [5] He defines optimal a jurisdiction where marginal net benefits are equal to zero.
In 21st century two authors, named Griffith and Klemm, confirmed the trend of Stiglitz and Oates defining this competition dangerous because could lead States to "race to the bottom"

[2] SZAROWSKA I., 2009, *Tax burden and competition in the European Union – Does it change?*, Public Administration & Regional Studies , Vol. 2, n. 4, pp. 18-22. The author described the possible role of taxation examining if it provides positive or negative effects in the market.
[3] TIEBOUT C. A., 1956, *Pure Theory of Local Expenditures,* The Journal of Political Economy, Vol. 64, n. 5, pp. 416-424. The author studies role of taxation inside the market, explaining possible advantages provided by its role. The reasoning is that, the citizen (voter) decides based on the possible public estates provided by the government, but also the voter evaluates if the tax burden is right or not according to the will of pay taxes.
[4] STIGLITZ J. E., 1997, Ekonomie veřejného sektoru., Grada Publishing, p. 664, Praha
[5] OATES W. E., 1973, *Fiscal Federalism*, Journal of Public Economics, Vol. 2, Issue 2, pp. 188-191

and without entries from tax burden, the consequence is a sacrifice of the welfare for all citizens and corporations inside the domestic territories.[6]
What is the real question, it is about which is the impact of tax competition between different governments? What is the impact conceived as size and state of economy, the different power and redistribution processes?
These opposite views are fundamental because they represent also the actual issue for EU.

1.2 What is EU's legal system aim? How does its common internal market function?

EU is one of the main important institutions around the world, born in 1992 with the Treaty of Maastricht aimed to guarantee free movement inside its Member States. It was born with the scope to promote peace, freedom and international trade between European countries.
Its personal history began after the second World War due to the desire of the States to stop the fight between themselves and with the need to favour international trade to promote the domestic growth. Following the macroeconomics principles, a State which provided export in other countries, had the possibility to increase its domestic production enabled with right policy to increase the GDP and also at the same time the wealth of its residents.
In April 1951 the Benelux with France, Germany and Italy signed the Treaty of Paris establishing for the European Coal and Steel Community (ECSC).
On 25th March 1957 there was the first common Treaty agreement signed between European countries, aimed to create a Common Market / European Economic Community and European Atomic Energy Effect, which entries in force from 1st January 1958.
With this new agreement, it was officially adopted the concept of common market through elimination of common duties and any restrictions among Member States. It was created a common tariff and first common policies in public relation with third countries.
In 1987 it was approved the Single European Act, meaning took at the centre of conversation the concept of integration. It was an agreement enacted by EEC in order to fix a timetable able to determine an economic merge between Member States and a single European currency and common foreign and domestic policy.
The Act was signed in February 1986 in Luxembourg entering into force from 1st July, 1987.
The purpose was encouraging the development of depressed areas at economic level and increase the public funding aimed to reach social and regional programs.

[6] GRIFFITH R., KLEMM A., 2004, *What Has Been the Tax Competition Experience of the Last 20 Years?, The Institute for Fiscal Studies*, Working Papers n. 04/05. The author evaluates the role of taxation and although an undefined outcome, they said an existence of interdependence in the setting of taxes really strong.

Thus, it represented the first pass through to the cohesion. It favoured the free movement of goods, labour, capital and services. For example, in those years there were many differences regarding national health and safety standard for consumer goods.

The SEA also created qualified majority voting for all legislation related to completion of common market. At each member was given multiple votes, number depended on national population and approval of any legislation required two thirds of the votes of all members, increasing the importance of European Parliament.

In this chapter, it will describe how actual legal system provides efficiency of common internal market and genuine competition.

Initial point of the thesis is concentrated on a focus on the legal system that could be able to give a complete understanding of what is EU's "internal market" and how the legal system ensures it.

It's a system not restricted to law field, but to economic field and principle in perspective to generate a result in economic terms.

This law system can be based on a sort of principle called economic constitution, planned to have a one single common area for the 27 actual Member States.

The aim, which is founded this idea, is to give at the population the maximum benefit, maximum wealth and welfare through the concept of Pareto-efficiency.

Used in the economic world and political science, called in that way from the creator Vilfredo Pareto is the best situation available and it happens in the case anyone could not improve his/her situation without making anyone worse off.

Starting point of EU was surely the TEU (Treaty European Union), which described its main intentions.

The key points were the promotion of fundamental rights of people such as peace, security and justice and the establishment of the internal market, based on its sustainability, price stability and anti-trust policies, aimed to discourage the wilful of some companies to abuse of its dominant position.

Other important aspect inside art. 3 TEU was the fight against inequalities, starting from social field, arriving to creation of common points as the currency (think about Euro area), but at the same time ensuring the respect of different cultures and languages.

The functioning of the market (based on the aim to reach the Pareto efficiency is the maximization of the wealth) granted the correct application of EU's goal: efficiency.

A big pass made in the history was the creation of Schengen Area in 1985; an agreement between some Member States to give freedom of movement of 4 fundamental elements, ensured then by art. 14 par. 2 TEC and art. 26 par. 2 TFEU:

- Goods
- Services
- Persons
- Capitals

With this, it was implemented the establishment of free competition among companies, enterprises and free movement of factors. The last, they could go wherever and whenever they want, without restrictions and obstacles, able to increase the efficiency.

An important aspect to take in account inside this idea, was an historical event which changed the history: the fall of Berlin Wall in 9th November 1989.

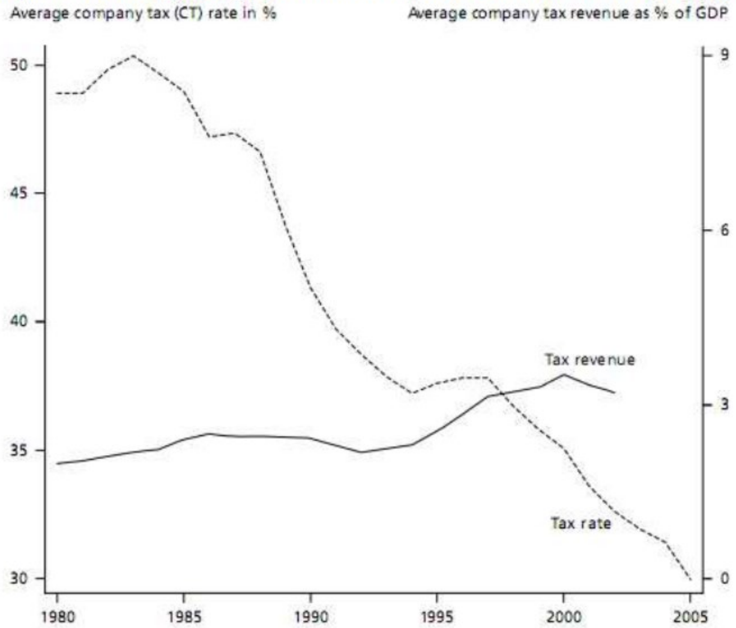
It increased the burden for EU to reach its initial aim due to different taxation systems, different cultures and political ideas after integration of Eastern Europe Countries.

There was a criticism around East European States due to own tax friendly policies provided by lower rates as well as total revenues.

However, Kubàtovà in 2008 opposes this thesis demonstrating that a change in tax rates is not made to distort competition, but to fill budget.[7]

If we see the study conducted by Ganghof and Genschel, we found that for a decrease of tax rate the tax revenues in reality increased, confirmed the principle of Laffer curve.[8]

Figure 1 Average corporate tax rates and revenues in EU-15 (1980–2005)



Source: Ganghof, S., Genschel, P., Taxation and Democracy in the EU, p. 6

[7] KUBÁTOVÁ K., 2005, *Daňová teorie a politika*, ASPI, Third Edition, p. 279, Praha

[8] Laffer curve expresses dependence of tax revenue on rate of taxation (or tax rate). It proves that maximum rate of taxation does not mean maximum revenue of public budgets. When increasing rate of taxation, tax revenue only increases up to a certain point (Laffer point), and when increasing the rate of taxation further, tax revenue begins to fall. See GANGHOF S., GENSCHEL P., 2007, *Taxation and Democracy in the EU*, MPIfG Discussion Paper n. 7/2

Although this study demonstrated an active role of taxation the principle of EU is that, taxation must play a neutral role. It's the main character, because if it plays an active role in legal system of Member States, it creates distortion and movements not aligned in reaching the maximum efficiency available inside the market.

It can be seen as a "possible poison in a human body", able to create rapid effects or slow effects but catastrophic, if accumulated, because they determine the death of the efficiency.

In the EU perspective the taxation needs to be harmonized between Member States, so in this way the tax remains neutral regarding functioning of market. Taxation must not interfere, it's necessary a situation which market function proceed well to reach the maximum wealth, a topic described later.

Regarding the free movement of the factors of production, European Union comprised a custom union able to cover all types of trade in good and all the prohibition between Member States of customs duties on imports and exports and the adoption of a common tariff for what concerns relations regarding third countries.

The custom union is composed by two sides, the internal one and external one.

Concerning the first, it prohibits duties between Member States while the external dictates the common guidelines for all Member States aimed to issue common tariff.

Free Trade Zone have only the first one.

Another important field is ensuring the neutrality of taxation inside the EU's territory.

So why this? Consider this example. A certain person looks for one product in the internal market of EU and we assume in order to make it easy, only two companies able to manufacture and sell at final consumer this good.

The companies, named XYZ and ABC are located in two different countries, the first one is more efficient than the second and it sells its products at the price of 1000 €, while other company located in other country sells final products at 1020 €.

The taxation system provided for the first country a 15% of taxes for the final value of product, while the second indicates a tax burden equal to 10% of taxes on final value of product.

So, final price for customer is 1150 € for XYZ's product against 1122 € for ABC's product, determining the purchase of ABC's product if the three fundamental principles of rational final customer are applied.

This difference is not determined from company's inefficiencies about process of production or inability to be efficacy in the market, but are due to the different taxation system provided by domestic countries. So, this is the big challenge for EU, avoid these situations and guarantee uniformity of tax treaties between EU states, achievable through the integration classified in positive and negative.

1.3 Positive integration

Positive integration is the integration based on Statutory provisions in EU law, something you find inside the laws of EU, while negative integration refers to anything is not possible to do for Member countries, it gives limits and prohibitions.
Able to implement positive integration, the Treaty of Lisbon in 2009 was fundamental, aimed to define the present institutions with different roles and responsibilities.
The common purpose to follow common policies and actions by Member States was subscribed in art. 1 and art. 13 of TFEU, confirming the commitment of institution to take active responsibility in promoting the interests of citizens and translate it in genuine behaviour inside common market.
For what concerns the secondary EU law the art. 288 TFEU provided definitions of regulations: "It shall be binding in its entirety and directly applicable in all Member States. Issued by EU institutions and drafted in language version of each 27-member States and all contents of regulation are abiding and compulsory, it is applicable immediately in each of 27-member States. It is immediately applicable in all Member States, it does not require any intervention by national legislation in order to be applicable".[9]
A directive, on contrary "shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. It shall be binding in its entirety. is addressed not to individuals, is addressed to Member States. They set goals, results to be achieved and the States are free to decide the way to reach this result and the way to be enacted through the domestic provision". [10]
EU explains only the goals and the objectives, but it is the State to decide how to arrive at them for directives. A decision is applicable at all subjects addressed in binding form, for the others it does not imply any restrictions or bindings.
Directives and regulations are part of the hard laws because they give rights and obligations, different it's for decisions which are part of soft law system. They are the instruments capable to determine actual positive harmonisation around EU's territory.

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[9] Consolidated version of the Treaty on functioning of the European Union, 26th October 2012, *Article 288*, Official Journal of the European Union, Part six, Title 1, Chapter 2, Section 1
[10] Ibidem

Ensuring the role of EU is the principle of subsidiarity, referred to any areas in which EU does not have exclusive competence and it defines the circumstances in which the actions taken by the Union prevails over actions taken by Member States.[11]

The objective of this principle applied in EU's context is to regulate the exercise of Union's non-exclusive powers. It gives the permission at EU to act in case the Member States are unable to achieve objectives of proposed actions in a satisfactory way. A classic example is the case of directive, which if not applied in the right timeline by a Member State, EU has the right to intervene.

The conditions to determine its intervention[12] are that area does not provide exclusive competence of EU and the objectives of the proposed action cannot be sufficiently achieved by the Member States. So, Member States need the intervention of EU (added value).

This scheme provides the basis of positive harmonisation; a common way, a guideline where are issued common rules followed by Member States for certain categories of taxes.

Also, the Court underlines the importance of harmonisation, saying that "in order to give effect to the fundamental freedoms in (Article 26 TFEU), harmonising measures are necessary to deal with disparities between the laws of the Member States in areas where such disparities are liable to create or maintain distorted conditions of competition".[13]

Art. 113 of TFEU provided that: "the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition".[14]

The positive harmonisation was referred to turnover taxes, excise duties and some forms of indirect taxation. Indirect taxation is about relationship between taxes and index of how much the taxpayer has the ability to pay, think about of studies conducted in the consumption of good and service acquired by consumers.

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[11] It was formally established by Maastricht Treaty but it was already incorporated a subsidiarity criterion in SEA.

[12] EUROPEAN PARLIAMENT, 2018, *The EU legal system and decision-making procedures*, Unit for Coordination of Editorial and Communication Activities. The document described the hierarchy of EU legal system and areas of intervention of EU.

[13] Court of Justice European Union, 11th June 1991, C-300/89, *Commission of the European Communities v Council of the European Communities. - Directive on waste from the titanium dioxide*, ECR I-02867

[14] Consolidated version of the Treaty on functioning of the European Union, 6th July 2016, *Article 113*, Official Journal of the European Union, Part three, Title 7, Chapter 2

The indirect taxes apply on items, requires reasoning and argumentation and for this tax on consumption is the classic example.
For indirect taxation, far reaching uniformity has been reached thanks to the commitment of EU in providing a Custom Code, the Recast VAT Directive and the Horizontal Excises Directive.
In art. 28 of TFEU EU described the free movement of goods, in par.1, specifying the coverage of all goods inside EU and defining a common policy to be adopted for Member State inside and outside EU's borders.[15]
It underlined the presence of two sides, the internal one with prohibition of internal duties among the borders of Member States and the external one which develops the creation of common tariff for trade with third countries. Important, also the provisions for Free Trade Zone, territories which present only internal borders.
The biggest part of EU provisions related to custom duties is Union Custom Code arranged in three main topics separated in general provision, methods of levying duties and formalities and supervision.
The Union Custom Code with the regulation 952/13 is compulsory, in sense that all the Member States have to apply it in the form decided by EU. There are two ordinary procedures:

1. Goods that are material, if you receive the product from third countries outside EU it is defined as good imported, which will be applied the tariff decided in unanimity way. They entered in a sort of status able to classify if tariff is applicable or not. In the case of importation and exportation of material good, a custom duty on the percentage of value is applied, different for any categories of goods. Depending on category the tariff will be different. There are sorts of preferential rates for the States where EU stipulates agreements to incentive the flow with low duties. So based on the origin of good, the duty applied is different.
2. When the customs value of goods in order to ensure the efficiency of the market EU explains that it can be used the art. 74[16] UCC:
   "The customs value, pursuant to paragraph 1, shall be:
   a) The transaction value of identical good sold for export to the customs territory of the Union and exported at or about the same time as the good being valued
   b) The transaction value of similar goods sold for export to the customs territory of the Union and exported at or about the same time as the goods being valued

[15] Consolidated version of the Treaty on functioning of the European Union, 26th October 2012, *Article 28*, Official Journal of the European Union, Part three, Title 2
[16] Regulation 952/2013, 9th October 2013, *of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (recast),* Union Custom code, Chapter 3, Art. 74

c) The value based on the unit price at which the imported goods, or identical or similar imported goods, are sold within the customs territory of the Union in the greatest aggregate quantity to persons not related to the sellers
d) The computed value"

For the Recast VAT Directive, there was the reorganization of previous legal text, putting directives inside a one single systematic test. It has two sides the Recast, legal side and economic side.

You have tax on consumption but at the same time the tax on added value, designed to be neutral in the market. Title 1 of Recast VAT Directive described the subject matter and scope, which is established the common system, aimed to have a proportional application to goods and service of a general tax on consumption. The Directive, in art. 1 par. 2 said: "on each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT born directly by the various cost components".[17]

Art. 2 provides the conditions for those transactions to be taxed with VAT, giving the definition of which good could be classified as EU's good, while art. 3 described detailed cases and situation which VAT application does not occur. The classic example is the case of temporary warehouse.

The essence is to determine the chargeability and deduction. The first happens in any case a taxable person supplies goods and services coupled with. Under the Recast VAT Directive he/she has the right to deduct from the tax for which is liable respecting his/her supplies.

Directive was also studied to ensure neutrality of VAT between the different businesses. So, when one company sells at the other company due to different phases of production, it charges the price of the good sold with the VAT. After the buyer company works the product and sells the final product at consumer it charged the price with the VAT.

Regarding the Horizontal Excise Directive, it lays down rules concerning all excise goods providing a computerised system to record movements of excise goods within Europe.

The need is to update the current directive with Dutch Part, but this is what EU wants to reach in 2023. At the moment is still working in providing a temporary solution to cover this loophole.

The actual directive regarded proposal of EU Commission is the 2020/262.

[17] Directive 2006/112/EC, 28th November 2006, *on the common system of value added tax*, Official Journal of the European Union, Art. 1, par. 2

It highlights that the “conditions for charging excise duty on goods covered by Directive 2008/118/EC need to remain harmonised in order to ensure the proper functioning of the internal market”.[18]

It underlines also the need that excise duties remain the same in all Member States and also make more clarity as possible to find who is liable to pay excise duties.

Then European Council says that it should not be applicable for goods “totally destroyed and irretrievably lost”.

An appropriate standard for the comparison of effective taxation is the implicit rate, tax rate considering size of statutory tax rate and other aspects able to determine which is the effective taxes paid.

$$\text{Implicit tax rate (ITR)} = T/Y \times 100\%$$

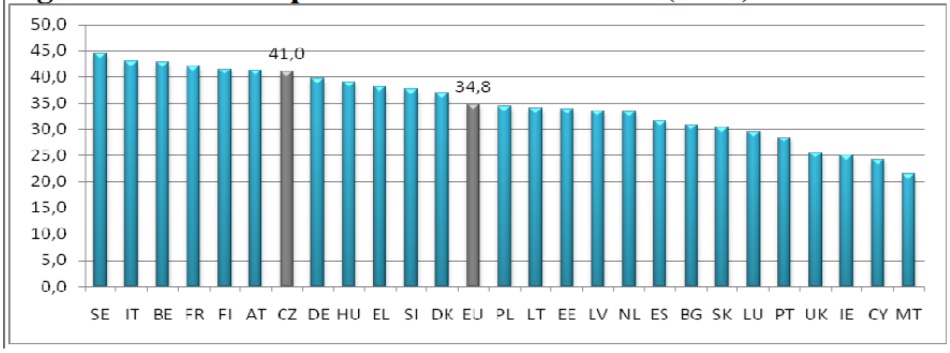
Where T is tax duty and Y the gross income from which tax is counted.

From the model built by Irena Szarowska, the comparison of statutory and implicit tax rates “shows tax incentives provided by authorities in individual countries; comparison of implicit tax rates across individual states provides indications whether there are significantly dissimilar tax approaches to companies with the same characteristics but located in various countries”.[19]

In this model there was a distinction of tax burden based on labour, capital, consumption and the summary.

$$\text{Implicit tax rate labour (ITR)} = \text{Taxes on labour}/(\text{compensation of employees} + \text{wage bill and payroll taxes})$$

Figure 2 Labour Implicit Tax Rate in % GDP (2006)



Source: Szarowska Irena’s compilation based on data from Eurostat

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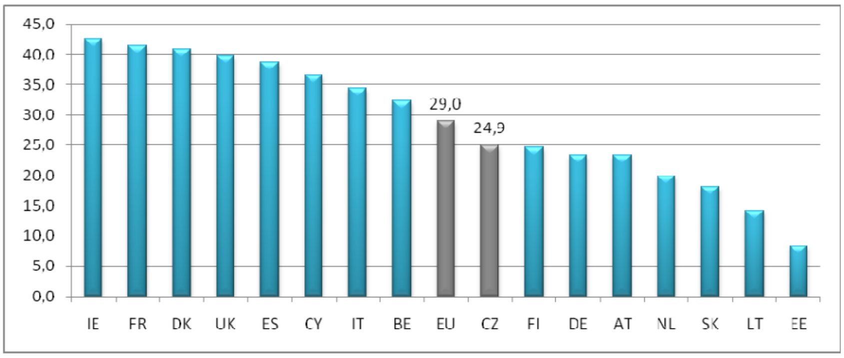
[18] Directive 2020/262, 19th December 2019, *laying down the general arrangements for excise duty (recast)*, Official Journal of the European Union, Recast, par.2

[19] SZAROWSKA I., 2009, *Tax burden and competition in the European Union – Does it change?, Public Administration & Regional Studies* , Vol. 2, n. 4, p. 25. The author summarizes theories approaches in tax competition. The paper occurs the hypothesis that tax burden’s value falls in time and those indirect taxes outweigh direct taxes considering the tax burden in EU.

It's possible to see how Italy is above the average of EU and it's the second country with the highest tax burden for labour tax rate.
Other index, in order to observe the ability to pay, is total capital available by taxpayers.
With it, direct taxes are applied, but in this case, EU provides only the approximation of laws.
Conducting the same study made for labour implicit tax rate it's possible to observe that, Italy is above the average of EU and also the increase of Ireland and Spain, observing the last decade.
For capital implicit tax rate, it was underlined the high effect of competition on outcomes inside the graph, because fiscal policy determines the attractiveness or not of foreign direct investments. The calculation was conducted as proportion of collectable taxes on income/potentially taxable capital income.

Figure 3 Capital Implicit Tax Rate in % GDP (2006)

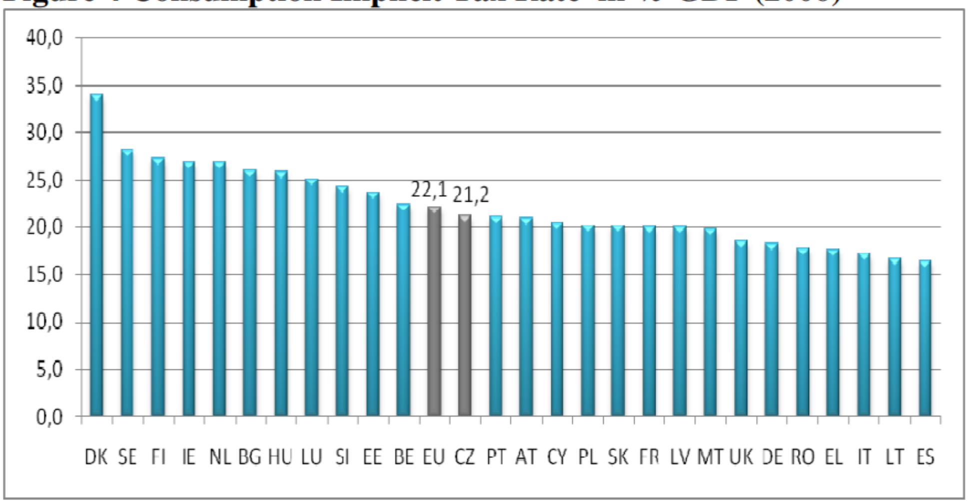


Source: Szarowska Irena's compilation based on data from Eurostat

For consumption implicit tax rate, the calculation considered the total revenues from taxes from consumption (ex. VAT) and the total final costs of households of consumption.

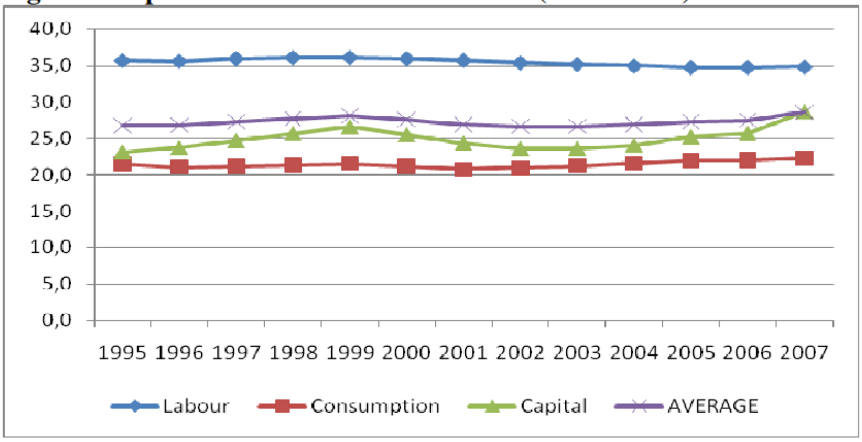
Implicit tax rate consumptions = Taxes on consumption/ final consumption expenditure of households

Figure 4 Consumption Implicit Tax Rate in % GDP (2006)



Source: Szarowska Irena's compilation based on data from Eurostat

Figure 5 Implicit tax rates in EU in % GDP (1995 –2007)

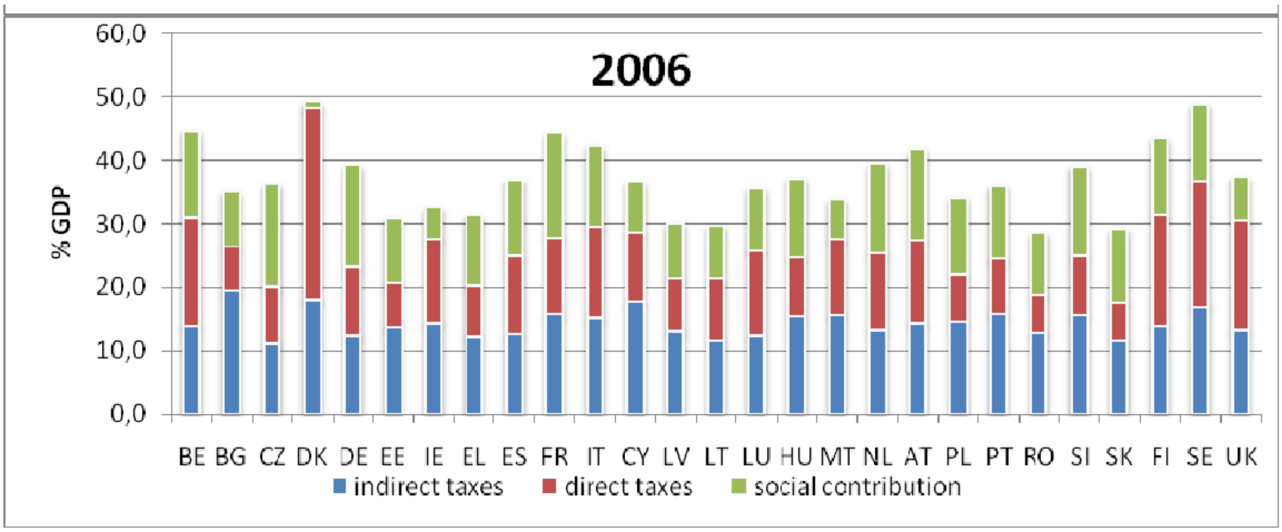


Note: calculation used arithmetic average data

Source: Szarowska Irena's compilation based on data from Eurostat

It can be seen how the labour rate remains constant over the years, analysing the trend before global financial crisis, while the capital tax rate burden is increased from 22,5 to 27,5 over the years, determining higher tax burden. Also, an outcome of this analysis is that labour rate remains the highest tax burden.

Observing the highest "tax revenues category" for countries is possible to see that, before crisis, in 2006, sixteen countries of twenty-seven provided major part from indirect taxes and Italy is one of this, while other countries as Belgium, Denmark, Finland obtained own tax revenues from direct taxes and Germany, France and Netherland obtained major revenues by social contribution.



Source: Szarowska Irena compilation's based on data from Eurostat

So, it's an important aspect to focus, due to the fact that, although there is a common area and common policy provided by EU's legal system, the countries have different frameworks and legal systems able to determine many differences inside this common area.

It is an aspect which represents a possible threat for EU, because the countries which provide major revenues by direct taxes and social contribution, are not fully harmonised through regulations or directives. Actually, EU provides only the approximation of laws for direct taxes.
Observing the past, in 1962 the Neumark Report suggested harmonization for direct taxation.
In 1966 Segrè Report analysed some measures for implement a new legislation for European capital market.
In 1969 the Program for the Harmonization of Direct Taxation brought a proposal for a directive on the cross-border dividends and corporate restructurings, implemented only in 1990.[20]
The corporate tax rates provide negative externalities defined in national country's view as erosion of its national base through:

- The inflows inside that country of foreign advantageous tax positions[21]
- Cross-shift profits from domestic country to another country with lower or no taxation.

Direct tax's uniformity was slow in pace terms and limited due to the reluctance of Member States in finding common solutions.
There is a sort of interaction between positive integration and negative integration: as no positive integration is not applicable in certain fields as direct taxation, the Member States can decide freely how to create appropriate domestic provision in order to ensure the efficiency of internal market.

1.4 Negative integration

To limit freedom of countries, it was created the negative integration in order to prohibit the discriminations and to not limit with some restrictions, the movement of capitals, goods, services and person among Member States.
To ensure the negative integration, Court of Justice was the main actor able to do this, been compliant for what regarded the four fundamental freedoms described above.
The statement arises intense controversy when it was released, especially it was considered as possible decline of the conferral of powers.[22]
CJEU specifies, also when happens its intervention, due to the presence of "appreciable" distortion, based on art. 114 TFEU.

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[20] GARBARINO C., 2016, *Harmonization and coordination of corporate taxes in the EU,* European Community tax review, Vol. 25, Issue 5, p. 277. The author studies the corporate income taxation, explaining the negative externalities derived from missing common guideline and measure implemented by Member States of EU. It explains it through three dimensions: intra-EU, EU-inbound and EU-outbound.
[21] Ibidem, p. 280
[22] BARENTS R., 1993, "*The Internal Market Unlimited: Some Observations on the Legal Basis of Community Legislation*", Common Market Law Review, Vol. 30, Issue 1, pp. 85–109

Preliminary rulings under art. 267 TFEU, CJEU provides decision on the ground of a request that has to be made by national judge.[23]

This article[24] explains that: "the court of Justice of European Union shall have jurisdiction to give preliminary rulings concerning:

a) The interpretation of the Treaties
b) The validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union"

If it's necessary an intervention of CJEU, any person or Member State could ask primarily at it, before any tribunal or court. The possibility to ask at CJEU is provided also for all cases pending in domestic tribunals or court, where domestic jurisdiction does not include any remedy to solve the dispute.

The national courts have right to ask for a preliminary ruling if and when the judge has real doubt about how to interpret the EU law or to main proceedings before national court, it can be done the question also to every stage of procedure.

According to par. 3 art. 267, courts are obliged to shall do so if no appeal is available against their judgement.

The form/content of a Reference to the CJEU depends on national procedural law and should deal only questions referred to EU law.

The influence of CJEU over corporate direct tax matters is both significant and far reaching.

"In the absence of harmonising legislation, the Court has taken the lead-role as regards corporate tax matters, consistently determining the incompatibility of discriminatory, or restrictive, national tax measures with free movement provisions".[25]

Fundamental for the CJEU was the art. 114 of TFEU which confers upon the Union the competence to approve legislative measures able to ensure correct functioning of Internal Market avoiding distortion and disparities. [26]

Actually, there are six EU legislative instrument on direct taxes dealing with problems of cross-border transactions or forms of cooperation between Member States.

The lack of this is due to the need of unanimity vote and legal basis.

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[23] Court of Justice European Union, 11th June 1991, C-300/89, *Commission of the European Communities v Council of the European Communities. - Directive on waste from the titanium dioxide*, ECR I-02867, par.15

[24] Consolidated version of the Treaty on functioning of the European Union, 6th July 2016, *Article 267*, Official Journal of the European Union, Part six, Title 1, Chapter 1, Section 5

[25] FUEST C., DE LA FERIA R., 2016, *The Economic Effects of EU Tax Jurisprudence*, European Law Review, Vol. 41, Issue 1, p. 44. The authors study a new framework to evaluate impact of CJEU on the construction of European Internal Market

[26] The reference to "distortion of competition" was objected to a criticism, see KUMM M., 2006, Constitutionalising Subsidiarity in Integrated Markets: The Case of Tobacco Regulation, European Law Journal, Vol. 12, n. 4, pp. 503-533

EU tries to find a countermeasure with art. 114 and art. 115 of TFEU, but harmonisation of this category remains a point to be fulfilled (think about of tax revenues explained before).
The CJEU decision in Avoir Fiscal in 1986 seems like a Pandora's Box and under the mantra "although direct taxation is a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with Community law"[27], CJEU is the reference, is the actor, is the key provider of integration made in negative way.
It becomes actual, present and fundamental, victim of criticism but the work made CJEU is fundamental and smooth, considering it provides all the limits and prohibitions for MNEs and Member States. It's the main reference for European corporate tax policy and law.
It applies constantly discrimination and restriction approaches, aimed to intervene in stopping the corporate tax difference among States as block of the fundamental freedoms in an extension that some have argued that national sovereignty remained only formally.[28]
Other provided criticism about of lack of sovereignty considering domestic tax provisions and lack of awareness of particulars phases of tax provisions.
But without it, EU will lose the instruments necessary to achieve objective of European Internal Market, because it establishes the limit, the prohibition what do not to do by domestic provision.
Equally in Ruding Report was devoted large part in describing how differences in national corporate tax system develop investment distortions. Think about the possible profit shifting conducted by companies for aggressive tax planning and the abuse of jurisdiction.

1.4.1 Halifax case

Practice case on the fundamental role played by CJEU was the Halifax sentence C-255/02. It was first case on the Emsland -Stärke[29] test which finds the presence of subjective and objective element.
Founded on 1853 as Halifax Permanent Benefit and Investment Society it was created in UK.

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[27] Court of Justice European Union, 16th July 1998, C-264/96, *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (HM Inspector of Taxes),* ECR I-4711, par. 19
See also amongst others: Court of Justice European Union, 14th February 1995, C-279/93, *Schumacker*, ECR I-00225 par. 21; Court of Justice European Union, 11th August 1995, C-80/94, *Wielockx*, ECR I-2493, par. 16; Court of Justice European Union, 29th April 1999, C-311/97, *Royal Bank of Scotland*, ECR I-2651, par. 19; Court of Justice European Union, 13th April 2000, C-251/98*, C. Baars and Inspecteur der Belastingdienst Particulieren/Ondernemingen Gorinchem*, ECR I-2787, par. 17.
[28] PISTONE P., 2010, "*The Impact of ECJ Case Law on National Taxation*", Bulletin for International Taxation 8/9, pp. 412-428.
[29] Court of Justice European Union, 14th December 2000, C-110/99, *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas*, ECR I-11569

It's important in the history of EU due to the fact it provides a sentence of abuse for exploiting the jurisdiction for taxation's issues. The origin of abuse of law started on 1970 judgement "Van Binsbergen", where CJEU pointed out a restriction of fundamental freedoms (services).

UK faced a question to the Court based on case of possible abusive practice by financial entity. The sentence was referred to Halifax plc, Leeds Permanent Development Service Ltd and County Wide Property Investments Ltd against Commissioners.

The goal was the reduction of tax burden of Halifax Plc Group due to application of relief from VAT. Halifax was able to recover less than 5% of its input VAT.[30]

The Court distinguishes the transactions in genuine and abusive, based on two elements test:

"An abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive [31]and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage".[32]

If abusive practice exists, the Court described that there must be redefinition of the situation prevailed in absence of abusive transactions.

Advocate General Poiares Maduro said that "this notion of abuse operates as a principle governing the interpretation of Community law".[33]

In the par. 87 of the Opinion Advocate Maduro said that the notion of abuse, applicable to VAT system, operates with a test of comprising two elements, necessary condition to determine the abuse of Community law. First element is defined by subjective element mentioned by Court in Emsland, focuses on defining purpose of activities in question.

It must not be associated for what regards the element of objective, which is the absence of any other economic justification for the activity. It's an element which is compared with the Community rules. "Therefore, where there is no contra diction between recognition of the claim made by the taxable person and the aims and results pursued by the legal provision invoked, no abuse can be asserted".[34]

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[30] Court of Justice European Union, 21st February 2006, C-255/02, *Halifax plc*, ECR I-01609

[31] Directive 77/388/EEC, 17th May 1977, *on harmonisation of the laws of Member States,* Official Journal of the European Communities

[32] Ibidem para. 74, 75.

[33] Court of Justice European Union, 14th December 2000, C-110/99, *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas*, ECR I-11569, par. 52

[34] Court of Justice European Union, 7th April 2005, *Halifax and other, opinion of Advocate General Poiares Maduro*, ECR I-01609, para. 87-90

In par. 90 it was explained there can be little doubt, that the possibility must be recognized in such cases, "where activities are accounted for by a mixture of tax and non-tax considerations, further restrictions could be introduced for claims arising from activities which, to varying extents, predominantly seek to achieve tax advantages".[35]

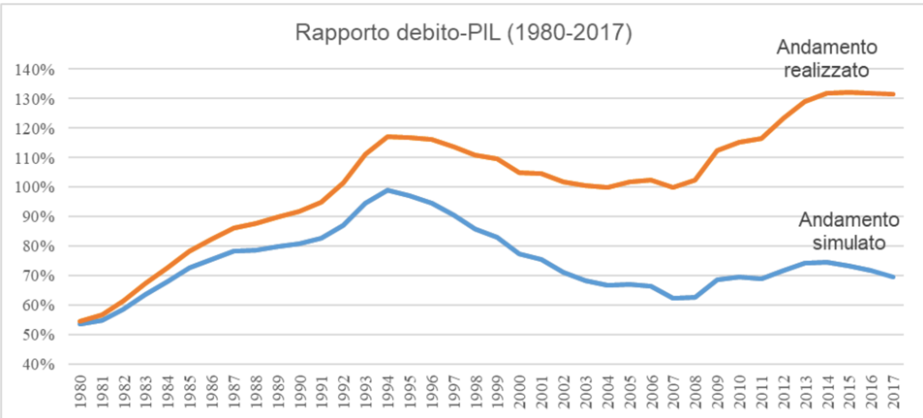
This case was really important, because it provided one of first sentences by CJEU referred to tax avoidance and tax evasion behaviour conducted, with the abuse of jurisdiction.

1.5 Consequence of absence of tax neutrality inside market: tax evasion and tax avoidance.

What exist from this, it's that EU presents serious problems at the basis of its idea: how is possible to guarantee an efficient market with competition without any distortion taken by taxes?

The answer is that it's really complicated. We are in front a big trade-off: if the EU makes a unique legal text is clearly that all States lose the power to do domestic policy, because taxation is one of the main instruments able to determine the success or fail of policy.

Then second important point refers to the presence of different scenarios analysing public finances of the countries. Consider only one parameter, public debt/GDP and one Member State: Italy.



Source: Gatteschi Silvia, 2017, Il peso dell'evasione fiscale sul debito pubblico, Università Cattolica del Sacro Cuore

In this graph it's possible to see the huge contribution over the years of tax evasion in increasing the level of Italian debt/GDP.[36] It determined, analysing this graph, a hole of 60% of entries for

[35] Court of Justice European Union, 7th April 2005, *Halifax and other, opinion of Advocate General Poiares Maduro*, ECR I-01609, para. 87-90

[36] GATTESCHI S., 2017, *Il peso dell'evasione fiscale sul debito pubblico,* Università Cattolica del Sacro Cuore The author describes how tax evasion and tax avoidance decreased the public entries for Italy analysing the period 1980-2017

the State over GDP, so without this phenomenon the Italy will be really near to the parameters of EU regarding debt/GDP.

The last relation of economy on tax evasion and contributions produced by a Commission, driven by Enrico Giovannini, estimated that during 2012-2014 tax evasion was near to 108 billion of euros excluding from this analysis contributes for independent working and some other taxes, so it represents a value lower than the real that based on some estimates is near to 130 billion (8% of GDP 2014).[37]

Analysing the historical data, Italy has reduced this trend because in the past during 80' years and 90' years the tax evasion and avoidance was bigger than the last 10 years, justified for more controls, some anti-evasion measures taken.

Table IT.1: Revenue (% of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
I. Indirect taxes	13.9	14.1	14.7	14.5	13.7	13.6	14.1	14.2	15.2	14.9
VAT	5.6	5.7	6.0	5.9	5.7	5.5	6.1	6.0	5.9	5.8
II. Direct taxes	13.4	12.9	13.8	14.5	14.7	14.9	14.3	14.2	14.8	15.2
Personal income	10.1	10.1	10.5	10.9	11.3	11.3	11.3	11.1	11.8	11.9
Corporate income	2.1	2.2	2.8	3.1	2.9	2.4	2.3	2.2	2.3	2.5
III. Social Contributions (compulsory actual contributions)	11.9	11.9	11.6	12.3	12.8	13.2	13.0	12.9	13.0	13.0
Employers'	8.4	8.3	8.1	8.5	8.7	9.1	9.0	8.9	8.9	8.9
Households'	3.5	3.6	3.5	3.8	4.1	4.1	4.0	4.0	4.1	4.1
IV. Less: amounts assessed but unlikely to be collected	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
V. Total (I + II + III – IV)	39.1	38.9	40.1	41.4	41.2	41.7	41.4	41.4	43.0	43.1
VI. Social contributions (imputed + voluntary contributions)	0.3	0.3	0.3	0.3	0.2	0.3	0.3	0.3	0.3	0.3
VII. Total (incl. Imputed + voluntary contributions (V+VI)	39.4	39.2	40.3	41.6	41.5	42.0	41.7	41.7	43.3	43.4

Source: Eurostat (online data code: gov_10a_taxag)

This is the actual composition of tax revenues provided by Italy analysing data from 2004 to 2013.

Italy is my domestic country where debt compared to GDP is 120%, while for countries as Netherlands is under 60%.

We know that EU parameters established by Treaty of Maastricht define the borders of deficit over GDP around 3% and public debt over GDP under 60% and maintain an inflation rate around 2%.

If EU makes a policy able to help Italian government to cover public debt over GDP, this creates negative externalities and damages at the other countries. Why?

Because every country should apply taxes and policy specific for its domestic needs.

Also, other consequence as described above is the actual tax evasion and tax avoidance.

[37] GATTESCHI S., 2017, *Il peso dell'evasione fiscale sul debito pubblico,* Università Cattolica del Sacro Cuore
The author describes how tax evasion and tax avoidance decreased the public entries for Italy analysing the period 1980-2017

It is a real difficult scenario the common Internal Market for EU, but it must do something, because although it presents many parameters and variables to consider, the idea to reach efficiency is ambitious and fascinating.

One point is analysing which are the discrepancies and the categories of taxes where are present big differences among Member States. Think about the resources that MNEs have, they could exploit it and making aggressive tax planning.

Later, a further and detailed analysis in second Chapter, will be provided.

In order to ensure it, fundamental is the fair taxation system, which if taxes remain unpaid, they cause revenue loss in the budget of Member States leading to excessive tax burden for all citizens, which conduct correct behaviour.

To do a correct estimate of actual Tax Gap it was issued the Tax Gap Project Group under the Fiscalis 2020 Program. This Program was composed by European Commission which coordinated 15 Member States.

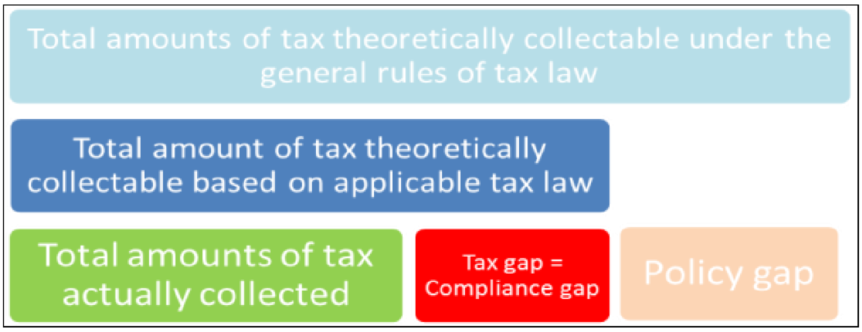
The first consequence found above were referred to fiscal policy and public spending, fair sharing of burden and at general level entire economy.

This occurrence of tax gap was justified by actions taken to make frauds, evasion or aggressive tax planning determining a missing meaning of the fundamental principles of taxation.

The estimation on this tax gap were based on macroeconomic aggregates and it was calculated as "difference between total amounts of tax theoretically collectable based on the applicable tax law and the total amounts of tax actually collected in a given period".[38]

Tax gap could be divided in assessment gap and collection gap, referred to amount of what taxes were assessed compared to total amount of theoretically collectable.

Figure 1: Definition of tax gap



Source: European Commission Directorate-General Taxation and Customs Union, 2016, Report on VAT Gap Estimations by FISCALIS, Tax Gap Project Group (FPG/041), Brussels

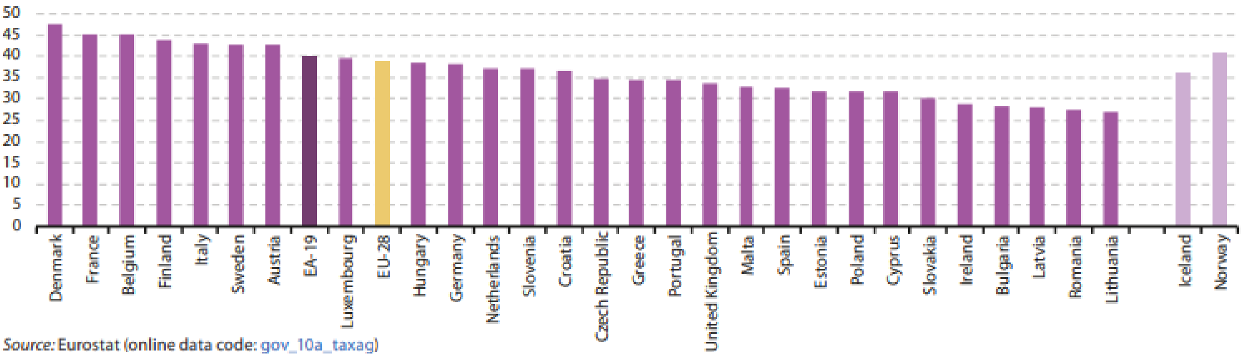
[38] EUROPEAN COMMISSION DIRECTORATE-GENERAL TAXATION and CUSTOMS UNION, 2016, *Report on VAT Gap Estimations by FISCALIS*, Tax Gap Project Group (FPG/041), Brussels, pp. 13-15
The European Commission described its calculation to find the current tax gap between taxes collected and collectable tax revenues.

After the description of what concerns the tax gap of EU it's important also to provide which are the actual categories interested by this tax gap. In this table there is a framework of tax revenues' categories for Member States based on Eurostat's data.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
I. Indirect taxes	:	:	13.3	13.2	12.8	12.6	13.0	13.2	13.4	13.5
VAT	:	:	6.7	6.8	6.7	6.4	6.8	6.9	6.9	6.9
II. Direct taxes	:	:	13.2	13.5	13.4	12.5	12.3	12.6	12.9	13.2
Personal income	:	:	9.0	9.2	9.3	9.2	8.9	9.0	9.3	9.4
Corporate income (including holding gains)	:	:	3.2	3.2	2.9	2.2	2.3	2.4	2.4	2.5
IIIa. Social contributions (compulsory actual contributions)	:	:	:	:	:	:	:	:	:	:
IIIb. Social contributions (compulsory and voluntary actual contributions)	:	:	12.0	11.9	12.1	12.5	12.3	12.3	12.4	12.6
Employers' actual social contributions	:	:	6.8	6.8	6.9	7.1	7.0	7.0	7.0	7.1
Households' actual social contributions	:	:	5.2	5.1	5.2	5.4	5.3	5.3	5.4	5.5
IV. Less: amounts assessed but unlikely to be collected	:	:	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
V. Total (I + II + IIIa – IV)	:	:	38.2	38.2	38.1	37.3	37.2	37.7	38.4	38.8
VI. Social contributions (imputed + voluntary contributions)	:	:	:	:	:	:	:	:	:	:
VII. Total (incl. Imputed + voluntary contributions (V+VI)	:	:	39.4	39.4	39.2	38.6	38.5	39.0	39.6	40.0

Source: Eurostat (online data code: gov_10a_taxag)

Figure EU.1: Total receipts from taxes and compulsory social contributions, 2013 (% of GDP)

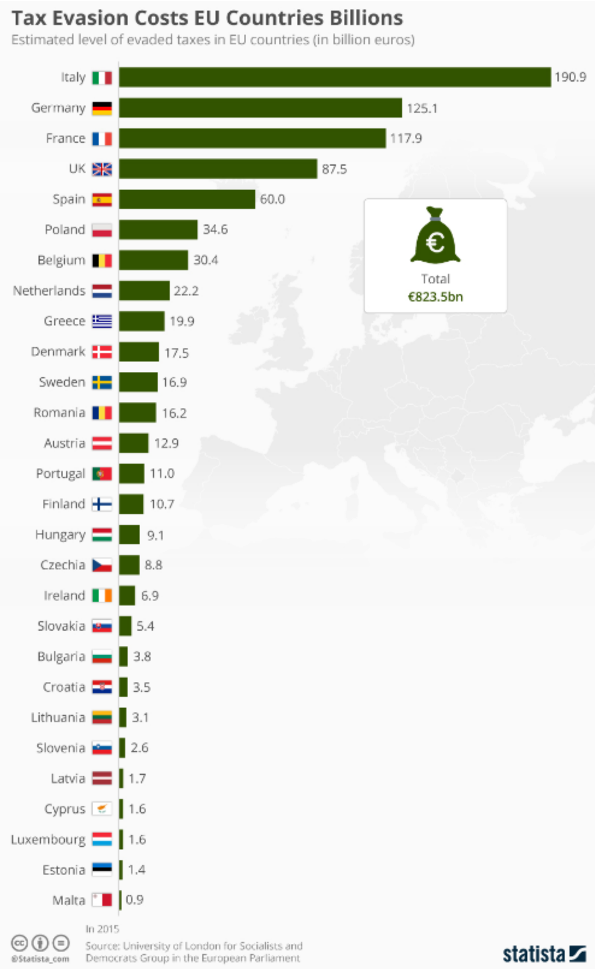


Source: Eurostat (online data code: gov_10a_taxag)

It's possible to see how the entries for EU are equally divided into indirect taxes, direct taxes and social contributors. This represents a big issue because only indirect taxes are harmonised between Member States, but the other two sections of tax revenues are only approximated in integration's terms, and for some States as Germany and France they represent the major part of tax revenues.

A study on the dimensions of how much tax evasion and tax avoidance affect the efficiency of the market was conducted. The data were calculated relating to tax evasion, tax avoidance and financial crimes approved 26th March 2019 by European Parliament, thanks to the research made by Richard Murphy.[39]

[39] GALULLO R., MINCUZZI A., 2019, *Gli europei evadono 2,25 miliardi al giorno. Record pro capite in Danimarca (Italia esclusa)*, Il Sole 24 Ore



The major country which sees this phenomenon is Italy (190 billion €), followed by Germany and France. If we analyse the bottom of this ranking, we find Luxembourg and Malta.

Other important aspect seems to confirm what said before. The Eastern European countries suffer less tax evasion.

Totally from 2009 to 2015 the EU suffers a 12% or 16% of tax revenues loss due to this phenomenon.

Every year the sum subtracted is around 823,5 billion, every day 94 million, every minute 1,5 million and every second 26.113 €.[40]

Other important point of discussion was the description of tax havens present in Europe which are Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta and Netherlands[41] and a criticism at the domestic countries was made to the behaviour regarding this topic.

Analytics provide that the major part of evasion is regarded at VAT, the final tax on consumption for the consumer.

The current framework shows that EU has limited competence to act in the field of taxation and problems with the process of harmonisation.

The European Commission underlines the benefits given by non-harmful tax competition, generating also lower tax pressure.

The actual weaknesses are classified in three main sections:

- Public finances: the tax burden applied by national provision is not aligned with the eventual scenario issued with harmonisation, leading in lower provision of public service and jeopardization of sustainability determining an eventual increase of public debt.

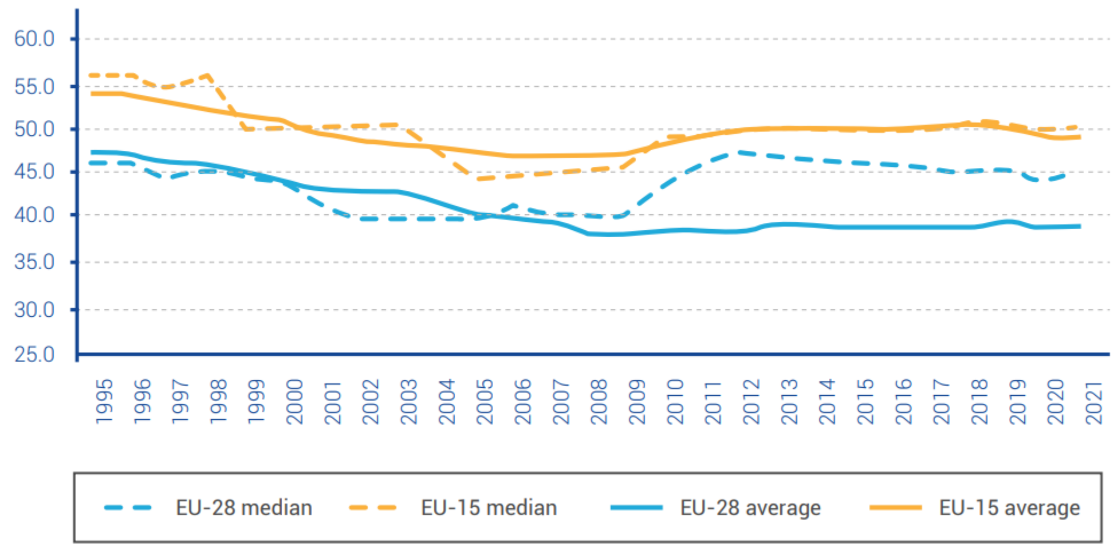
[40] GALULLO R., MINCUZZI A., 2019, *Gli europei evadono 2,25 miliardi al giorno. Record pro capite in Danimarca (Italia esclusa)*, Il Sole 24 Ore

[41] MEOLI F., 2020, *Paradisi fiscali in Ue: ecco quanti soldi ci sottraggono Olanda, Irlanda e Lussemburgo offrendo alle multinazionali una tassazione di favore*, Il Fatto Quotidiano

- Social equity: tax cuts are different by each State, each sector and income type, because countries try to increase the tax burden in the most elastic categories of tax base such as wages, salaries and consumption.
- Political cohesion: the countries consider other Member States as peers, determining a general downward of tax burden, reinforcing the Euroscepticism by citizens.

Figure 1

Development of median and average top statutory personal income tax rates for EU 15 and EU 28 countries



Source: European Commission, DG Taxation and Customs Union, Taxes in Europe Database and KPMG and IBFD data – non-weighted by population size

Analysing the historical trend an important consideration regards the Member States entered after 1990s, because countries as Estonia or Hungary presented a low tax burden for personal tax income, determining more possibilities for taxpayers to avoid or evade.

In the yellow line it is represented the block of historical 15 Member States which determined an alignment superior than the current situation, according to the first weakness described above.

Also, another potential threat derived from this inefficiency created by missing neutrality of tax in common Internal Market is the presence of tax havens.

With enlargement of EU's territory, another issue came out. The need of cooperation and the exchange of information were important to ensure the satisfaction of goals for EU.

Tax authorities found an agreement for closer cooperation aimed to apply correct tax burden based upon the Directive 2011/16 EU, which defines the necessary procedure and secure platform ensuring cooperation. It regards all tax categories, excluded VAT, custom duties, excise duties and social contributions because they are already defined in articles of TFEU regarding the harmonisation and approximation of laws.

The Directive was referred to natural persons (individuals), legal persons (companies) and all types of residents, stable in one or more EU Member States (i.e. foundations).
The aim was the exchange of information in three possible forms:

- Spontaneous exchange of information, when one country finds information relevant for possible tax avoidance and evasion and it is the State of Source or the State of Residence.
- Automatic exchange of information, which becomes in this way for cross-border situation and happens in the case a taxpayer is active in a country which is not the State of residence.
  The State must provide information at the State of residence in mandatory way about employment income, pension income, directors fees, income and ownership of immovable property and life insurance products.[42] The purpose is to have financial account information, cross-border tax ruling and advance pricing arrangements and tax planning schemes.
- Exchange of information on request: used when there is the need of additional information for tax purposes by another country.

To facilitate the process, the Directive also provides standardised format for the different types of information shared and it requires at Member State feedback about the information received in order to evaluate if the Directive really functions well or not.

1.5.1 Aggressive tax planning

The second point to underline is also the practice of tax avoidance which consist in taxpayers reducing tax liability through arrangements that may be legal but in contradiction with the intent of law. The taxpayers exploit loopholes of tax system leading to double no taxation.
The aim of fighting it is to not lose possible revenues for education, health and public investment and at the same time preserve the fair tax burden for all citizens avoiding any distortion of the fair competition between companies. As described before, the Code of Conduct was fundamental to issue a series of patent box regimes. The focus of EU is to not lose tax

[42] EUROPEAN COMMISSION, 2022, *Administrative cooperation in (direct) taxation in the EU,* Taxation and Customs Union. EU provides a general overview of the reasoning behind the need to a better exchange of information between Member States.
Available on: https://taxation-customs.ec.europa.eu/taxation-1/tax-co-operation-and-control/general-overview/enhanced-administrative-cooperation-field-direct-taxation_en#:~:text=Exchange%20of%20Information%3A%20the%20Directive%20provides%20for%20the,in%20three%20forms%3A%20spontaneous%2C%20automatic%20and%20on%20request, visited on 19th October 2022

revenues by cross-borders operations conducted, so one example in this direction was the agreement with Switzerland in providing the disclosure of tax information at EU in 2015.
In quantitative terms, it costs every year at EU 50-70 billion of euros, equal to 0.4 % of GDP for a State of lower bound or the 17% of CIT (corporate income tax).[43]
Tax avoidance determines also spill-over effect in other territories, because the profit shifted to or through Member State represents a clear loss of possible tax revenues; this threat is composed especially by tax havens.
Other criticism is the distortion effect in the fair play for the companies and also to share the fair burden of taxes. In 2015, UNCTAD indicate that especially MNE in high-tax countries pay 30% less tax than comparable domestic firms.
The tax avoidance happens through three main ways:

1. Debt shifting, where internal debt is used to move the high tax burden in low tax burden.
2. Strategic location of intellectual property rights and intangible assets.
3. Misuse of transfer pricing in low tax jurisdiction due to the benefit obtained in paying less taxes.

Tax avoidance could be derived from some tax rules or from their absence.
First point EU was not aligned is the presence of anti-abuse rules regarding the topics as controlled foreign companies, interest limitation and thin capitalisation.[44]
Second point is the set of indicators which do not determine tax avoidance directly, but their absence could be very relevant. It's the case of withholding taxes which aims to prevent the phenomenon of double taxation.
Double taxation arises when "taxpayers receive the tax application based on the Country of source for income flow and the country or residence".[45]
The tax burden derived could be affected by three possible rights:

- Both States define taxpayer as resident: two or more countries assert right to tax a certain income of a taxpayer considered him/her as resident creating a dual-resident taxpayer. Similar conflict is the case of residence and citizenship jurisdiction, where the State of Residence overlaps State of citizenship.

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[43] DOVER R., FERRETT B., GRAVINO D., JONES E. and MERLER S., 2015, *Bringing transparency, coordination and convergence to corporate tax policies in the European Union,* European Parliament, p. 4
The experts studied an estimate of tax losses by aggressive tax planning conducted by taxpayers.
[44] In the Chapter 2, it will be provided a detailed description
[45] SOOM A., 2020, *Double Taxation Resulting from the ATAD: Is There a Relief?*, Intertax, Vol. 48, Issue 3, pp. 273-285. It was conducted a study of the impact of double taxation after ATAD implementation, providing a theoretical description of double taxation cases which could determine a higher tax burden due to double taxation of the income.

- One State exercises taxes for the residence reason, and the other for the source of income.
- Both States define themselves the country of source.

Focusing on the second definition, economic double taxation could be the consequence of successive taxation of income passed from one person to other, thinking about at classic scenarios of the distribution of dividends at shareholders, once they are approved by the firm.
Other situation for economic double taxation occurs when income is taxed to a partnership and to the partners. The flow of income remains the same but it's taxed twice by two different countries in two different hands of taxpayers.
Returning to the case of withholding taxes, its presence in both States determine the absence of cross-border flows but at the same time it blocks the aggressive tax planning.
A point of macroeconomic analysis will be to see the presence of the foreign direct investment (FDI) kept by special purpose entities and microeconomic analysis with specific financial income flows (dividends, interests and royalties).
For example, royalties could provide if there is a strange movement of intangible assets and intellectual property, so it functions as a warning that something is happening.
Go along to this topic in the following tables it's possible to see the implementation in 2017 of anti-avoidance measures inside Member States.

Table 1: Overview of some anti-tax avoidance rules missing in Member States' national laws, 2017

	BE	BG	CY	EE	HR	LU	MT	NL	RO	SI	AT	CZ	IE	LV	LT	PL	SK	DE	EL	FI	HU	PT	FR	IT	SE	UK	DK	ES
Interest limitation or thin-capitalisation rules	✓	✓	✗	✗	✓	✓	✗	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Controlled Foreign Companies Rules	✗	✗	✗	✗	✗	✗	✗	✓	✗	✗	✗	✗	✗	✗	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

Source: Ramboll Management Consulting and Corit Advisory (2015).

Studying the behaviour of countries into the presence or not of withholding taxes, important response exits.
The Member States as Netherlands, Luxembourg and Malta did not provide taxes for royalties and interests, determining a loophole of cohesion for EU's jurisdiction, an important issue described in the next paragraph of the elaborate.

Table 2: Withholding taxes in EU Member States towards third country jurisdictions, 2017

	HU	MT	CY	EE	LU	NL	IE	UK	AT	DE	FI	SE	BE	BG	CZ	DK	EL	ES	FR	HR	IT	LT	LV	PL	PT	RO	SI	SK
Royalties	✗	✗	✓	✓	✗	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Interests	✗	✗	✗	✗	✗	✗	✓	✓	✗	✗	✗	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Dividends	✗	✗	✗	✗	✓	✓	✗	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

Source: ZEW (2016), with updates based on national reforms.

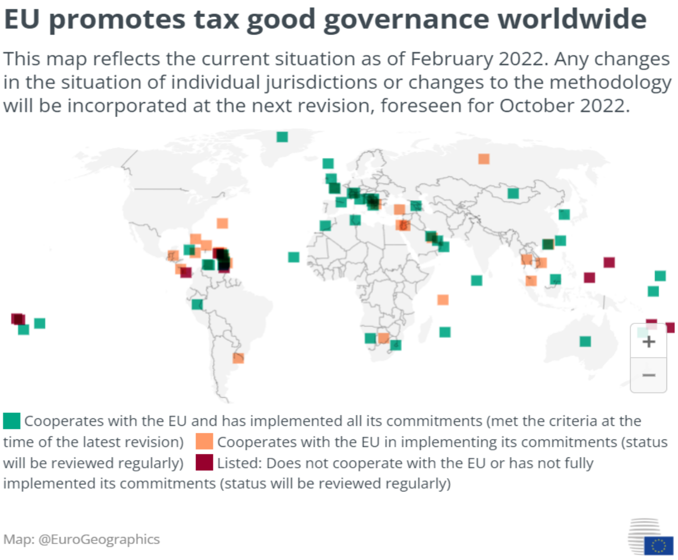
Notes:

(1) The above table focuses on the domestic withholding tax (WHT) rates, i.e. the rates that are specified in national corporate tax law. It therefore does not reflect the WHT rates specified in double tax treaties.

(2) A cross means that the Member State does not apply a withholding tax (exceeding 0%).

1.6 A big threat for internal market: tax havens

Tax havens create external and internal challenges for EU countries tax' bases summarized to the conclusions adopted by ECOFIN Council, which indicated a short list of non-cooperative jurisdictions aimed to encourage positive changes through the cooperation. (Annex I)
The States in phase of reform were included in the Annex II and the countries which already give their cooperation are not included in any annex.
Pierre Moscovici, Commissioner for Economic and Financial Affairs, Taxation and Customs said: *"the EU takes its international tax good governance commitments seriously. It is reasonable for us to expect the same from our international partners. We want to have fair and open discussions with our partners on tax issues that concern us all in the global community. The EU list will be our tool to deal with third countries that refuse to play fair".*[46]



EU Council establishes number of parameters in order to classify the countries.
The first was tax transparency, respected with the exchange of tax data through automatic exchange of tax information or common reporting system provided by OECD, or by request of EU. Then it's considered if a country is an OECD member on mutual administrative assistance in tax matter or it presents a network able to cover all EU Member States.
Second parameter is fair taxation, jurisdictions should not have harmful tax measures, should not facilitate offshoring of facilities looking for profits without a real economic activity.
The third parameter is anti BEPS measures where EU indicates the necessity to implement measures aimed to contrast base erosion profit shifting at the minimum standard.

[46] EUROPEAN COMMISSION, 15th September 2016, *Fair Taxation: Commission launches work to create first common EU list of non-cooperative tax jurisdictions,* Press release, Brussels.

Then jurisdiction should receive positive assessment by peer reviews based on the effective implementation of countermeasures for BEPS on country-by-country report.

Timeline updated at this year started on 2020 with the last update including conclusion on progress achieved on tax issues.

In October 2020 Cayman Islands and Oman were removed from Black List, and it was introduced Barbados and Anguilla.

Barbados, a year later was removed and it was replaced by Dominica which six months later on October 2021 was removed from the list with Anguilla and Seychelles.

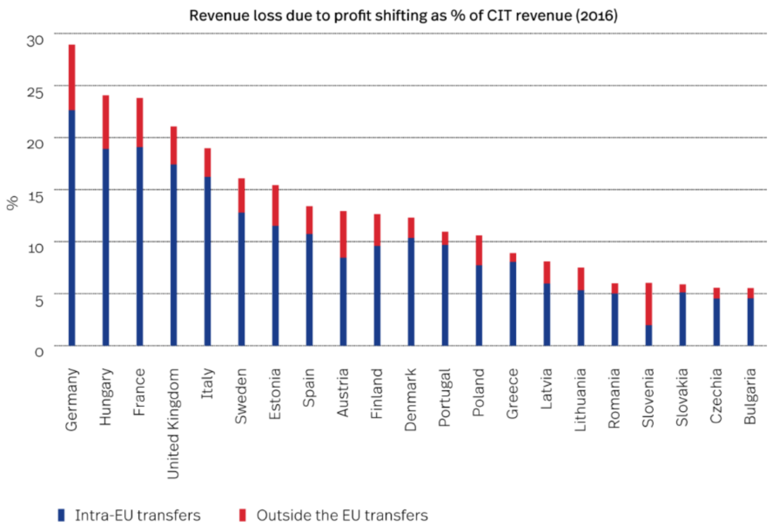
In February of this year, the EU Council updated the list of non-cooperative countries for tax purposes and it is composed by American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, US Virgin Islands, Vanuatu.[47]

The consequence to be part of blacklist include withholding taxes at higher rate on payments received in these jurisdictions, carrying also a negative image in reputation that affect the possibility for these countries to have access of fund for domestic growth.

A study of the Tax Justice network said that these States contribute to 2% of global tax losses, while EU with favourable tax policies of the States as Netherlands, Ireland and Luxembourg and other member countries represent the 36%.[48]

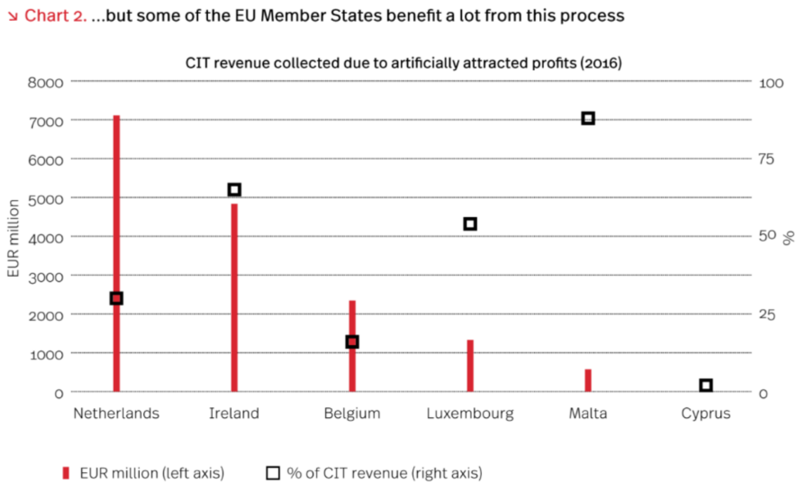
These countries with Belgium Cyprus and Malta implemented legal regulations conducive to artificial profit transfers.

↘ Chart 1. Most of the EU Member States lose a huge part of CIT revenue due to artificial profit shifting...



[47] EUROPEAN COUNCIL, 2022, *EU list of non-cooperative jurisdictions for tax purposes.*
Available on: https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/, consulted on 2nd October 2022

[48] POLISH ECONOMIC INSTITUTE, 2020, EU Member States lose EUR 170 billion per year due to EU tax havens, Macroeconomics, Press releases, Reports 2020.
Available on: https://pie.net.pl/en/eu-member-states-lose-eur-170-billion-per-year-due-to-eu-tax-havens/, visited on 19th October 2022



Source pictures: Polish Economic Institute, 2020, EU Member States lose EUR 170 billion per year due to EU tax havens

Noted on the study of Polish Economic Institute, expert in analysing foreign trade, macroeconomics, energy and digital economy, the revenue loss inside EU is due mainly for intra-EU transfers and the Member States who benefit more from this were the countries above, determining a loss of 170 billion of euros as described previously.

EU Commission decides to call out the harmful tax practices in Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta and Netherlands through the publishment of European Semester in 2018.

"The Ireland report states that the absence of anti-abuse rules for the exemption from withholding taxes on dividend payments made by companies based in Ireland suggests that country's corporate tax rules may be used in tax avoidance structures".[49]

For Ireland was notable from data, because it presented the highest net royalty payment as percentage of GDP, determining for MNEs a way to make aggressive tax planning.

Absence of withholding taxes on royalty and interest payments was provided also in Luxembourg.

Netherlands reported tax reform agenda, with a loophole regarded withholding taxes on dividend payments by cooperatives and the creation of hybrid mismatches for limited partnerships.

It presents an extensive Double Taxation Treaty which gives the possibility to reduce withholding taxes on dividends, interests and royalties' payments on financial flow at MNEs due also for the secretive position kept by this country, aligned with the 2020 Financial Secrecy Index.

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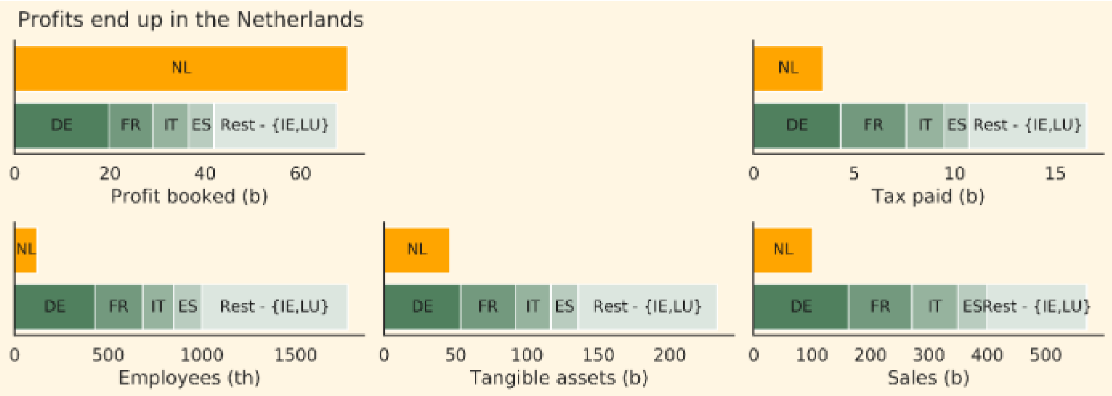
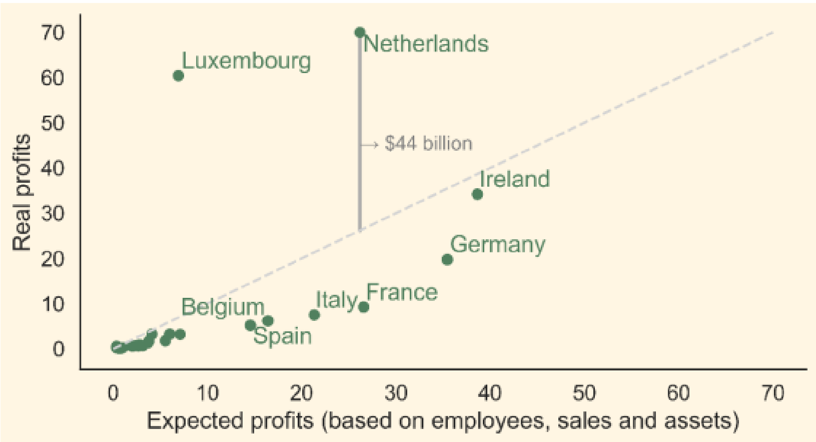
[49] MARTIN J., 2018, *EU Commission calls out harmful tax practices in Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta, Netherlands*, MNE Tax.
Available on: https://mnetax.com/26447-26447, consulted on 19th October 2022

The Netherlands is responsible for losing more than 10 billion of dollars of corporate tax revenue every year. It plays an important position in profit shifting by MNEs, think about that US multinationals booked 70 billion of dollars paying only 3,4 billion of dollars as tax burden, determining an amount of 8% GDP with this foreign income.



The table demonstrates how the number of profits recognized in Netherlands are not aligned with measures of economic activity. In the figure Cobham and Bernardo consider profit, taxes, employees, tangible assets and sales.

Continuing to this line, EU renounces actually at 10 billion to 15 billion of dollars by region each year, creating also negative externalities in reducing domestic tax burden.[50]



As Ireland, Cyprus, Malta and Hungary it presented lack of anti-abuse rules to fight tax planning of MNE and tax avoidance phenomenon and missed withholding taxes for royalties and interest payments.

[50] COBHAM A., BERNARDO-GARCIA J., 2020, *Time for the EU to close its own tax havens*, Tax Justice Network

Source tables: Cobham Alex, Bernando-Garcia Javier, 2020, Time for the EU to close its own tax havens, Tax Justice Network

These countries were included in grey list of Annex II and EU Council sent letters asking at these seven countries to improve tax systems in order to encourage cooperation inside EU territory.

After seeing the threats and weaknesses presented by current EU's legal system, an important question is necessary. What does actually EU do in order to change this trend?

The EU did something for its first time in the history which will be developed in the next chapter.

Chapter 2: ATAD implementation: how does it stop the MNE's aggressive tax planning and BEPS?

Seen the current situation, EU desired to stop the aggressive tax planning and tax evasion, in order to favour the public entries of Member States and at the same time solve loopholes exploited by MNEs to take advantage in competitive terms, which determine competition's death.

As seen in previous chapter, the lack of uniformity provides many ways for MNEs to exploit benefits of different jurisdiction and reduce the total tax burden.

The EU decided to study something aligned with the new targets established by OECD, international institution's fighter of tax evasion and tax avoidance which represent the point of reference around the world to determine how to apply Tax Treaties in order to favour the efficiency of trading and market between States. A fundamental change was issued by EU for the first time to protect its ideals.

An important instrument able to assembly total commitment of different organizations inside EU was implemented for the first time: the directive against tax avoidance (ATAD).

2.1 Why did EU introduce ATAD?

EU introduced for the first time ATAD due to the willing to align its objectives with the action taken by OECD, the main actor able to give clarity and transparency for what concerns tax issues.

Analysing the framework described in the first chapter, the EU needed it, due to absence of anti-abuse rules regarding CFC, interest limit deduction and the absence of the withholding taxes in some countries. All of this process started in 2015 with the publication of countermeasures of OECD for what concerns BEPS.

2.1.1 OECD's role

Fundamental to remember is that OECD provides no binding rules with its first section of model tax Convention where a person finds treaties classified in different articles, while in the second section is possible to see the explanations of the contents and of the meaning of each single provision making this section a sort of instruction book.

This tool shares a guideline on the accepted interpretations of the main text and it has become a reference for taxpayers, tax administrations and the courts. It supports everyone who needs help in interpreting tax treaties.
The pros of this commentary were to provide a common way, standardizing international agreements and reduction of the international double taxation.
The cons were the constant attempt to have a compromise between different members, who clearly want to take advantage for themselves. Another critical point was the rule of vote in unanimous consent, which is largely mitigated, thanks to the possibility for countries to develop some reservations and observations.
But this issue could cause some problems and for this it's fundamental the mutual intention of both States in order to avoid tax evasion and avoidance and also Treaty shopping.
The interpretation of Tax Treaties refers to customary international law, as embodied in the Vienna Convention on the Law of Treaties, most countries have signed it, except US.
In art. 4 par.1 OECD stated the definition of the case the person is taxable (including individual, company and other body of persons) in State of Residence. It is necessary to define domicile, residence, place of management or any other criterion and also include any State and any subdivision.
The issue becomes complex in the case of partnerships when a State treats them as pass-through entities for tax purposes.
In art. 2 OECD defined the Taxes covered to give a guideline for which are taxes involved in typical treaties and in par.1 OECD states that the treaty is to apply "to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities".[51]
To avoid the situation of uncertainty where there is a conflict of residence most countries provide a tie-breaker rules, assigning residence jurisdiction to one country only.
Using the concept if one rule doesn't apply, pass through the next, it establishes five conditions to define residence. After the first, in case of ineffectiveness, a person is resident if he/she has a habitual abode. If neither first rule and second rule are effective the third defined that person "shall be deemed to be a resident only of the State of which he is a national".[52]
If the last rule is not effective, the last defines a possible mutual agreement between Contracting States.

[51] OECD, 2017, *Articles of the Model Convention with respect to taxes on income and on capital*, OECD Publishing, Paris, Art. 2
[52] OECD, 2017, *Articles of the Model Convention with respect to taxes on income and on capital*, OECD Publishing, Paris, Art. 4

Different is the case of legal entities: "where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated". [53]
In the Commentary the legal entity is defined as the "place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made". [54]
An important definition of OECD MC was also the concept of permanent establishment (PE) meaning "a fixed place of business through which the business of an enterprise is wholly or partly carried on".[55]
It includes place of management, an office, a factory, a workshop, a mine and a branch.
Residence definition and permanent establishment definition are fundamental for this thesis, due to the fact that aggressive tax planning is conducted also by digital firms, firms which based on this principle pays taxes only in place of effective location.
This was the initial point for OECD, able to define after GAARs and TAARs against BEPS, a point of inspiration for the implementation of ATAD by EU.

2.1.2 OECD: countermeasures GAARs and TAARs against BEPS

OECD due to the advance of the phenomenon of tax evasion and avoidance decide to stop it.
Referring to GAAR (general anti-avoidance rules) they elaborated legislation to reduce, eliminate the possibilities of tax avoidance. It provides a general definition for what concerns tax avoidance in the legal system.
It defines what is tax avoidance and which are its consequences if happens, because it denies tax benefits to taxpayers and applied the normal tax burden associated with gaining of that final result.
The advantage is that it's applicable for each situation of tax avoidance.
Several countries have some forms of GAARs. Countries implement and develop their GAARs in a different way. The common characteristics found in GAARs among countries including:

[53] OECD, 2017, *Articles of the Model Convention with respect to taxes on income and on capital*, OECD Publishing, Paris, Art. 4, par.3
[54] OECD, 2017, Commentaries on the Articles of the Model Tax Convention, Model Tax convention (Condensed Version), OECD Publishing, Paris
[55] OECD, 2017, *Articles of the Model Convention with respect to taxes on income and on capital*, OECD Publishing, Paris, Art. 5

- identify a pattern or arrangement, find the whole of a transaction with its components; it's important that tax authority provides enough flexibility regarded the way in defining the pattern;
- quantify how much is the tax benefit or tax advantage associated; it means a reduction to liability to pay taxes (credit, rebate, deduction), postponement in timing of the payment, any advantage provided by the delay in payment taxes and anything regard amount of gross revenue in order to calculate exempted income and amount not subjected to be taxed;
- test to calculate if firm gains a tax advantage.

The GAAR is not self-executing, tax authority must decide to make demonstrating a relevant and valid determination. It can take different forms and it applies to different taxes.

Some differences which could emerge are the inclusion of misuse or abuse provision, element provisions. A GAAR when introduced in domestic law needs to pay attention in design and draft for the consistency, because some complexities could arise in implementation of a domestic provision intended to override a tax treaty in force, because commonly the tax treaty prevails.[56]

For what concerned EU, with ATAD was implemented GAAR in art. 6, which will be described later.

The TAAR refers to target anti-avoidance rule aiming to "treat distributions on a winding up as income rather than capital distributions where taxpayers are using separate companies for individual contracts, which are then wound up as the contract ends in order to convert income profits into capital". [57]

They are targeted to specific problems aiming to eliminate the highly specific tax avoidance.

They were provided to fight BEPS.

Taxation is at core of countries' sovereignty, but the coordination of domestic tax provision leads to some frictions and gaps. It's fundamental that countries in composing the domestic provisions take into account also the other tax rules provided by other countries.

There is no similar principle of coherence at the international level leading to arbitrage for taxpayers, only the part of double taxation was solved with coherence about tax laws between different countries.

[56] WAERZEGGERS C., HILLIER C., 2016, *Introducing a general anti-avoidance rule (GAAR)*, *Ensuring that a GAAR Achieves its Purpose (January 31, 2016)*, Tax Law IMF Technical Note, n. 2016/1, IMF Legal Department

[57] CRONERI LIBRARY, 2022, *328-930 Targeted anti-avoidance rule.*
Available on: https://library.croneri.co.uk/cch_uk/btr/328-930, visited on 19th October 2022

Especially in cross-border situation between the States, the MNEs were able to exploit the loopholes of jurisdictions in order to eroding base of the profits taxable.
The countries suffer this issue in a disproportional way.
Multinational enterprises are a large proportion of global GDP and globalisation enlarges this issue, because it has opened new opportunities for MNEs to minimise tax burden, bringing to a tense situation in which citizens are sensitive to tax fairness.
They are composed by one company which have the control on the others (holding) and other separate legal entities which are part of the group. The MNEs could be present in the markets in three possible types:

- horizontal MNEs when the different entities produce same or equal good;
- vertical MNEs when the different entities are inside the global value chain process, able to complete the different phases of transformation of raw material into the final product;
- diversified MNEs they do not imply any vertical or horizontal relationship, creating different types of outputs.

They organize their "global value chain". The firms reorganize processes and the phases of production, consequently providing possible outsourcing and offshoring.[58]
The developing countries represent the possibility for these firms to gain competitive advantage, making their products or services with higher quality or at lower costs depending on strategy decided.
It's critical for all parties to regulate the activity of multinationals because governments are harmed due to revenue losses and higher costs and overall, important it is the resource allocation, affected by the tax motivated behaviour.
For developing countries, the missing part of tax revenues, leads to problems about public investments, that compromise economic growth.
MNEs face significant reputational risk if their tax rate is viewed too low. As Rego said: "multinational firms can avoid taxes through structured transactions among different jurisdictions".[59]
At the same time companies take other types of risk conducting these activities, sometimes failing to take advantage from legal opportunities. Opposite problem happened for the companies who are domestically located in jurisdiction with high tax burden as family

[58] DELLA ROVERE A., VINCENTI F., 2017, *La rilevanza della gestione della value chain nelle imprese multinazionali*, Amministrazione & Finanza, n. 7/2017, pp. 57-63
[59] OLE-KRISTIAN H., MARK M., WAYNE B. T., 2013, *Tax Avoidance and Geographic Earnings Disclosure*, Journal of Accounting & Economics (JAE), Forthcoming, Rotman School of Management, Working Paper n. 2285110

businesses which have problems to compete with MNEs due to its ability to shift profits in countries which present low tax burden, compromising fairness in competition.

The digital economy also contributes to enlarge BEPS, posing challenges for international taxation, characterizing for the unparalleled reliance on intangible assets, personal data and the adoption of business which are multi-sided, creating difficulties to track where the value occurs and what jurisdiction must apply.

It's fundamental an international cooperation, so the domestic countries must work together to tackle BEPS and restore trust and transparency and reduce tax avoidance and tax evasion in order to decrease the current cost equal to 100-240 billion USD of annual losses, equal to 4-10% of global corporate income tax revenue.[60]

In this changing international tax environment, some States said a concern about how international standards on which bilateral tax treaties are based allocating taxing rights between source and residence States. OECD said that: "new international standards must be designed to ensure the coherence of corporate income taxation at the international level".[61]

This provision shall, notwithstanding the provisions of art. 1, also apply to persons who are not residents of one or both of the Contracting State there were provided BEPS Actions (Base Erosion and Profit Shifting) referring to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax.

Collaboration with 135 countries and jurisdictions determine creation from OECD of 15 measures[62] to tackle tax avoidance, improve coherence and improve transparency. Object of analysis of this elaborate will be the:

- (Action 1) Tax Challenges arising from digitalisation, developing a consensus-based solution by 2021: find the main problems caused by digital economy for the application of current tax rules and develop new proposals to overcome and solve these difficulties with a holistic approach considering both direct and indirect taxation. Issues included are the significant position in digital environment of firms in other countries without being liable to taxation due to lack of nexus under current international rules, value generated through use of digital products and services, the characterisation of income derived from new business models, the application of source rules and how to determine collection of VAT/GST considering cross-border supply of digital goods and services.

[60] OECD provides a general overview of the tax avoidance phenomenon. See: OECD, 2021, *BEPS Actions*. Available on: https://www.oecd.org/tax/beps/beps-actions, visited on 19th October 2022
[61] Ibidem
[62] Ibidem

- (Action 3) Controlled Foreign Company reducing the incentive of taxpayers to shift income from a market country into foreign subsidiaries in a low-tax jurisdiction. Other issue was the excessive deductible payment (i.e interests); interest expense could provide rise to double non-taxation in both inbound and outbound investment scenarios.
- (Action 4) Limit base erosion via interest deductions and other financial payments: develop recommendations prevent base erosion through interest expense, through use of related party and third-party debt to achieve excessive interest deductions or to finance production of exempt. In connection with this action there is transfer pricing guidance will also be developed regarding pricing of related party financial transactions, derivative and other insurance arrangements.
- (Action 6) Prevention of tax treaty abuse developing model tax treaty provisions and recommendations to prevent treaty abuse
- (Action 7) Prevent artificial avoidance of PE status, redefinition this concept must be updated to reduce abuse, think about the case of MNEs which in artificial way could fragment operations among the group's entities to qualify for the exceptions to PE status.
- (Action 8-10) Transfer Pricing: guidance for applying the arm's length principle. The action 8 regards intangibles assets moved among group members. OECD wants to adopt a clear and transparent definition about this category of assets, ensuring correct allocation of profit associated thanks to the development of specific transfer pricing rules and to the guideline on cost contribution arrangements.

  Action 9 refers to risks and capital where OECD defines special measures and rules to avoid inappropriate returns taking with risks or capital, in order to have alignment with risks and value creation. Action 10 regards the other high-risk transaction between third parties, involving the adoption of transfer pricing rules with the aim to clarify circumstances in which transactions can be recharacterized and the application of methods especially the profit splits consider the global context of value chain and provide protection against base eroding payments.

2.2 ATAD 1

On 8th December 2015, the Council of the European Union called for "common, yet flexible, solutions at the EU level consistent with OECD BEPS conclusions".[63]

[63] COUNCIL OF THE EUROPEAN UNION, 8th December 2015, *Council conclusions on corporate taxation base erosion and profit shifting*, Press Release, par. 10

The creation of anti-avoidance measures began with the EU Transparency Package[64] ,closely linked to agenda of tax frauds. They exploit the loopholes present in jurisdiction resulting in an erosion for the Member States in revenues' terms undermining the right burden-sharing between taxpayers. The aim of ATAD was providing actions to fulfil and cover the BEPS described.

For this EU Commission created a proposal for automatic exchange of information between Member States on tax rulings, a confirmation State gives at its taxpayers on calculation's method of taxes. [65]

Other initiatives implemented were the review of the "Code of Conduct on Business Taxation" aimed to ensure the fair corporate tax competition in order to give more efficacy and more transparency. It was created by the EU ministers of finance in 1997 as a no-binding, intergovernmental instrument used firstly to identify and evaluate possible harmful preferential tax measures in Member States.

The EU Member States committed to change damaged tax measures and reform new measures aligned to the Code of Conduct.

To evaluate tax measures, in 1998 was established the Code of Conduct Group, composed of high-level representatives of the Member State and the European Commission. The mandate for each representative is two years assisted by the General Secretariat of the Council, currently covered by Ms. Lyudmila Petkova, deputy minister at Bulgarian ministry of finance.

To encourage a positive change outside EU the Council established in 2017, the EU list of non-cooperative jurisdiction for tax purpose, revised ordinary by EU ministers.

In November the EU Council screened 92 jurisdictions based on economic ties with EU, institutional stability and importance of country's financial sector, concluding that 17 non-EU-countries or territories were not aligned with minimum requirements on EU's concerns.

The Code of Conduct is composed by five criteria to evaluate if taxes are harmful or not.

First criteria evaluates whether advantages are accorded only to non-residents or in respect of transactions made with non-residents

Secondly advantages do not affect the tax base of the State of Source.

Third criteria regard the evaluation if "advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages".[66]

[64] EUROPEAN COMMISSION, 2015, *Tax Transparency Package*, Taxation and Customs Union. Available on: https://taxation-customs.ec.europa.eu/tax-transparency-package_en, visited on 19th October 2022
[65] see Chapter 1, Directive 2011/16
[66] COUNCIL OF THE EUROPEAN UNION, 1998, *Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy - Resolution of the Council and the Representatives of the*

Fourth point is control if the determination of profit for international activities within a multinational group of companies accepted principles, rules agreed with OECD.
The last criteria are concerned to evaluate the transparency of tax measures, including if the provision at administrative level is transparent or not.
Another activity developed was the tracking of data, thanks to the collaboration with Eurostat and Member States to create a reliable estimate of tax evasion and avoidance in order to give some backwards indicators able to help the development of new directives.
On 28th January 2016 the Commission presented its proposal for an Anti-Tax Avoidance Directive as part of the Anti-Tax Avoidance Package accepted.
It was published in the Official Journal of the European Union on 20th June 2016 and entered into force 20 days later. The hard law regulations and directives were supported by soft law measures.
The European Council said that "the current political priorities in international taxation highlight the need for ensuring that tax is paid where profits and value are generated. It is thus imperative to restore trust in the fairness of tax systems and allow governments to effectively exercise their tax sovereignty. These new political objectives have been translated into concrete action recommendations in the context of the initiative against base erosion and profit shifting (BEPS) by the Organisation for Economic Cooperation and Development (OECD)".[67]
The Directive was issued aimed to stop the outflow of income of budgets of billions of euros a year.
The proposal of ATAD involved a debate among EU national parliaments when it was sent to them for subsidiarity scrutiny. The EU's Parliament exposed its disappointment for the version published of ATAD, due to less stringent text.[68]
The Commission sets out an ambitious agenda to claim down the corporate tax avoidance in order to guarantee fairness of competition among firms. The amplification of harmonisation creates more protection from Internal Market's perspective due to the control of Commission after four years of ATAD's entry in evaluating if Directive was implemented correctly or not.
The Directive EU 2016/1164 lays down law against tax avoidance practices that affect the efficient and correct functioning of the Internal Market.

Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation - Taxation of saving, Official Journal C 002

[67] Directive 2016/1164/EU, 12th July 2016, *laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union

[68] EUROPEAN PARLIAMENT, 8th June 2016, *Parliament calls for crackdown on corporate tax avoidance*, Press Release. Available on: http://www.europarl.europa.eu/news/en/news-room/20160603IPR30204/parliament-calls-for-crackdown -on-corporate-tax-avoidance, visited on 19th October 2022

Chapeau Communication			
Anti Tax Avoidance Directive	**Recommendation on Tax Treaties**	**Revised Administrative Cooperation Directive**	**Communication on External Strategy**
Legally binding anti-avoidance measures	Advice on how to revise tax treaties against abuse	Country-by-Country reporting between tax authorities	Measures to promote tax good governance internationally
Staff Working Document			

Source: European Commission, 2016, Anti-Tax Avoidance Package

The ATAD Directive was affected positively by 15 OECD Action Items against BEPS published on 5th October 2015, dictating a need to find common solutions at the EU level by the Council to ensure fair and effective taxation in the Union in sufficient coherent and coordinated practice.

“Fair play” must be reached in its minimum standards trough anti-avoidance measures.

In the point 3 European Council said “it is necessary to lay down rules in order to strengthen the average level of protection against aggressive tax planning in the internal market. As these rules would have to fit in 28 separate corporate tax systems, they should be limited to general provisions and leave the implementation to Member States as they are better placed to shape the specific elements of those rules in a way that fits best their corporate tax systems. This objective could be achieved by creating a minimum level of protection for national corporate tax systems against tax avoidance practices across the Union”.[69]

The aim is improving efficiency of Internal Market tackling down tax avoidance practices with a common minimum level of protection.

In point 4 of the introduction, the European Council explained the necessity to establish rules applicable to taxpayers subjected to corporate tax extending the applicability of directive also to permanent establishment of those corporate taxpayers’ resident located in other Member States.

Then, it was described the necessity to fight the erosion of tax bases in internal market and the shifting of profits outside internal market.

[69] EUROPEAN PARLIAMENT, 8th June 2016, *Parliament calls for crackdown on corporate tax avoidance*, Press Release. Available on: http://www.europarl.europa.eu/news/en/news-room/20160603IPR30204/parliament-calls-for-crackdown -on-corporate-tax-avoidance, visited on 19th October 2022

In the integrated market is fundamental the common strategic approach and coordinated action. The Anti-Tax Avoidance Package included measures to prevent the aggressive tax planning, boost the transparency and build a level playing field for each type of business inside EU, helping the EU countries to increase their action and coordination against tax evasion and tax avoidance.

To promote efficiency and equal opportunities, tax issue represents an actual problem to solve and to monitor every day in order to be aligned with the progress, so for this was created ATAD. It wants to complement the existing rules on hybrid mismatches and prevent companies from exploiting national mismatches and avoid taxation.

With ATAD, it was published Staff Working Document and it contained five legally anti-abuse measures which all Member States applied against aggressive tax planning starting from 1st January 2019. It ensured a fairer environment for business giving more stability.

In the chapter 1, was highlighted in art. 1 the scope of the directive explaining for which taxpayers is applicable.

In art. 2[70] it defined some concepts in order to give more clarity about the scope of the Directive:

- Borrowing costs "means interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance as defined in national law, including, without being limited to, payments under profit participating loans, imputed interest on instruments such as convertible bonds and zero-coupon bonds, amounts under alternative financing arrangements …"
- Exceeding borrowing costs "means the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law;"
- Tax period means a normal calendar year or any appropriate period aligned with tax purposes;
- Associated enterprises:
    a) an entity in which the taxpayer holds directly or indirectly a participation in terms of voting rights or capital ownership of 25 percent or more or is entitled to receive 25 percent or more of the profits of that entity;
    b) an individual or entity which holds directly or indirectly a participation in terms of voting rights or capital ownership in a taxpayer of 25 percent or more or is entitled to receive 25 percent or more of the profits of the taxpayer;

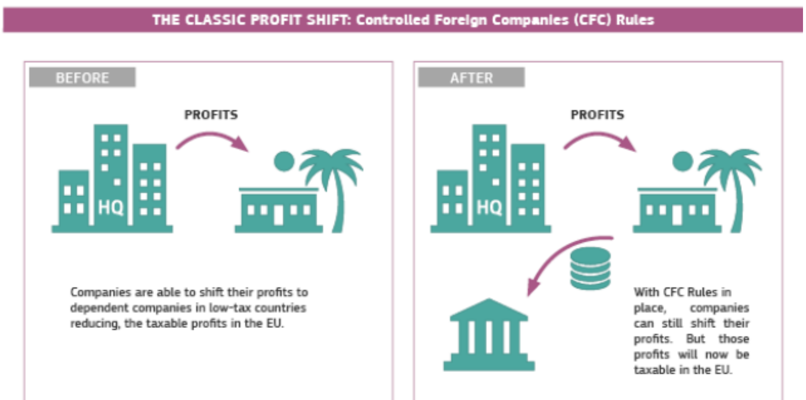
[70] The following terms derived from the definition of EU Commission in Art. 2 of ATAD. See Directive 2016/1164/EU, 12th July 2016, *laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union

Important is the case of hybrid entity where the requirement is modified up to 50%.

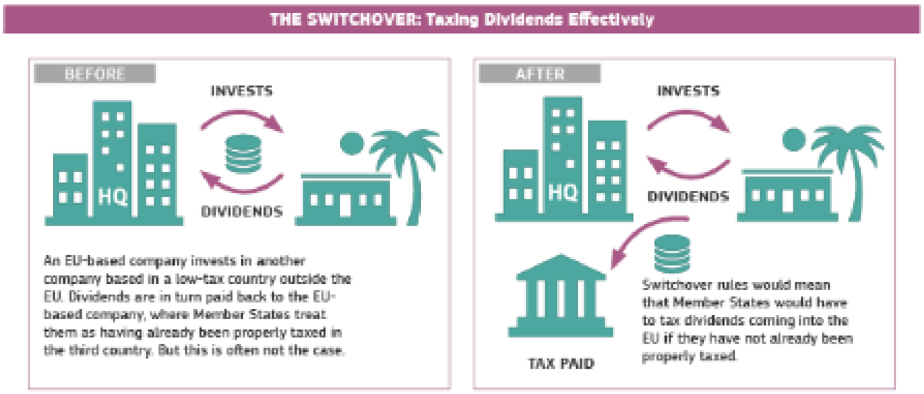
- Financial undertaking
- Transfer of assets: “operation whereby a Member State loses the right to tax the transferred assets, whilst the assets remain under the legal or economic ownership of the same taxpayer;”
- Transfer of tax residence: “operation whereby a taxpayer ceases to be resident for tax purposes in a Member State, whilst acquiring tax residence in another Member State or third country;”
- Transfer of a business carried on by a permanent establishment “operation whereby a taxpayer ceases to have taxable presence in a Member State whilst acquiring such presence in another Member State or third country without becoming resident for tax purposes in that Member State or third country;”
- Hybrid mismatch is a situation between taxpayer in Member State and associated enterprise in another Member State between parties in Member States where the following outcome is attributable to differences in the legal characterisation of a financial instrument or entity:
    - “a deduction of the same payment, expenses or losses occurs both in the Member State in which the payment has its source, the expenses are incurred or the losses are suffered and in another Member State (‘double deduction’); or”
    - “There is a deduction of a payment in the Member State in which the payment has its source without a corresponding inclusion for tax purposes of the same payment in the other Member State (‘deduction without inclusion’).”

In art. 3 of ATAD, European Council underlined the not preclusion of the application of domestic provision with its measures against tax avoidance developed in the Chapter 2, where the ATAD had five core points divided into:

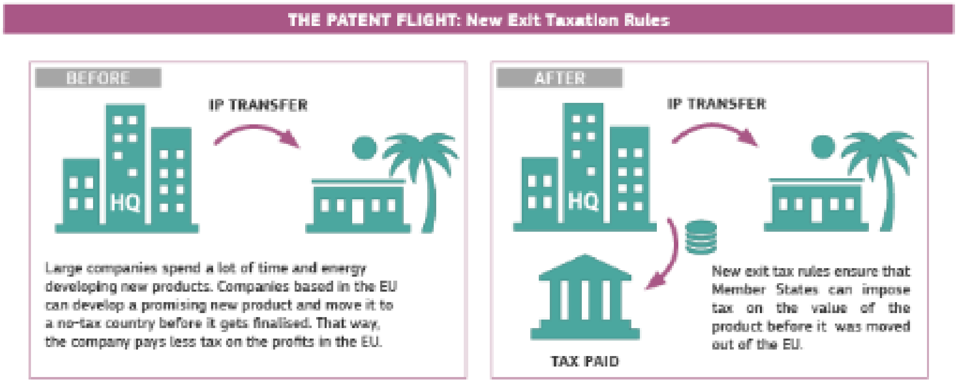
1. Controlled foreign company (CFC rule): deter profit shifting to a low/no tax country, aim not only for EU but also for OECD with publication of its Model Commentary.



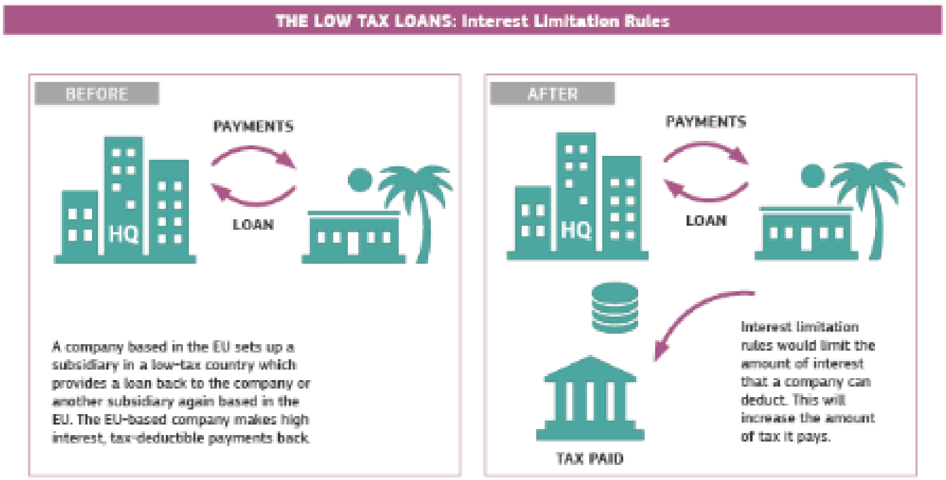
2. Switchover rule: preventing double non-taxation of specific categories of income



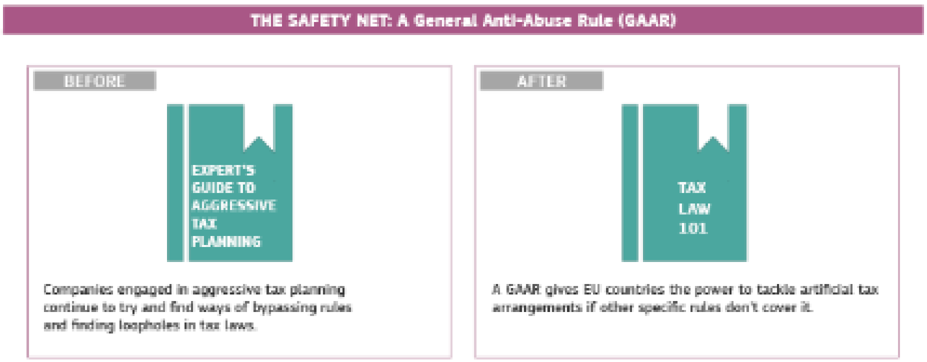
3. Exit taxation: prevent the tax avoidance with the re-location of assets, especially the intangible assets.



4. Interest limitation: prevent the activity to create "artificial debt" with the aim to minimise tax burden. European Council in article 4 provides interest limitation rule:



5. GAARS: provide general rules applicable for each case of tax avoidance.



Source pictures: European Commission, 2016, Anti-Tax Avoidance Directive

The five points described above, will be object of the analysis of this chapter, in a way to see if effectively ATAD contributes to give uniformity of legal system and decrease the aggressive tax planning made by MNEs.

Regarding the latest point in article 6 was provided the full description of general anti-avoidance measures. It is composed by three core elements: arrangement, tax advantage and abuse.

In the par. 1 the Directive 2016/1164 said "for the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part".[71]

In the par. 2 defines the area of interest of GAAR said that "an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality".[72]

In the par. 3 it described how solve the tax avoidance case "where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law".[73]

The structure is defining in a way, it sets initially low thresholds for classifying the arrangement and tax advantage, narrowing deeply then in what should be identified as "abusive".

It integrates a general anti-abuse rule in the domain of tax law among all Member States.

[71] Directive 2016/1164/EU, 12th July 2016, *laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union, Art. 6, par.1

[72] Ibidem par. 2

[73] Ibidem par. 3

There is also the need to reach the aim to "tackle abusive tax practices that have not yet been dealt with through specifically targeted provisions",[74] such as transfer pricing or CFC rules.
The Recital n. 11 defines the application of art. 6 of ATAD should be applied for cross-border situations.
The objective is analysing which is the impact of this important Directive in EU and what are the outcomes followed with this anti-avoidance measures to decrease the level of tax evasion and avoidance, addressed especially for aggressive tax planning of MNEs.
In the next paragraph it will be described the newest version of ATAD issued in 2017.

2.3 ATAD 2

Aimed to contrast the dealignment from hybrid mismatches with third countries regarding tax differences in double taxation issue it was developed a new version of ATAD, called ATAD 2.
It was named directive EU 2017/952 approved by Council in 29th May 2017 with the purpose to fight BEPS 2 Action.
In article 1 it was defined the scope to apply Directive at all taxpayers subjected to corporate tax inside territory of Member States, including permanent establishment in one or more Member States of entities resident for tax purposes in third country and article 9, point a, applied to all entities treated as transparent for tax purposes by Member State.
Article 9, point a, was the core point of ATAD 2 because it defined a change of perimeter for hybrid mismatches definition.
In fact, ATAD 1 regulated only the hybrid mismatches regarding different domestic tax provision between member countries.
In the par. 1 of art. 9 of the Directive 2017/952 there was the definition of the subject regarded in reverse hybrid mismatches; it regards "one or more associated non-resident entities holding in aggregate a direct or indirect interest in 50 per cent or more of the voting rights, capital interests or rights to a share of profit in a hybrid entity that is incorporated or established in a Member State are located in a jurisdiction or jurisdictions that regard the hybrid entity as a taxable person, the hybrid entity shall be regarded as a resident of that Member State and taxed on its income to the extent that that income is not otherwise taxed under the laws of the Member State or any other jurisdiction". [75]

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[74] Directive 2016/1164/EU, 12th July 2016*, laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union, Recital n.11
[75] Directive 2017/952, 29th May 2017, *amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries*, Official Journal of the European Union

In the par. 2 EU indicated the exclusion of application for collective investment vehicle defined as investment fund or vehicle widely held by diversified portfolio of securities subjected to investor-protection regulation in country where it is issued.

Other differences included in ATAD 2 were:

- Optional elimination for Member Country from application field of the directive for financial operations
- Entry into force from 1st January 2020 (one more year compared to ATAD 1)

The two directives imposed at Member States to apply:

- New law of CFC and GAARs from 1st January 2019
- Application of exit taxation rules from 1st January 2020
- Measures regarded hybrid mismatches from 1st January 2020
- Apply rules regarding interest deduction limitation

Specifically in article 9, point b, it formulated the tax residency mismatches; expenses or losses of a taxpayer resident in two or more jurisdictions for tax purposes is deductible from the tax base in both jurisdictions in order to avoid double taxation and if both jurisdictions are Member States according to double taxation treaty the Member State where taxpayer is not resident shall deny deduction from income.

At national measures, in 2017 EU said at Member States to apply at least one administrative measure regarded the reinforcement in monitoring the transactions, increase the risk audit for beneficiaries of listed regimes in black list and increase risk audits for whom utilized the tax schemes involving listed regimes.

In 2021 there was the commitment of Member State by endorsement of Council to adopt one of four following measures:

- No possibility to deduct costs located in a listed country
- Limit the artificial deferral of tax to offshore with CFC rules
- Withholding tax measures for false exemptions or refunds
- Limit participation exemption on shareholder dividends

At the moment 16 States of 26 applied at least two of four measures described above.

Also, EU recommended it third partners countries to apply anti-avoidance rules and it has developed its personal Black List issue on 2019.[76] In this table there is the summary of which anti-abuse measures were provided by countries after ATAD 2 entries into force in 2019.

[76] EUROPEAN COUNCIL, 2022, *EU list of non-cooperative jurisdictions for tax purposes.* Available on: https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/, consulted on 2nd October 2022

Country	CFC rules	Interest limitation	Hybrids mismatches	Exit taxation	GAAR
Austria	Yes	No	Yes	Yes	Yes
Belgium	Yes	Yes	Yes	Yes	Yes
Bulgaria	Yes	Yes	No	No	Yes
Croatia	Yes	Yes	No	by 2020	Yes
Cyprus	By Dec. 2019	by 2020	Yes	by 2020	Yes
Czech Republic	Yes	Yes	by 2020	by 2020	No
Denmark	Yes	Yes	Yes	by 2020	Yes
Estonia	Yes	Yes	Yes	Yes	Yes
Finland	Yes	Yes	Yes	Yes	Yes
France	Yes	Yes	Yes	Yes	Yes
Germany	Yes	Yes	Yes	Yes	Yes
Greece	Yes	Yes	Yes	No	Yes
Hungary	Yes	Yes	Yes	No	Yes
Ireland	Yes	No	No	Yes	Yes
Italy	Yes	Yes	Yes	Yes	Yes
Latvia	Yes	Yes	Yes	No	No
Lithuania	Yes	Yes	No	No	Yes
Luxembourg	Yes	Yes	Yes	Yes	Yes
Malta	Yes	Yes	Yes	by 2020	Yes
Netherlands	Yes	Yes	Yes	Yes	Yes
Poland	Yes	Yes	Yes	Yes	Yes
Portugal	Yes	Yes	Yes	Yes	Yes
Romania	Yes	Yes	By Dec. 2019	Yes	Yes
Slovakia	Yes	Yes	Yes	Yes	Yes
Slovenia	Yes	Yes	Yes	No	Yes
Spain	Yes	Yes	Yes	Yes	Yes
Sweden	Yes	Yes	Yes	Yes	Yes
United Kingdom	Yes	Yes	Yes	Yes	Yes

Source: (own compilation of the author based on 2021)

2.4 CFC: the distortion of the market before and after ATAD

ATAD defines many guidelines to follow for Member State. One of the main points was referred to controlled foreign companies, a section always exploited by MNEs in order to decrease tax burden and determine the creation of loopholes described in first chapter for public finances of Member States.

2.4.1 CFC introduction

Deeping the part of the companies, ATAD brings effects about the competition and therefore the efficiency of Internal Market.
It provides for the minimum integration of rules in the areas of CFCs, hybrid mismatches and interest deduction and it requires the application of GAARs and the exit tax.
The aim was discouraging the aggressive tax planning activity of the multinational companies to shift profits from parent company in high tax burden country to a low tax burden country.
The Controlled Foreign Company is a corporate entity that operates in different business, in different jurisdictions or countries than residency of controlling owners.
It must have a sufficient influence or control by a parent company.
It could be taken place in form of extensive tax deferrals for countries where CFC is place, in the context of worldwide taxation impact or in territorial taxation impact or in the form of tax avoidance in the perspective of the country where CFC is located.
This is so relevant in tax jurisdiction due to the danger presented in moving flows of income in countries which present low tax burden, as for instance the tax havens described above, providing tax distortion and consequently the inefficiency of internal market.
If the existence of the legal entity of a company in tax haven, this is disregarded by the country of a shareholder which lives for example in a Member State of EU.
So, the company is not taxed by the State of the Shareholder, but it is taxed under the rules of the country where is located the legal entity, and the shareholder is taxed only for its part of shares by the country of residence.
The first point to focus attention is the following: does the shareholder create a "false" company to put in this "empty box" income and maintain them in the company to have a low tax burden? He/she will make aggressive tax planning, called also tax avoidance.
First attempt of EU to regulate the CFC happened with the Parent-Subsidiary Directive[77] which defines the order to apply the directive to:

- dividends received by firms of that country which come from the subsidiaries of another Member State
- dividends by companies of that country to companies of other Member States of which they are subsidiaries.

The company subjected were the firms listed in Annex hereto, all the firms categorized as resident in that State for tax purpose, defining that those companies under terms of double

[77] Directive 90/435/EEC, 23rd July 1990, *on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States*, Official Journal of the European Communities

taxation agreement with third State are not defined residents outside Community and it describes the particular cases to consider firm as taxable person.
Also, it provides the definition of parent company for all firms which own at least 25% of capital of companies of another State which fulfils same conditions, while subsidiary is clearly the company owned for at least 25% of capital by parent company described previously.[78]
Remember that CFC legislation is referred especially to residents in Tax havens, corporations and firms taxed with different country's jurisdiction by its owners or situation where domestic taxpayers have an important influence in company's affairs.
OECD introduced in the Action 3 of BEPS the fight to wrong usage of CFC asking to more coherence between domestic rules, in a way to take from of a "building block".
In this block point it was defined the CFC with its exemptions and threshold requirements.
Other point is that CFC aggressive tax planning functions for transactions or arrangement typically with a no little or no business, commercial or no tax-purpose and involve different and detailed steps for realize it.
It is a plan which takes a consistent flow of income diverted; the taxpayer must have resources to deposit inside the company, distorting tax revenues for the country of residence due to the presentation of only one small part of its personal total income.
It damages also the integrity of the system due to the fact that first it determined only an advantage of MNE, thanks to its power to exploit these opportunities; for the small firm or small activity is not convenient to make it. The risk is not justified.
"Small business" is intended to mean any business which intends to use solely its current profits for further capital investment in the enterprise[79], i.e self-financed domestic investment by employer.
It excludes those firms in mature life cycle which are able to distribute cash with dividends at their owners.
Secondly it will be harmful for the public wealth of the State, because it determines unfair competition but also no entries for the country, creating new issues for public finances.
A first point of comparison and evaluating if the taxpayer makes an aggressive tax planning is to do a macroeconomic analysis based on FDI.

[78] Directive 90/435/EEC, 23rd July 1990, *on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States*, Official Journal of the European Communities
[79] BOGENSCHNEIDER B. N., 2016, *A Theory of Small Business Tax Neutrality*, FSU Business Review, Vol. 15, p. 34. The author describes the small business in order to compare its role in tax neutrality observing the disadvantage in competition terms compared to MNEs. It described the absence of tax neutrality environment for small domestic firms.

2.4.2 CFC after ATAD application

Believing in the scarce commitment in shut off the aggressive tax planning, the EU Commission develops anti-avoidance measures, regarding especially CFC.

Art.8 and art. 9 of the Directive 2016/1164 explained the conditions for right application of CFC. The aim was to favour the income flows without the purpose to exploit it for tax purposes. The Commission refers to a study which demonstrated that if the discipline of CFC was issued in right way it provided a critical anti-abuse rule as they could discourage the phenomenon of tax avoidance.

ATAD provides minimum of integration for rules for national corporate tax systems.

The aim was discouraging MNEs in shifting profits from the parent company to the subsidiaries located in low tax jurisdictions.

Other important issue was related to the debate why EU does not implement harmonisation for corporate tax rates. It relies on Member State being able to tax companies where make profits effectively and aligned with domestic provisions.

The incentives, as explained by EU Commission, derived by opaque tax rulings, special tax regimes and loopholes present in national domestic laws which give the possibility to make aggressive tax planning.

Then ATAD does not develop any attempt to interfere with countries' sovereign right to decide own corporate tax rates. Countries have right to choose the best legislation aimed to prevent the aggressive tax planning and unfair tax competition.

If there is one country which impacted in negative way to one country's revenues, the other country could provide protective measures aimed to maintain right the calculation of tax base.

The art. 7 par. 1 of the ATAD stated that all the entities or PE whose profits are part of taxable income or are exempted from taxation by Member State will be considered as CFC if the following conditions are satisfied:

a) The taxpayer or the parent company has shares or voting rights greater than 50% of the enterprise, owns more than 50% of capital and more than 50% of profits.
b) The actual CIT paid by taxpayer or entity is lower than the difference between the CIT would have been paid on same profit in the State of Residence inside EU and the actual CIT paid by the entity or PE located in the State of Source.

In the par. 2 Directive explains which income are included in the tax base.

The first category (point a) referred to:

- interests and incomes generated by financial assets,
- royalties or income generated by the intellectual property,

- dividends from the shares,
- income from insurance or banking activities and
- incomes from financial leasing.

This point shall not apply only in the case controlled foreign company demonstrates a clear link with substantive economic activity supported by employees, assets and relevant facts and projects.

The decision of Member State regards only in the case the CFC is not resident inside one of the Member States.

Second category of income not distributed (point b) was the income generated by artificial arrangements, established only to gain a tax advantage. It refers to the entity or permanent establishment which does not own assets and assumes all risk for purpose that are not aligned with economic activity.

In par. 4 the Directive gave possibility at Member State to exclude form the scope of second category of income not distributed the entities or permanent establishments:[80]

a) "with accounting profits of no more than EUR 750.000, and non-trading income of no more than EUR 75.000; or
b) "of which the accounting profits amount to no more than 10 percent of its operating costs for the tax period"

In point b operating costs may be excluded from total cost of good sold (COGS) outside where the firm is located, for tax purposes and payments to associated enterprises.

The Directive does not list only the income considered in the calculation of the right tax burden, but it defines which rules controlled foreign companies must take into account in art. 8.

For those categories of income included in art. 7 par. 2, point a, the taxpayer must consider domestic provision of the Member State where it is resident, in order to calculate the right tax burden.

For those categories of income included in art. 7 par. 2, point b, the income taxable is only the part generated through assets and risks linked to people functions inside the controlling company. The method to determine it, is the arm length's principle.

ATAD, provides two types of options under which the Member States could impose the CFC charge:

- Model A: interest, dividends, royalties and income from financial activities are attributed directly at the taxpayer or the parent company of CFC;

[80] Directive 2016/1164/EU, 12th July 2016*, laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union, Art. 7, par. 4

- Model B: the part of undistributed income of the CFC maintained inside only for tax purposes (absence of justified reasons) is attributed directly to the taxpayer or parent company.

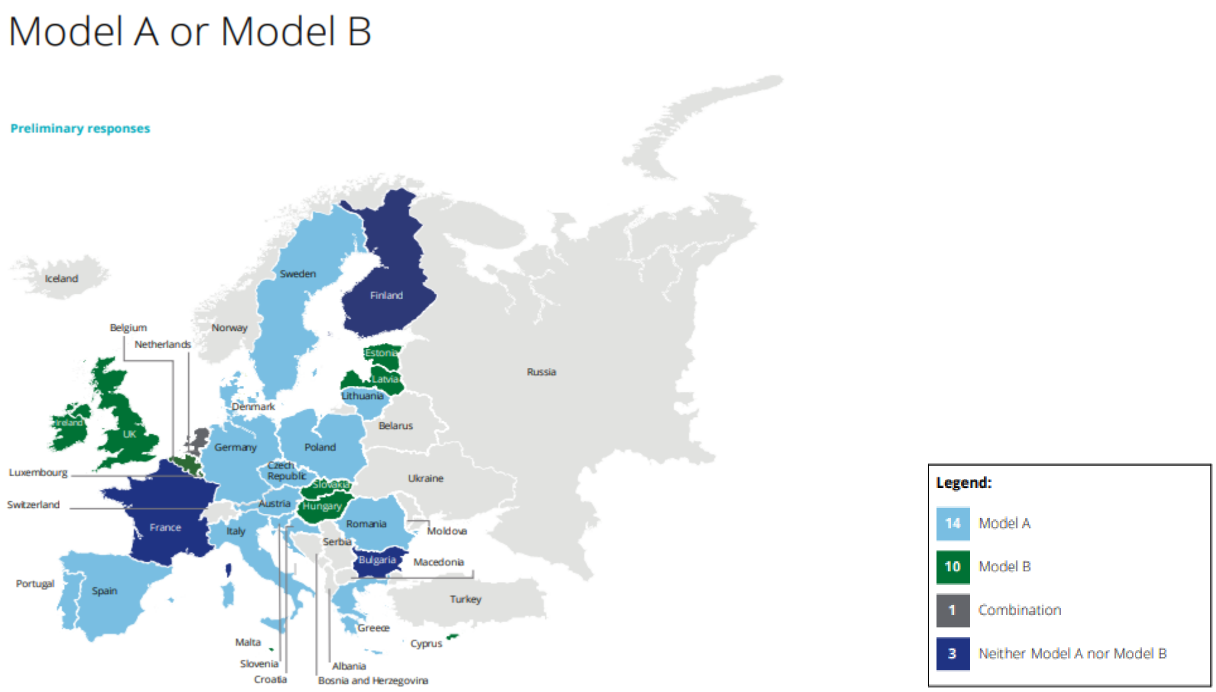
The exception for Model A, as said by ATAD happens only in the case the taxpayer is able to demonstrate the substantive economic activities of the CFC. The taxpayer could demonstrate it with the staff of the company, the tangible and intangible assets and premises.

Important to observe is the case where CFC is not located inside EU's territory, in this case it could not provide the exemption described or in the case if one-third or less of income falls in defined passive income categories (dividends, interests or royalties) or from transactions which involve shareholders or parent company.

The income from CFC is calculated based on domestic laws of Member State where the taxpayer is resident. The exception for Model B says that if a Member State implements CFC rules with non-genuine arrangements, it should not include the income from CFC in the total income of taxpayers, based on the fact it misses the essential purpose of obtaining tax advantage, so in other words, taxpayer does not act to make aggressive tax planning.

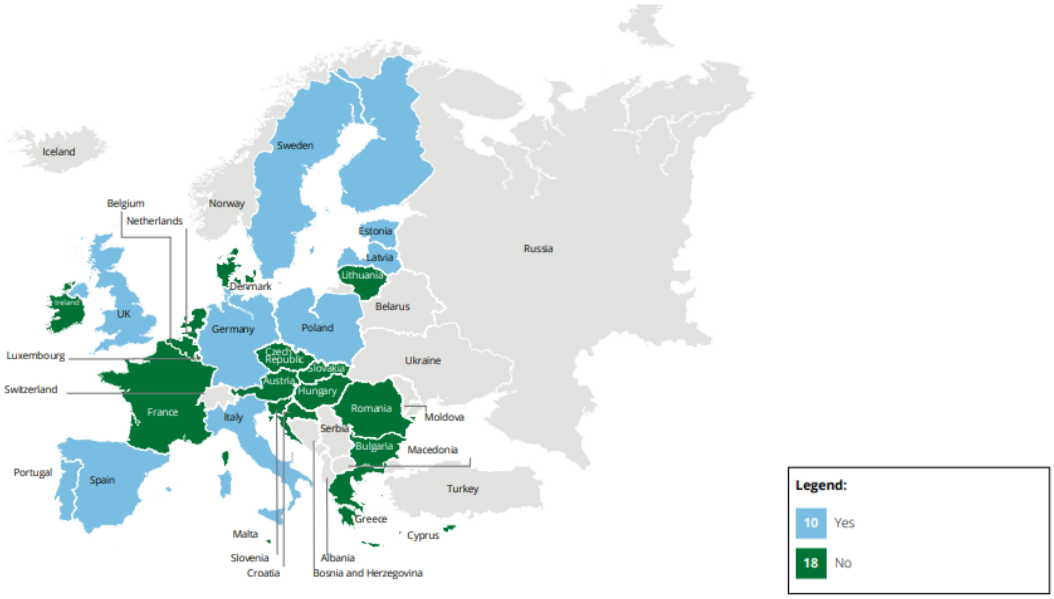
Different speech regards the income generated through assets and risks related to people functions.

This category must be included under the CFC provisions and the arm length's principle is adopted to provide right calculation.



Source: Deloitte, 2021, EU Anti-Tax Avoidance Directive Implementation of controlled foreign company rules

Doing this it provides uniformity; if one country does not apply directive and infringe it, European Commission brings the case before CJEU. In this map, there is the representation of the current situation where some countries adopt the model A and others the model B.
Curious fact is the case of France and Finland which decide to adopt neither of Model A and B.
After ATAD 1 entries into force, there were 7 infringements by Austria, Denmark, Germany, Ireland, Portugal, Romania and Spain.
Also, some countries decide to restrict the domestic provisions to increase the level of protection when comparing the actual CIT paid with the amount of CIT would have been charged in the State of Residence.



Source: Deloitte, 2021, EU Anti-Tax Avoidance Directive Implementation of controlled foreign company rules
After the definition of which scenario is established for the CFC, our attention must be focused on a microeconomic analysis based on definition of income categories of the firm.
The jurisdiction could use:

- categorical analysis;
- substance analysis;
- excess profit analysis or transactional and entity approach.

The first one refers to legal text which gives the definition of which income flows are interests, dividends, insurance or royalties.
Related to the second approach it defines the substance, so which income belongs to the person or to the firm. It could consider the physical presence of permanent establishment or genuine economic activity made by CFC to classify income flows.

The third was referred to a comparison to normal income received by shareholder respect an equity investment, in order to see if dividend is too low only for maintain a low tax burden for taxpayers and deposit temporary income in CFC.
In this ATAD was clear due to the definition that if more than 50% of income falls in certain categories, the action made for aggressive tax planning become clearer.[81]
A limit of what ATAD regulates is the missing relief in case of any double taxation for CFC. In this topic the taxpayer is damaged and as explained before double taxation could be one of the reasons to do aggressive tax planning.
In this case EU was not aligned on what OECD suggests to avoid situation of double tax burden. ATAD provides the relief only for few distributed profits based on shares in the CFC; in this case the proceeds shall be deducted from the total tax base objected of calculation for the right amount of tax burden.[82]
The CFC has not only positive harmonisation, but also negative. Aligned with the limits the CJEU in Cadbury Schweppes defines a little field of application of CFC rules in the EU context. It happens the intervention of CJEU in any case there is a restriction of freedom justified by an action of tax evasion and tax avoidance. It wants to avoid the abuse of rules, despite these years the approach CJEU is quite relaxing for the tight limits.

2.4.3 Cadbury Schweppes

Referring to the role of negative harmonisation and MNE aggressive tax planning, CJEU provides a historical case with the group Cadbury Schweppes.
They established two subsidiaries in Ireland with the purpose to benefit for the favourable tax regime regarding profits derived from financing activities.
The issue of the case was art. 43 and art. 48 of EC Treaty. The question referred to whether the freedom of establishment precludes national tax legislation and from imposing a charge upon parent company on profits made by foreign subsidiary.
The CJEU sentence indicated necessity to evaluate the behaviour of the taxpayer.
To prevent home multinational enterprises (MNEs) from shifting the profits to low-tax jurisdictions, many headquarter countries introduced CFC rules.
Based on the variable conditions, these rules impose that low-taxed earnings of affected MNE's foreign affiliates be taxed at tax rate of parent company's country.

[81] Directive 2016/1164/EU, 12th July 2016*, laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union, Art. 8, par.1, point c
[82] Ibidem, Art.8, par.5

In 2006 the CJEU stated with the judgement of Cadbury-Schweppes an infringement of the principle of freedom of establishment. The sentence recalls that could not be created artificial arrangements aimed to provide with subsidiary a lower tax burden in State where it has been established.[83]

In par. 64 of Cadbury Schweppes case, the CJEU indicated a test for determining existence of artificial arrangement, term used for first time in 1998, in Imperial Chemical Industries case. For the test, it referred to the previous case of Halifax even though the terms were different. In the previous cases the action was defined as "abuse" and "abusive practice", not "artificial arrangement", implying the definition of artificial arrangements as abusive practices for area of not harmonised direct taxes.[84] The abuse defined by this sentence was determined by:

i. no genuine economic activity conducted by taxpayer and
ii. the purpose to gain tax advantages and conduct aggressive tax planning.

Schenkelberg evaluates the impact of the judgement on MNE subsidiaries in low-tax countries by comparing the evolution of reported profits for affiliates owned by European MNEs.[85]

The results found define that, European owned subsidiaries in low tax burden countries increase their pre-tax earnings by 10% compared to control group.

This trend is highlighted more also for countries with a very low-tax and for firms which receive income such as interests, licenses and royalties.

Her results also providing that the increased profit shifting activities for the 85% are related to transfer pricing and less than 15% are related to debt shifting able to provide the phenomenon of thin capitalisation.

So, the Cadbury-Schweppes case weakened the effectiveness of European CFC regulations and the effect of profit shifting was higher in the countries with a low corporate tax rate.

MNEs with mobile income reacted more strongly to this judgement.

The data explained above were referred to the study conducted by Schenkelberg and for the tax summaries presented by PWC, KPMG and EY considering also macroeconomic control variables.

The output was reached through an estimate of the impact of Cadbury-Schweppes judgement on pre-tax earnings or EBT. Schenkelberg focuses her attention on earnings before interests and taxes and on the earning before tax, providing that impact was greater in EBT.

[83] Court of Justice European Union, 12th September 2006, C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd vs Commissioners of Inland Revenue*, ECR I-07995, par. 49

[84] SAYDÈ A., 2014, *Abuse of E.U. Law and Regulation of the Internal Market*, Oxford: Hart Publishing, p. 92.

[85] SCHENKELBERG S., 2018, *The Cadbury Schweppes Judgment and its Implications on Profit Shifting Activities within Europe*, University of Cologne.

A demonstration of how ATAD could play a key role in fighting aggressive tax planning of MNEs.

2.5 Shell companies

Due to all these possible parameters able to contribute in increasing the phenomenon of tax evasion and tax avoidance, in April 2018, the European Parliament's Special Committee on Financial Crimes, Tax Evasion and Avoidance asked for the European Parliamentary Research Service to produce some data about shell companies in EU.
The objective of study was understanding the phenomenon of shell companies estimating the incidence of such companies. It also explained the reasons behind this study and the main risks associated with shell companies and current policies.
The word "shell companies" defines a company used with the aim to favour the profit flows for other firms (especially passive incomes) due to lower tax burden to pay. Often, it is called letterbox company, empty box company or special purpose entity, depending on the context.[86]
MNEs use these types of companies with the CFC, explaining the reasoning behind the introduction of specific article in ATAD by EU.
Anonymous shell companies are one of the types of shell companies, which provides anonymity as key element, while simultaneously guaranteeing control over shell companies and its resources.
The ultimate beneficial owner remains hidden behind its company, or behind a chain of interconnecting shell companies.
The anonymous shell company has featured in many International Consortium of Investigative Journalists and these firms are associated to the world of tax evasion, corruption and money laundering.
Letterbox companies is the second type of shell company is generally registered in one Member State while the main economic activity takes place in the territory of another Member State. The purpose is to diminish the labour cost burden and social contributions where the substantial

[86] See for instance the following publications for use of different terms: OECD, 2008, *Glossary of Foreign Direct Investment Terms and Definitions, Investment Division*, Directorate for Financial and Enterprise Affairs, OECD Publishing, Paris; OECD, 2013 *Addressing Base Erosion and Profit Shifting*, OECD Publishing, Paris; EUROPEAN COMMISSION, 11th July 2013, *Smart regulation - Responding to the needs of small and medium-sized enterprises*, COM (2013)122; MCGUARAN K., 2016, *The impact of letterbox-type practices on labour rights and public revenue*, SOMO; FINDLEY M. G., NIELSON D. L., SHARMAN J. C., 2014, *Global Shell Games: Experiments in Transnational Relations, Crime, and Terrorism*, Cambridge University Press Journals

economic activity is taken. Generally, they are mentioned in the circumvention of the Posting or Workers Directive.[87]

SPE (Special Purpose Entity) is the third type of shell company and it refers to entities whose core business consist of group financing or holding activities.

These firms are completely different from the first two types, based on the fact that the number of employees is nil or very low and there is only a little physical presence in host economy. The assets and liabilities in this activity are mainly investments in or from other countries. The aim in this case is to deposit assets and liabilities, practicing aggressive tax planning.

From the study done to satisfy request of European Parliament, the first outcome produced was the absence of reliable data. The problem was approached by looking proxies as possible indicators of presence and magnitude of shell companies basing on macroeconomic parameters.

The parameters object of study was:

- Total amount of foreign-owned firms in Member States.
- Ratio of FDI (foreign direct investment) compared to GDP of Member State
- Profitability gap between foreign and direct companies in Member State.

A key point is important to underline; the shell companies can be legal unless the case they are associated with anonymity, circumvention of Posting of Workers Directive or treaty abuse.

These conditions provide the basis to conduct a behaviour of aggressive tax planning, tax evasion, abuse of social rights, distorting the Common Internal Market of EU.

The research made after a review of the literature by the study indicated that high number of shell companies in a country is correlated with several other characteristics such as number of foreign-owned companies which are more profitable than local counterparts, high ratio of FDI compared to GDP, low corporate tax burden or the absence or low of withholding tax rates for passive incomes as royalties, interests and dividends.

The indicators described are not the providers of definitive evidence or existence or numbers or impact of shell companies in EU.

Determining the number of foreign-controlled companies is not an easy task, as described in the study done by London School of Economics: “collecting this data proved extremely challenging, as the information that the national registries keep is partial, and the commercial databases were inconsistent and scarce”.[88]

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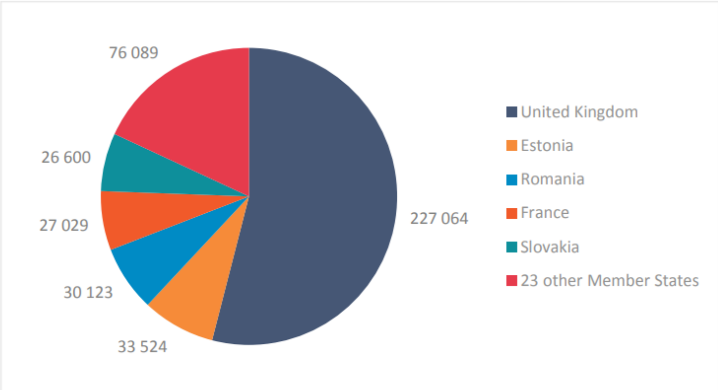
[87] Directive 96/71/EC, 16th December 1996, *concerning the posting of workers in the framework of the provision of services*, Official Journal of the European Union

[88] LONDON SCHOOL OF ECONOMICS (LSE), 2016, *Study on the Law Applicable to Companies, prepared for the European Commission*, p.33

The study encountered many difficulties in collecting data on the number of companies that are present in Member State other than the one in which they have been incorporated or have real seat. In this graph there is an estimation of the presence of shell companies in EU's territory.



Source: London School of Economics, 2016, Study on the Law Applicable to Companies, Table 3, p. 43: Top target countries of businesses incorporated in other Member States, estimates of LSE authors, based on data from Bureau van Dijk Orbis.

UK was the leader in the total amount of shell companies followed by Estonia, Romania, France and Slovakia. The reason of these numbers derived from the favourable corporate tax burden and labour laws. Note that this is only an estimate and not the real data of shell companies.

The second parameter was the foreign direct investment (FDI) as a share of GDP.

Foreign direct investment is defined as "cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor".[89]

The reason behind it, is that, if the direct investor builds a long-term relationship with the direct investment, he/she wants to ensure significant influence in the management of the enterprise.

This action is highlighted in the situation where direct investor owns at least 10% of voting rights and the benefits of this is the direct access to an economy which present favourable conditions in tax field.

FDI does not provide only negative effects due to the fact it represents also an important vehicle for the development of countries, (think about developing countries), helping to improve competition of the host and the domestic country's economy.[90]

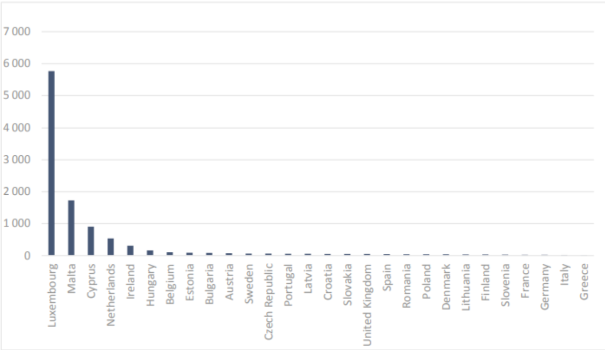
The FDI could be of two types:

[89] KIENĎL K. I., THIRION E., 2018, *An overview of shell companies in the European Union*, published by European Parliament Research Service, p.15

[90] OECD, 2008, *Benchmark Definition of Foreign Direct Investment*, Fourth edition, OECD Publishing, Paris, p.14

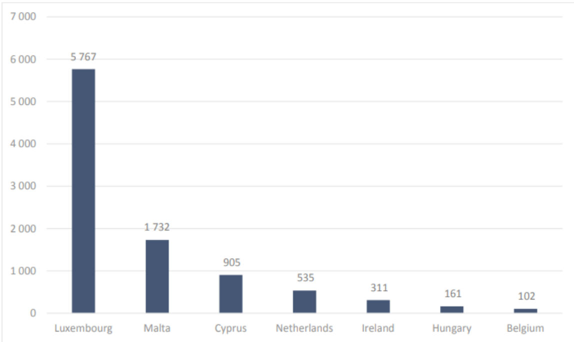
- Inward foreign direct investment is the investment by foreign people in businesses inside the territory in Member State;
- Outward foreign direct investment is investment made by residents of a Member State outside the domestic territory in business abroad.

Figure 3 – Inward FDI stock as a percentage of GDP (2015)



Source: 2017 IHS Report on Aggressive tax planning indicators

Figure 4 – Inward FDI stock as a percentage of GDP (2015) for Member States with inward FDI exceeding GDP

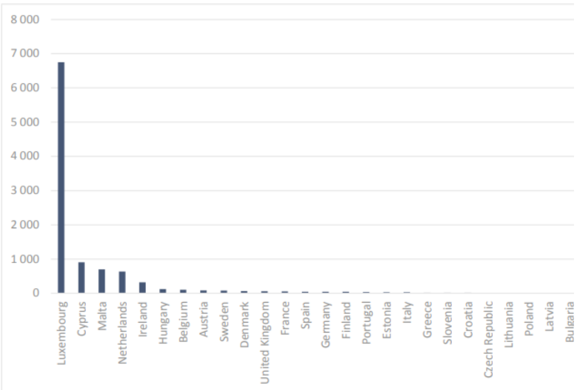


Source: 2017 IHS Report on Aggressive tax planning indicators.

These graphs demonstrated the importance of studying the current threats inside EU, because the inward FDI highlighted the danger provided by Malta (17 times its GDP), Cyprus (9 times its GDP), Netherlands (5 times its GDP) and Ireland (3 times its GDP). It was explained the scenario before introduction of ATAD, confirming the need to intervene in cross-border profit shifting, taking into account the free movement of capital among Member States.

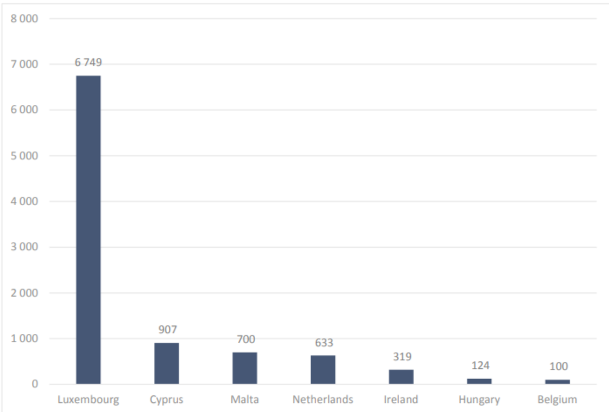
The same phenomenon is presented also for what concerns the outward FDI.

Figure 6 – Outward FDI stock as a percentage of GDP (2015)



Source: 2017 IHS Report on Aggressive tax planning indicators.

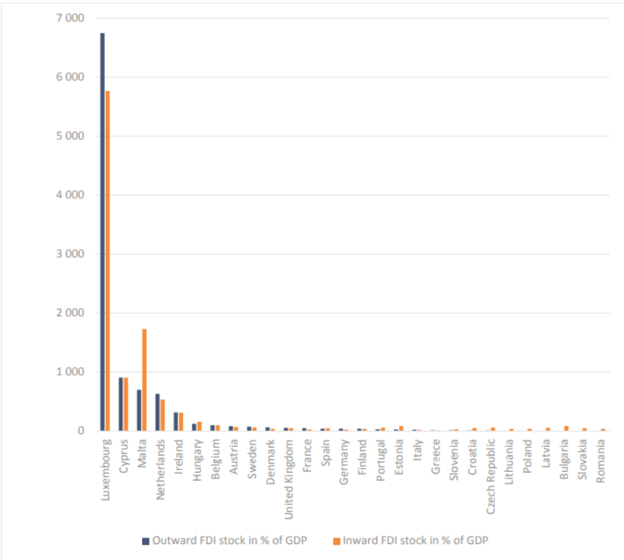
Figure 7 – Outward FDI stock as a percentage of GDP (2015) for Member States with outward FDI exceeding GDP



Source: IHS, 2017, Report on Aggressive tax planning indicators

The scenario demonstrated by these graphs is the same for the inward FDI. The combined inward and outward FDI for the countries stands out that Malta, Cyprus, Luxembourg, Netherlands and Ireland are country who contribute to increase the aggressive tax planning. “The very high level of both inward and outward FDI stocks are a clear indication of the attractiveness of Cyprus, Luxembourg, Malta and the Netherlands for holding companies, which themselves are foreign owned".[91]

Figure 8 – Foreign direct investment positions as a percentage of GDP (2015)

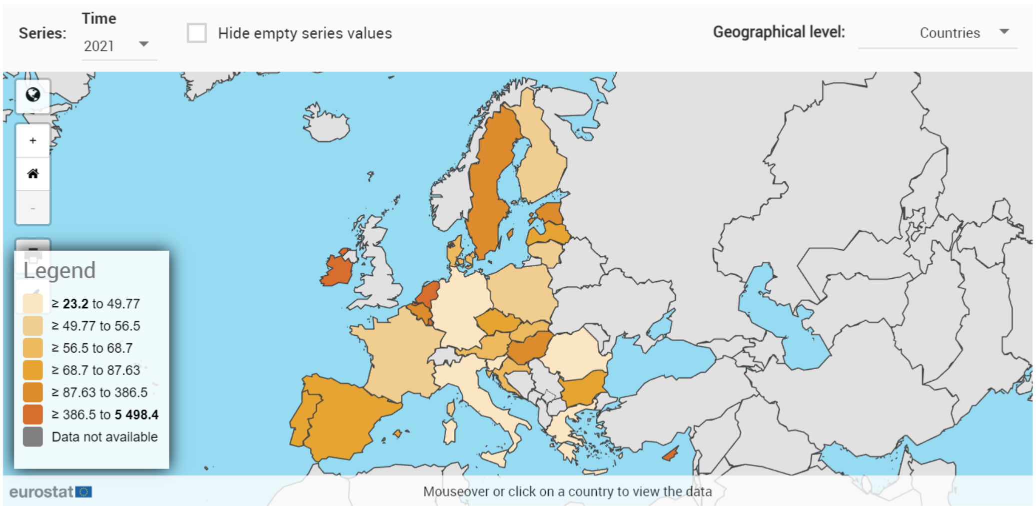


Source: 2017 IHS Report on Aggressive tax planning indicators.

The study demonstrated also gives us another important answer: the big amount of FDI is held by SPE and these entities are focused on moving financial flows, rather to provide benefits for implementing a real economic activity. So, they favour aggressive tax planning.

This means it did not contribute to economic growth of that country but it is only a channel used to move funds in a country with low tax burden, leading to overstatement of FDI. The investment does not have impact in technology growth, or creation of new jobs positions or to provide new solutions able to increase the welfare in that country.

A first outcome is that the EU must be able to classify which FDI are genuine for Common Internal Market and which are only provided for private interests in decreasing total tax burden.



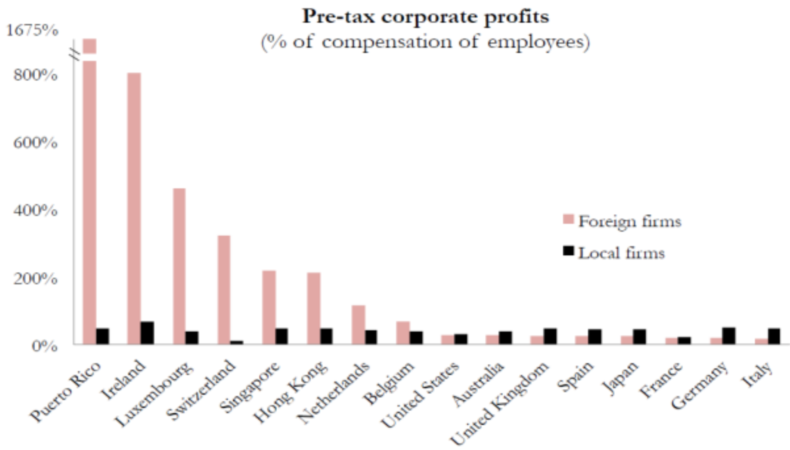
Source: Eurostat, 2021, map of FDI in % of GDP.

[91] IHS, 2017, *Aggressive tax planning indicators, prepared for the European Commission, DG TAXUD Taxation papers*, Working paper n. 71, pp. 68-69

The map highlights this phenomenon is still present comparing 2015 with 2021, especially in Luxembourg, Ireland, Cyprus which are the States consider internal tax havens by Polish Economic Institute.

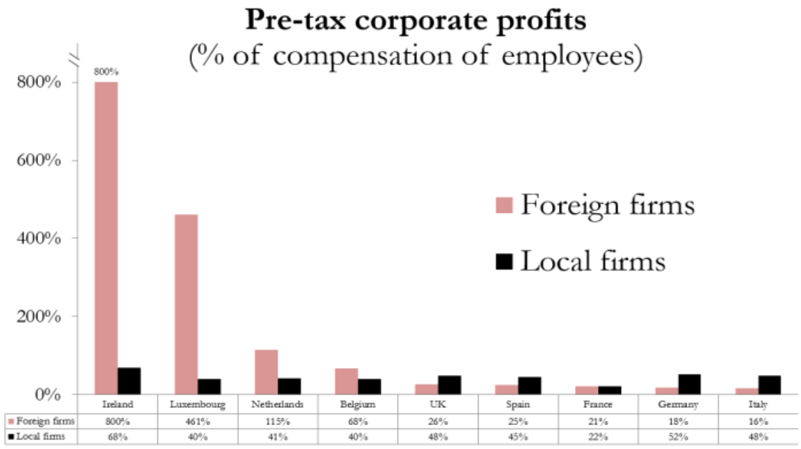
A recent IMF report on Luxembourg described that: “the large increase in FDI by special purpose vehicles in Luxembourg in recent years suggests that incentives to locate multinational assets in the country have been very strong”.[92]

Third indicator to evaluate presence of shell companies or not was, to analyse the profitability gap between foreign and domestic companies inside the territory of Member States.



Source: Tørsløv, Wier and Zucman, 2018.

The result was that some countries have high profitability in foreign-controlled sector than local sector. The sources of this difference in profitability gap were a combination of multinationals intangible assets in low-tax affiliates and transfer pricing game. There was a clear movement of profits outside countries with high-tax jurisdiction for Luxembourg, Ireland and Netherlands.[93]



Source: Tørsløv, Wier and Zucman, 2018.

[92] IMF, 2018, *Staff Country Reports – Luxembourg*, p. 17

[93] TØRSLØV T., WIER L., ZUCMAN G., 2018, *The Missing Profits of Nations*, NBER Working Paper No. 24701

2.5.1 Risks associated by the use of shell companies

Shell companies are dangerous and legal. An example to use correctly the shell companies happens in the case of holding personal or family assets to facilitate inheritance. They could protect land or property from high price increases by the owner for example.

On the other side, the shell companies are a vehicle for tax avoidance, evasion and money laundering. As explained before, the treaty shopping and transfer pricing are the instruments exploited to decrease tax burden. This determines economic and social effects.

The first threat is represented by the anonymity which makes shell companies very dangerous. It provides the control of a company without taking the responsibility directly. The purpose is hiding the identity of true owner, the person who really controls or profits. These people are the beneficial owner.

The concept of beneficial owner was defined by EU in the Directive 2015/849. It described him/her as the natural person who "ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted and includes at least".[94]

In the case of firms, the beneficial owner[95] is defined as:

i. The last person or persons who own a legal entity through direct or indirect ownership due to the minimal ownership of the shares or voting rights or interest in that entity, including through bearer shareholdings, or through control via other means. It is referred to entities other different from a company listed on a regulated market which of course must provide disclosure requirements consistent with Union law or it must respect international standards which ensure the transparency of information referred to ownership.

Direct ownership happens in the case the shareholder has 25% plus one share or ownership interest for a quote more than 25% in the customer held by natural person.

Indirect ownership happens in the case shareholder has 25% plus one share or ownership interest for the 25% in the customer held by corporate entity, which has the control of multiple firms, which are under the control of the same person.

ii. if, after the satisfaction of all possible means and seeing there are no reasons for any suspicion, no person under point (i) is identified, or if arises some doubt that identified persons are the real beneficial owners, the natural person or persons who cover senior managing official's place, the obliged entities shall keep records of the actions taken

[94] Directive 2015/849, 20th May 2015, *of the European Parliament preventing the use of financial system aimed to launder money or terrorist financing*, Official Journal of the European Union

[95] Ibidem

able to support the identification of the beneficial owner under definition developed in point (i)

Based on the study by Sharman in 2010, the anonymous was critical in providing illegal businesses with shell companies, considering for example the movement of intangible assets. Sharman processed the transaction which became untraceable, very useful to hide criminal profits or escape from tax obligations.[96]

Other risk associated is the treaty abuse as explained. So, for this EU decided to point it out due to the necessity to regulate it.

Summarizing it the use of shell companies with instrument present in the market, amplifies tax evasion and tax avoidance. This table demonstrated different impacts for identified risks.

	Economic impacts	Political and social impacts
Risks relating to money laundering[64]	Loss of tax revenue Productivity loss Unfair competition	Development of criminal activities Undermining of political stability
Risks related to tax evasion and tax avoidance[65]	Loss of tax revenues	Threat to social contract
Risks related to corruption[66]	Negative effect on GDP Lower economic output and growth	Decreased trust in institutions Rise in inequality Decreased public satisfaction with governments and their life in general Negative effect on the smooth functioning of public institutions Diversion of public action from intended purpose
Risks of abuse of labour and social rights	Loss of tax revenues	Rise in inequalities Diminished worker protection

Source: Kiendl Krišto I. and Thirion E., 2018, An overview of shell companies in the European Union

This gives a clear view of the current threat represented by shell companies due to the fact it's difficult to estimate the exact data, the losses comparing GDP and the negative externalities created such as social impact and the overstatement of workers who conduct irregular activities or are not under a contract who protect their rights.

Thus, it determines big threat of Internal Market and for this reason EU works currently in providing new solutions, particularly, for what regards e-commerce business of firms, which are not physically located in EU's territory. In chapter 3, a further description of new solution for shell companies will be dedicated.

Some Member States try to stop this effect, introducing domestic provisions making illegal the shell companies. In April 2018 Latvia introduced it prohibiting at banks, intermediaries and investment management from establishing and maintaining business relationships or executing transactions. EU issued a Parent-Subsidiary Directive indirectly targeting the misuse of shell

[96] SHARMAN J.C., 2010, *'Shopping for Anonymous Shell Companies: An Audit Study of Anonymity and Crime in the International Financial System'*, Journal of Economic Perspectives, Vol. 24, n. 4, pp. 127-140

companies for treaty shopping. The directive said that "Member States shall withdraw the benefit of directive in cases of an arrangement put in place for the main purpose of obtaining a tax advantage".[97]

2.6 The role of tax treaties

Other important point to pay attention in this elaborate is the compatibility of CFC rules explained by ATAD with tax treaties with third countries.

BEPS project in Action 6 have identified "treaty abuse and treaty shopping as one of the most important sources of concerns"[98], providing countermeasures.

Treaty shopping occurs every time two parts engaged a third part in personal business only to exploit the benefits given by the tax treaties between two countries.

"Treaty abuse" is debated in tax communities, defined in OECD MC Commentary as result of the big extension of tax conventions "increases the risk of abuse by facilitating the use of arrangements aimed at securing the benefits of both the tax advantages available under certain domestic laws and the tax reliefs provided in the conventions".[99]

Important was the fact that if the companies take a business, the existence of the substance of this, due to the fact one of the parts could be considered as shell-box only to gain the tax benefits of the relationship.

If the parts made the treaty abuse, treaty benefits negotiated between the parties to a treaty are economically extended to residents of a third jurisdiction in such a way the parties did not intend.

The possible actions made could be transfer pricing strategies, arbitrage transaction or advantages of mismatches between two jurisdictions. It's dangerous due to improper use of tax treaties.[100]

The principle of reciprocity is therefore broken and the balance of concessions the parties make is altered. In this case the income tax base escapes or it is subjected to inadequate taxation in a way the parties wouldn't intend.

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[97] KIENĎL K. I., THIRION E., 2018, *An overview of shell companies in the European Union*, published by European Parliament Research Service

[98] OECD, 2019, *Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping*, OECD Publishing, Paris. Available on: https://doi.org/10.1787/9789264312388-en visited on 19th October 2022

[99] OECD, 2017, *Commentaries on the Articles of the Model Tax Convention, Model Tax convention (Condensed Version)*, OECD Publishing, Paris. Improper use of the Convention, par. 55, (see para. From 1 to 100)

[100] OECD, 2015, *Commentaries on the Articles of the Model Tax Convention*, *Model Tax convention (Condensed Version)*, OECD Publishing, Paris

The jurisdiction of residence of the ultimate income beneficiary has less incentive to join the tax treaty due to the fact that entering in tax treaty with jurisdiction of source, indirectly provide benefits for the residents without need for the jurisdiction of residence to provide reciprocal benefits.

OECD was the first to take action against, providing a minimum level of protection. They introduce a general anti-abuse rule in tax treaties in a way EU law will be compliant, without hampering the freedom of establish new law.

In 2017 the BEPS Project, based on art. 29, established new requirements needed to satisfy for obtaining the tax treaty.[101] They were:

- Scope of the treaties
- Corporate residence test for treaty purposes
- Limitation of benefits
- Treaty abuse
- Treaty entitlement and double exemption

The Commission wants to include the Recommendation on Tax Treaties.

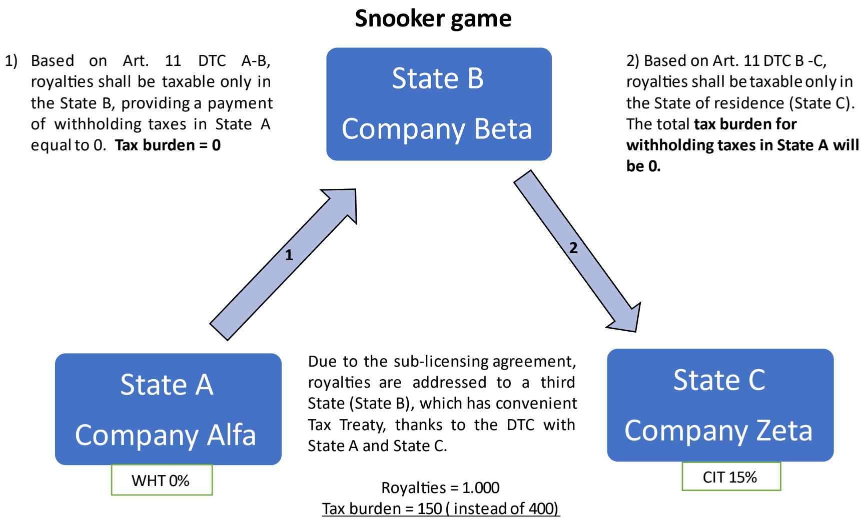
The issue was that over the last decades bilateral tax treaties concluded by nearly have served to prevent harmful double taxation and remove obstacles to cross-border trade in good and service, and movements of capital, technology and persons. This network goes to the treaty-shopping arrangements.

Taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming the treaty benefits in situations where these benefits were not intended to be granted, thereby depriving jurisdictions of tax revenues.

Treaty shopping is defined as the routing of income arising in one country to a person in another country thanks to the role played by an intermediary country, accurately selected to obtain its Tax Treaty benefits otherwise not available. Normally, it includes the "channelling" of income through shell companies in treaty havens.

In this table it's possible to see an example of Treaty Shopping for income provided by royalties, interests and dividends. The companies in this way they play a snooker game.

[101] GARBARINO C., 2020, *The impact of OECD BEPS Project on Tax treaties: access, entitlement and investment protection,* European Business Law Review, Vol. 31, Issue 5, pp. 763-798
The author wants to underline the intervention of OECD in reorganizing the bilateral tax treaties in order to avoid the situation of aggressive tax planning and tax evasion. It adopts the perspective of the country of destination of the investment, providing new limitations to avoid the PE status and access to benefits of bilateral treaties.



Source: own compilation

2.7 Thin capitalisation: Interest Limit Deduction

Other strategy taken by the companies to pay lower tax burden is the phenomenon called thin capitalisation. It is the strategy to increase the level of debt, without needs to finance the activity or for investments taken for company's growth, determining high proportion of debt related total capital. The aim is ensuring a lower amount of income in such a way to decrease the taxable income, because interests on debt represent a deduction from taxable income. It occurs only in the case the level of debt is higher than the level of equity.

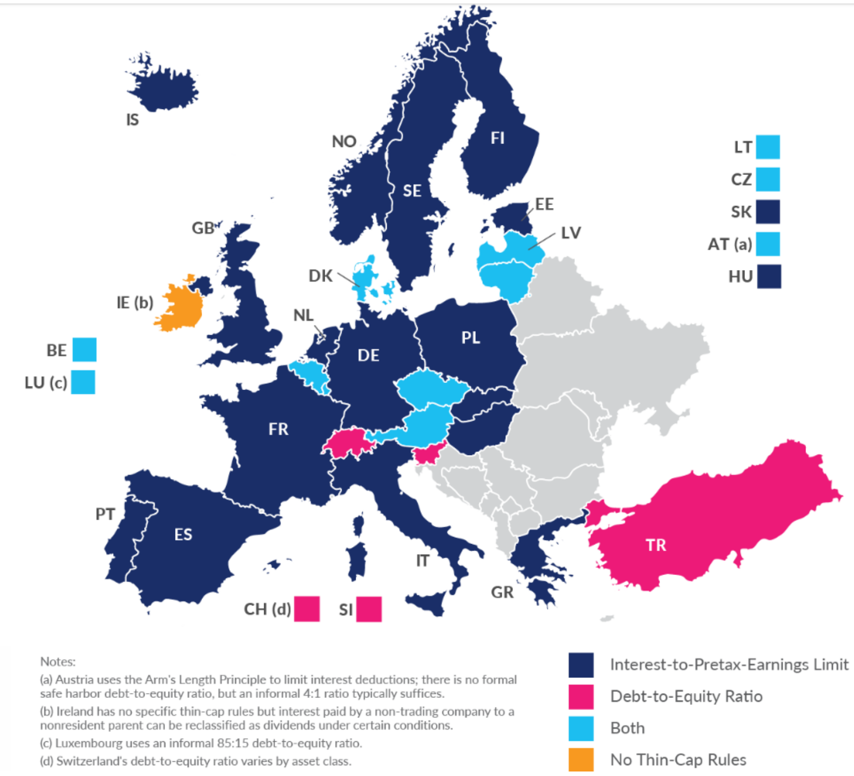
Thin cap is a term derived by the Lankhorst-Hohorst case, where CJEU examined the violation of fundamental freedoms by the German rule about thin capitalization. It was important this decision, determining an important impact with the Union, because for many countries their domestic rules would not pass the EU's legal system, being controversial.

The CJEU's sentence contained a new approach compared to Cadbury Schweppes where was missed economic substance. It refers to art. 9 of OECD MC for categorized it as artificial arrangement.[102]

The artificial arrangement was made due to loans from non-resident firms to resident companies not aligned with the logic of arm's length principle, an objective element able to clarify the presence of artificial arrangement.

[102] Court of Justice European Union, 13th March 2007, C-524/04, *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue*, ECR I-2157, par. 80. "… legislation of a Member State may be justified by the need to combat abusive practices where it provides that interest paid by a resident subsidiary to a non-resident parent company is to be treated as a distribution only if, and in so far as, it exceeds what those companies would have agreed upon on an arm's-length basis, that is to say, the commercial terms which those parties would have accepted if they had not formed part of the same group of companies."

CJEU adopted two criteria to prevent tax avoidance and to determine the right proportion of thin capitalisation rule. The first was the demonstration of economic substance of the action without being subject to undue administrative constraints by taxpayer and the second criteria was the clear advantage taken by violation of arm's length principle in taxation's terms.[103]
High-tax countries of course create incentives for companies to finance investment with debt because the payments of interest are tax deductible, while the cost incurring for equity mainly are not deductible.
Multinational enterprises could take also advantage and make aggressive tax planning lending money internally from the subsidiary entities in low-tax jurisdictions to entities in high-tax jurisdictions. The difference by the two tax systems will be greater than the total tax burden paid in high tax jurisdiction, so it will decrease the worldwide tax liability.



Source: Deloitte, 2021, EU Anti-Tax Avoidance Directive Implementation of interest expense limitation rule

In order to stop these types of firms' actions, many countries try to regulate it with thin capitalisation rules, the term derives due to the fact that when a company has for large part of financing sources debt, the part of equity represents the minority part, determining the thin part of the firm.

[103] Court of Justice European Union, 13th March 2007, C-524/04, *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue*, ECR I-2157, para. 82-83

The two most common types which are used in practice are the "safe harbour rules" and "earnings stripping rules".
Concerning the first it restricts the amount of debt for which interest is deductible to a predefined debt-to-equity ratio. The interests which overcome the set ratio are not deductible; the purpose is to give a maximum amount which could be deductible.
Analysing the map which different colours that identify the different provisions of countries, only three countries have a debt-to-equity ratio.
Most European countries defined a maximum percentage of interests on EBITDA equal to 30%.
For example, if a parent company takes 200 € loan from the subsidiary and the interests' payments are 10 €. If the EBITDA at the end of the year is equal to 20 €, only 6 € of the total 10 € of interests would provide deduction from taxation.
The only EU country which does not provide any thin-cap rule is Ireland, which reconducts to the case of Cadbury-Schweppes.
The effects of this activity clearly provide distortion of internal market in EU due to the fact that consolidated tax base is not right. So, this is the point that ATAD intervenes: there was the need to stop this, because the freedom of capital flows could not be used to damage the market, but to favour the competition.
Also, this benefit would be exploited especially from MNEs, damaging the small activities which live with local people, local business, local territory.
Interesting is the analysis of Member States, in 2021 the States provide different provisions.
The Eastern European countries as Slovenia, Lithuania, Latvia, Denmark, Czech Republic defined a proportion of capital to the debt-to-equity ratio (4:1).
The Western European countries act differently, they provide a threshold in % of EBITDA as Italy, Germany and France.
The last two countries also indicate a quantitative threshold of 3 million of euros, in such a way to protect tax base in case of big loans taken by firms.
ATAD 1 tries to give uniformity among Member States. One core point was the art. 4 interest limitation rule, defining that, the deductibility of exceeding borrowing costs happens only if they are lower than 30 % of taxpayer's EBITDA.[104]
In the Directive it was defined taxpayer as:

a. "an entity which is permitted or required to apply the rules on behalf of a group, as defined according to national tax law". [105]

[104] Directive 2016/1164/EU, 12th July 2016, *laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union, Art. 4, par. 1
[105] Ibidem, Art. 4, par. 1 point a

b. “an entity in a group, as defined according to national tax law, which does not consolidate the results of its members for tax purposes”.[106]

If these circumstances are occurred, the exceeding borrowing costs and the EBITDA could be calculated at the level of group for firms.

EU legal systems provides also in art. 4 par.2 the EBITDA shall be calculated including to the total taxable income the amount of borrowing costs which exceed the border reported in par.1. It specifies also possibility for all taxpayers a derogation to deduct 3.000.000 € of exceeding borrowing costs, considering entire group or to deduct all exceeding borrowing cost in case the taxpayer is a sole entity, indicating an entity which is not a part of a group in financial accounting terms and it does not provide permanent establishment or associated enterprises.

Another issue was from which period starts the consideration of this rule and Directive in par.4 of art. 4 said the exclusion of exceeding borrowing cost for loans issued before 17th June 2016 and for loans of long-term period used to infrastructure projects where “the project operator, borrowing costs, assets and income are all in the Union”.[107]

The last point refers to all projects which are classified as public interest by a Member State.

From par. 5 to par. 8 Directive 2016/1164 gives clear definition of what taxpayer has the right to do in case its exceeding borrowing cost does not correspond in percentage of total exceeding borrowing costs of the group[108], providing the definition of the latter.

Taxpayer could deduct exceeding borrowing costs if they are lower at equivalent ratio of the group or could use same method as consolidated financial statements.

The other option in point b of par. 5 was the deduction of this type of costs referring to consolidated group where taxpayer is considered as a member. It provides two steps:

- “The group ratio is determined by dividing the exceeding borrowing costs of the group vis-à-vis third-parties over the EBITDA of the group”[109]
- “The group ratio is multiplied by the EBITDA of the taxpayer calculated pursuant to paragraph 2”[110]

[106] Directive 2016/1164/EU, 12th July 2016, *laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union, Art. 4, par. 1, point b
[107] Ibidem
[108] Consolidated group: all entities which are fully included in consolidated financial statements drawn up in accordance with the International Financial Reporting Standards or the national financial reporting system of a Member State. See: Directive 2016/1164, 12th July 2016, *laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union, Art. 4, par.8
[109] Directive 2016/1164, 12th July 2016, *laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, Official Journal of the European Union, Art. 4 par.5
[110] Ibidem

Chapter 3: New solutions of EU for the future and the new digital challenges

3.1 Digital world

A new challenge for the future is surely the digital world, due to the fact that companies pay taxes where are located, but with the growth and globalization, they sell everywhere around the world.

The concern raised over last years, due to the weakness presented by existing international tax system, unable to capture the digitalization of economy.

Digitalization was a phenomenon born after the boom of internet and the continuing development of information and technology, considering the new means of communication available over the year.

It represents an opportunity, a possibility to rebuild companies' business plan, and revolutionise the entire markets, defining new challenges and new possibilities, but at the same time it defined the down-grade of some MNEs unable to align their business with customers' needs.

An example, of course, is Nokia which sees its business decreasing after the creation of smartphone, and at the same time this invention determined the rise as leader of this sector for Apple.

The benefits and possibilities given by digitalisation in economic and social terms are in front of all.

A survey conducted by Friedrich-Ebert-Shiftung revealed interesting answers by the public.

The respondents for the majority were open-minded to digitalisation, evaluating it, as a way to increase their benefits, and almost half of the public thought that digitalisation improved their life.

Concerning the income equality, the answer was that digitalisation reduced it, while only for 10% the answer was positive about more income equality. This response was justified by the belief of people to increase controls for digital activities by policymakers.[111]

One point was the possibility for brick-and-mortar companies to move around the profits and intangible assets abroad, encountering the definition of "stateless income".

[111] KIRCHNER S., 2019, *Zeit für ein Update – Was die Menschen in Deutschland über Digitalisierung denken*, published by Friedrich-Ebert-Stiftung, p.2. The author made a survey based on digitalisation change in the customer's life. He evaluated if it was considered an advantage for the citizens under social and economic sides.

It was defined by Kleinbard as income "subject to tax only in a jurisdiction that is not the location of the customers or the factors of production through which the income is derived and is not the domicile of the group's parent company".[112]

The business of these entities involves not only transfer of production, but the transfer of sales due to the possibilities given by e-commerce.

Technological companies live with digital economy thanks to the use of data, online advertising or intellectual property, providing an easier aggressive tax planning.

First consequence was the mismatch created on the place where the value is created and the value where is taxed.

Some argue a new issue which is that businesses implicitly derive income from users abroad in the absence of physical presence and they do not pay any tax in that foreign country.

Therefore, they provide a need to reform the concept of tax burden based on permanent establishment, a point of discussion, for the MNEs who work in this sector as Amazon and Google.

One possible explanation is the core role played by intangible asset now in digital world, compared to the past where tangible assets were the key resources of companies.

Intangible assets are defined as assets without physical or financial presence and they are distinguished in three main sections:

- Software and databases (information)
- Innovation (patents, R&D)
- Competences (human capital, brand, know-how)

These assets bring the economy in a new phase of economy, determining a "silent industrial revolution"[113] because companies increase their amount of intangible assets investment compared to tangible assets investments.

Compared to tangible assets, the intangible assets are the key to make competitive advantage than other firms, due to the ability of firms to create, innovate and maintain inside the firm their advantage.

A limit of intangible assets is the loss of market value in shorter time than tangible assets and it's difficult to indicate exact amount. So, companies which base the business mainly in intangible assets are really complicated in estimating their value and thus creates consequently

[112] KLEINBARD E., 2011, *'Stateless Income'*, Florida Tax Review, Vol. 11, n. 9, pp. 699-771. It was provided the definition of stateless income as special tax attribute to all multinational enterprises.

[113] HASKEL J., WESTLAKE S., 2017, *Capitalism without capital: The rise of the intangible economy.* The authors underline how the digital economy determined a "quiet" revolution, obtained without the use of physical capital.

a difficult in scenario where royalties or know-how are moved from holding companies to controlled foreign entities.

This principle provides an advantage for these firms in corporate tax terms.

To address it, OECD started negotiations with more than 130 countries to adapt international tax system. Based on Action 1 against BEPS[114], OECD suggested a proposal to its Member States.

The proposal is to provide the payment of income tax for multinational enterprises, where the users are located, as written in Pillar 1. The issue was that multinational groups are able to separate the place of income generation (State of Source) from the place of taxation triggering the principle of territorial link.

Innovation, digitalization, globalization and intangible assets determine a way for MNEs to make aggressive tax planning with the actual legal system in EU.

Second possible proposal was a broad withholding tax applicable in market jurisdiction for all goods and services bought online or general withholding tax for all base eroding payments.[115]

For the latter, the solution describes an introduction of WHT tax on each sale made in State of Source. The idea was already included in Pillar One of OECD. With this proposal countries apply WHT tax on gross amount of any sale with a rate of 0.1% or 0.2%.[116]

Countries could find an agreement on one or more de minimis rules, based on the simplicity and proportionality requirements. This solution requires an amendment of tax treaties.[117]

Pillar One	Pillar Two
Early 2022 – Text of a Multilateral Convention (MLC) and Explanatory Statement to implement Amount A of Pillar One	**November 2021** – Model rules to define scope and mechanics for the GloBE rules
Early 2022 – Model rules for domestic legislation necessary for the implementation of Pillar One	**November 2021** – Model treaty provision to give effect to the subject to tax rule
Mid 2022 – High-level signing ceremony for the Multilateral Convention	**Mid 2022** – Multilateral Instrument (MLI) for implementation of the STTR in relevant bilateral treaties
End 2022 –Finalisation of work on Amount B for Pillar One	**End 2022** – Implementation framework to facilitate co-ordinated implementation of the GloBE rules
2023 – Implementation of the Two-Pillar Solution	

Source: OECD.

114 See second Chapter, par. 2.1

115 BRAUNER Y., BAEZ A., 2015, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy*, IBFD, pp. 12-17

116 PINTO N, JOÃO F., PISTONE P. and TURINA A., 2021, *Digital Services Tax: Assessing the Policy Reasons for its Introduction in the European Union: Feedback to the EU Consultation on the Introduction of a Digital Levy*, Journal Articles & Opinion Pieces IBFD, Intl. Tax Stud, Issue 4, pp. 13-14.
The authors describe possible solution to give equality between the business conducted by physical firms compared to digital firms. They provide an estimation of total tax burden based on different type of business and they include solutions for taxation of digital business.

117 Ibidem. In the previous study by the IBFD Task Force, it was included as addition inside Art. 7 of the OECD Model: "*Notwithstanding, profits derived by a company of a Contracting State in the Other Contracting State may be taxed in that State. However, in such case, the tax levied by that State cannot exceed x% of the gross amount of the sales*."

The most common form provided by States, in practice, is digital services tax (DST) which is a tax paid based on gross revenue streams of large digital companies. The expectations are to complete it at the end of 2023.

"On October 2021 Austria, France, Italy, Spain, UK and US laid out a plan to roll back digital service taxes and retaliatory tariff threats once Pillar 1 rules are implemented".[118]

But these are not the all countries which be impacted by OECD agreement, because half European countries announce, proposed, implemented a DST.

And what about actions from EU?

It shared the position of OECD but it has not already provided any common line for what concern digitalization. An urgency which must be covered, due to the fact one of aims of EU is avoid distortion of competition in Internal market, safeguarding its ideals.

From The Irish Times, in 2018, European Commission proposes some criteria[119] to identify which companies are considered with significant digital presence.

The companies targeted of this proposal were:

- Total revenues generated in a fiscal year greater than 7.000.000 million of euros;
- The total users of the digital service were more than 100.000 in a single tax period in one of Member States;
- Total contracts issued to provide digital service between company and user is greater than 3.000 (minimum threshold) in a single tax period.

These were the criteria of the proposal n. 147 of 2018 with the substation of permanent establishment concept with the significant digital present, adapting the parameters at the new economic environment. European Commission wants to measure the "fingerprint of an enterprise" in a determined territory.[120]

Taxation aimed to single sector, especially this sector, makes negative consequence due to the difficult distinction of digitalisation activity and it determines a conflict with international taxation principles if income's taxation unrelates to permanent establishment concept.

So, this remains a proposal due to the fact that ECOFIN was not according to EU commission. ECOFIN suggests the introduction of qualitative parameters to enrich the proposal of European Commission, reached with the proposal n. 148 of 2018 of common tax on digital services whose distribution had location inside EU borders.

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[118] ASEN E., BUNN D., 2021, *What European OECD Countries Are Doing about Digital Services Taxes*, Tax Foundation.
Available on: https://taxfoundation.org/comparing-corporate-tax-systems-europe-2021/, visited on 19th October 2022

[119] SMYTH P., 2018, *European Commission proposes 3% turnover tax for digital companies*, The Irish Times

[120] EUROPEAN COMMISSION, 21st March 2018, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence,* COM (2018) 147 final

It regarded only those revenues which provided clear evidence of the key role played by users and for the situations of dissociation between place of generation and taxation. The categories of revenues targeted from proposal were:

- Advertising activities
- Provision and sale of user data information
- Digital services as brokerage which demonstrate clear interaction between clients and legal entities

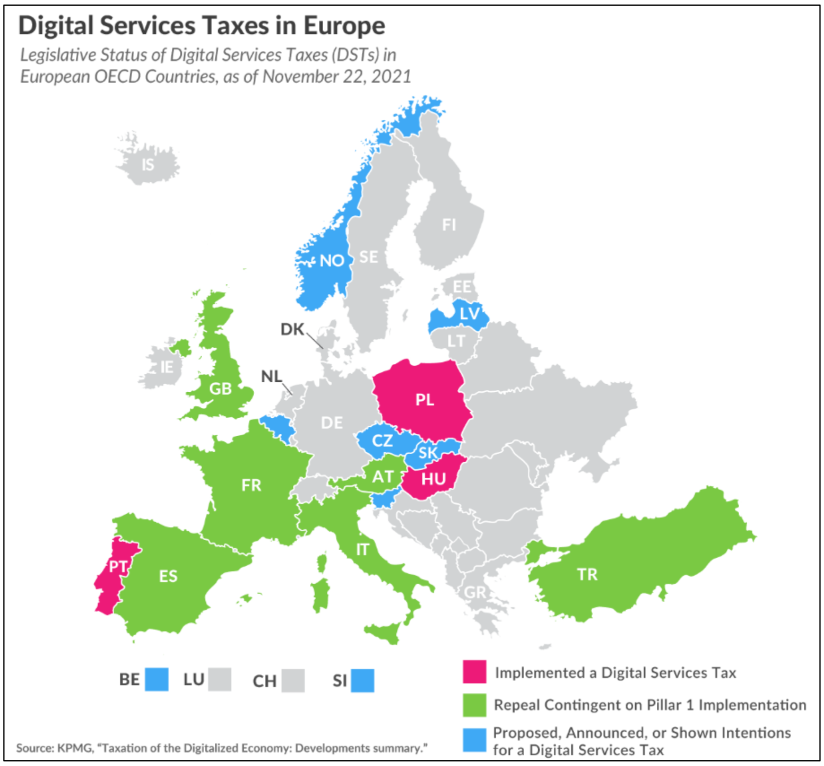
The taxation of digital service at global level defined taxable person only if the latter satisfies these thresholds:

- Global revenues over 750.000.000 euros and
- Inside European Union at least 50.000.000 of euros

The European Commission fix at the 3% turnover taxes on online advertising services, online market and sales revenues based on users' data collection.

This ensures more revenues for EU and based on Irish Times, the total tax revenue from DST was estimated at 5 billion of euros.

The European Commission before the communication stated that "companies engaged in digital activities, like all other companies, must share the tax burden needed to finance the public services on which they rely".[121]



[121] SMYTH P., 2018, *European Commission proposes 3% turnover tax for digital companies,* The Irish Times

Seeing the graph, Austria, France, Hungary, Italy, Poland, Spain, Turkey and UK have implemented a DST. Belgium, Czech Republic and Slovakia published some proposals to enact DST and Latvia, Norway and Slovenia have said some intentions to implement this type of tax. Other important aspect regards which type of digital business covers DST, and here it's evident a big difference among Member States.

For this, they are considered at the moment domestic law due to the lack of uniformity.

From an economic point of view, those "turnover-based, sector-specific taxes" are criticized regarding possible double burdens, investment's impact, innovation and growth.

From a tax view they were defined as potential legal barriers bringing consequences on bilateral tax treaties, EU fundamental freedoms and determine revenues shift from companies.[122]

It was at theoretical level defined as turnover taxes which are prohibited for domestic law considering art. 401 of VAT Directive.

It's not the case due to the fact DST are flat-rate turnover-based taxes and they are not charged as VAT mechanism during each stage of the process.

EU wants to harmonise it, intending to implement its own digital levy from 2023 onwards.[123]

Some doubts emerge from Pillar Two, due to the fact of principle of primacy between domestic provisions and EU's law and secondly for the satisfaction of the requirements of Internal Market.[124]

Think about the exclusivity of competence on providing a minimum tax regime for EU.

It will be sufficient an implementation of domestic provisions by countries, respecting the principle of no-discriminatory.

Observing the following table, it's possible to see inequality of laws implemented by Member States referred to two points: the tax burden in percentage terms and the scope of the digital tax service implemented.

Other difference was referred to the revenue threshold about countries as Belgium and Italy the threshold is 5 million of euros and 5,5 million of euros respectively against France and Austria which provide as minimal threshold 25 million of euros.

[122] KOFLER G., 2021, *Editorial: The Future of Digital Services Taxes,* European Community Tax Review, Vol. 20, Issue 2, p. 51 The author analyses the implementation of DST from Member States, explaining the possible consequences in economic and law point of view.

[123] KPMG, 2021, *"Taxation of the digitalized economy: Developments summary".* Available on: https://tax.kpmg.us/content/dam/tax/en/pdfs/2021/digitalized-economy-taxation-developments-summary.pdf

[124] DOURADO A. P, 2022, *Is There A Need for A Directive on Pillar Two?,* Intertax, Vol. 50, Issue 6/7, pp. 521 – 526. The author explains doubts around the possibility to provide harmonisation with Pillar Two of OECD from EU, analysing the principle of primacy and Art. 115 TFEU (principle of subsidiarity)

Country	Tax Rate	Scope	Global Revenue Threshold	Domestic Revenue Threshold	Status
Austria (AT)	5%	Online advertising	€750 million (US $840 million)	€25 million ($28 million)	**Implemented**
Belgium (BE)	3%	Selling of user data	€750 million ($840 million)	€5 million ($5.6 million)	**Proposed**
Czech Republic (CZ)	5%	· Targeted advertising · Use of multilateral digital interfaces · Provision of user data (additional thresholds apply)	€750 million ($840 million)	CZK 100 million ($4 million)	**Proposed**
France (FR)	3%	Provision of a digital interface Advertising services based on users' data	€750 million ($840 million)	€25 million ($28 million)	**Implemented**
Hungary (HU)	7.5%	Advertising revenue	HUF 100 million ($344,000))	N/A	**Implemented**
Italy (IT)	3%	· Advertising on a digital interface · Multilateral digital interface that allows users to buy/sell goods and services · Transmission of user data generated from using a digital interface	€750 million ($840 million)	€5.5 million ($6 million)	**Implemented**
Latvia (LV)	3%	–	–	–	**Announced/Shows Intentions**
Norway (NO)	–	–	–	–	**Announced/Shows Intentions**
Poland (PL)	1.5%	Audiovisual media service and audiovisual commercial communication	–	–	**Implemented**
Portugal (PT)	4%, 1%	Audiovisual commercial communication on video-sharing platforms (4%), subscriptions for video-on-demand services			**Implemented**
Slovakia (SK)	–	–	–	–	**Proposed**
Slovenia (SI)	–	–	–	–	**Announced/Shows Intentions**
Spain (ES)	3%	· Online advertising services · Sale of online advertising · Sale of user data	€750 million ($840 million)	€3 million ($3 million)	**Implemented**

Source: own compilation of the author based on study of Hak M., Devčič A., Budić H.[125]

In this table it's possible to see the current domestic laws implemented or in phase of proposal by Member States. For the part of EU, it explains that digital economy has brought many benefits to citizens and companies, but it must be regulated with the fair share of taxes and contribute to right functioning of the society.

[125] HAK M., DEVČIĆ A., BUDIĆ H., 2021, *Determinants of Digital Taxation in European Union,* WSEAS Transactions on Business and Economics, Vol. 18, pp. 1322-1327

Other weakness point is the increasing reliance of digital or transnational businesses on intangible assets, such as software and algorithms due to the easy way to move them around the world.[126]

On 21st July 2020 there was another proposal of European Council on digital levy, inviting the EU Commission to follow road tracked by OECD.

On 27th November 2020 the finance ministers adopted some conclusions of which are the main parts to be covered next years with tax policy. It was included the challenge of the digitalisation of economy.

Going to 2021, on 16th March the Council exchanges views on digital taxation. They decided to confirm their support for the ongoing OECD negotiations and also Commission gave support to propose a specific digital levy without prejudicing the corporate tax rules.

On 22nd March 2021 the Council adopted amendments to directive and defined the obligation for digital platform operation to report the total income by sellers on their platforms.[127]

The new rules referred to all the two sides of EU's borders (external and internal) helping taxpayers to pay the right tax burden. Definitive application is forwarded to entry into force from 1st January 2023.

The need of new rules is based on the unfair advantage that MNEs could have with aggressive tax planning. The elimination of communication and economic borders thanks also to digitalization, making easier the process of shifting taxable profits from one country to another compared to the past. The first reason is about the absence of tangible assets such as offices, machines, factories.

Think about the loophole described above, about the principle of taxation based on the physical presence of business. This determines a base erosion profit shifting by multinational enterprises, the little business cannot do that, it does not have necessary resources to sell around the world or to open subsidiaries in countries with low tax jurisdiction.

In Chapter 2 after macroeconomic and microeconomic analysis it was underlined the existence of corporate income tax gap. In the following paragraphs, there will be described two controversial situations happened with two big companies which work with digital business, Google and Amazon.

From the report conducted in December 2019 by Fair Tax Mark, (which studied the amount actually paid by technological companies and the amount required if all tax rates were applicable across all countries they operated), it emerged two outcomes:

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[126] SZCZEPANSKI M., 2021, *Taxing the digital economy, New developments and the way forward*, European Parliamentary Research Service

[127] EUROPEAN COUNCIL, 2022, *Digital Taxation.*
Available on: https://www.consilium.europa.eu/en/policies/digital-taxation/, visited on 19th October 2022

- Transfer of profits from countries to tax havens indicated as Bermuda, Ireland, Luxembourg and Netherlands, so three Member States were indicated as possible destination of these profits
- Amazon paid 12,7% against 35% corporate tax in US in period 2010-19 and Google paid in reality 7,1% of total taxes and fees against what accounted for 15,8%.

From next paragraph it will provide how these companies move around the world their profits due to transfer pricing methods, explaining that CFC for digital MNEs represent a threat for Internal Market.

3.2 Google case

One of the most famous firms around the world was subjected to tax avoidance analysis due to its actions. I'm speaking about Google LLC a company present everywhere with headquarter in Mountain View, California.
Google is famous for its dimensions and well-known online service, web search engine around the world with hundred subsidiaries and thousands of employees.
Observing period from 2010 to 2019 Google provides 647.7 billion of US dollars and net profits for 176.6 billion of US dollars.[128] Concentrating our attention on taxes field, Google provides the payment of tax burden around 27.9 billion, which represents 15,8% of total profits.
The question emerges is: why is it taxed only in its main headquarter?
Google made an aggressive tax planning, leading to tax avoidance with a strategy called "Double Irish Dutch Sandwich". It exploits this strategy, thanks to the gap presented in international tax remaining legal for the text of law, but clear contrary to the spirit.
Double Irish was a basic erosion and profit transfer (BEPS) corporate taxation tool used by MNEs since 1980s to avoid the corporate taxation on non-US-companies.
It functioned with the position of intellectual properties, royalties in a company registered in Ireland, controlled by a tax haven. So, for MNEs the creation of controlled company is a "joke", due to its available resources, and it is really dangerous. It is explained as the firm which has legal residence in one country but its location for tax purpose is in another country[129] as Bermuda Islands.
The choice of Ireland was justified mainly by two important points:

[128] FAIR TAX MARK, 2019, *The Silicon Six and their $100bn global tax gap*.
Available on: https://fairtaxmark.net/wp-content/uploads/2019/12/Silicon-SixReport-5-12-19.pdf, visited on 19th October 2022
[129] STEWART J., 2018, *'MNE tax strategies and Ireland'*, Critical Perspectives on International Business, Vol. 14, Issue 4, p. 347

- Corporate tax rate is equal to 12,5%, including the controlled foreign companies (US corporate tax rate is 35%);
- Ireland's jurisdiction provides possibility of deduction for the investments made in intangible assets as R&D or acquisition of know-how.

This was due to favour transaction between the subsidiary companies (CFC) in Ireland and Netherlands, able to shift the profits to decrease the total tax burden and exploit the low tax jurisdiction.

Therefore, Google plays this strategy well, due to the creation of its presence in three countries, selling the product in EU at 20 € for example, saying that Ireland bought it at 18 € and then Ireland bought it at 15 €. It's clear that flow of profits goes through the channel of tax haven.

The tax haven takes the major of profit from selling price without any operation and the difference between price of acquisition from tax haven and price of sale from Ireland is compensated with staff, advertising or shop expenses.

Ireland favoured it due to its low tax jurisdiction, for this EU opened an investigation of this country. The strategy functions with profits moves through one Irish company, going to the Dutch controlled company and finally come back to second firm located in a tax haven.

The Dutch firm was used, aimed to shift revenue from royalties to Google Ireland Holdings, a controlled company of the headquarter located in Bermuda, favoured also by the absence of withholding taxes in Dutch's jurisdiction on dividends paid by a foreign subsidiary to Dutch parent company. It was possible due to Dutch tax treaties, which provides also no application of withholding taxes for royalties.[130]

The history began in 2003 when Google agreed with an Irish subsidiary called Google Ireland Holdings to transfer part of intangible assets (intellectual properties) and advertising technologies referred to regions in Europe.

The issue was that Google was managed in Bermuda[131], despite the incorporation of the subsidiary in Ireland. Bermuda is one of the tax havens, considering that corporate tax rate was 0% in its domestic territory. This was possible thanks to the payment of royalties at Irish subsidiary from Bermuda, decreasing the overall tax burden.

But Google abused by EU's Directive, which regulated matters on taxation for royalties and cross-border interests in 2003. It described that Member States shall not impose any taxes concerned royalties' payment. As said by Directive 2003/49/EC any withholding taxes on

[130] See Chapter 1, paragraph 1.6 Tax havens

[131] KLEINBARD E., 2011, *'Stateless Income'*, Florida Tax Review, Vol. 11, n. 9, p. 708

royalty payments arising in a Member State, provided that the beneficial owner of the payment is a company or permanent establishment in another Member State. [132]

And this explained decision of Google's strategy to transfer profits to Bermuda and paid royalties to shell companies in Netherlands (Google BV). This payment was not exacerbated by taxes.

In 2014 after European action to ban Double Irish Dutch Sandwich the Irish government eliminated it. Michael Noonan, Irish ministry of Finance, planned on changing tax residency rules to avoid tax planning and tax avoidance schemes giving a time-lapse of 5 years for those companies who did those practices.[133]

The fight against Google was mainly implemented by French tax authority.

Paris Administrative Court found the missing payment around 1.2 billion of US dollars by the parent company of Google, based on the sale from 2005 to 2010 of online advertising to client by search engines. The accusation was referred to parent company and Irish subsidiary.[134]

The CJEU expressed the absence of reason to tax it, referring to the principle of permanent establishment of Google Ireland Limited in France via Google France and under the treaty agreement the taxes shall not be imposed to Irish subsidiary. [135]

To confirm the sentence was also the absence of the necessary means to classify it as permanent economic activity (human resource, machines, technical means). The same response was confirmed by Paris Administrative Court in April 2019. Google case highlights how principle of permanent establishment in this case was not the aligned with evolution of income flow of MNEs.

3.3 Amazon case

Digitalisation was a real problem for what concerns the taxation of multination enterprises. The most famous example of this was the case of Amazon in 2017, that was evaluated by European Commission, including with Google as one of six members of Silicon Valley.

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[132] Directive 2003/49/EC, 3rd June 2003, *on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States,* Official Journal of the European Union, Art. 1, par. 1

[133] THE IRISH TIMES, 2014, *"Full text: Michael Noonan's Budget 2015 speech".*
Available on: https://www.irishtimes.com/business/economy/full-text-michael-noonan-s-budget-2015-speech-1.1962981, accessed on 19th October 2022

[134] RUSHE D., 2017, *"Google ducks $1.27bn bill for back taxes in France"*, The Guardian.
Available on: https://www.theguardian.com/technology/2017/jul/12/google-taxes-france-ruling, accessed on 19th October 2022

[135] Court of Justice European Union, 24th September 2019, C507/17, *Google LLC, successor in law to Google Inc. v Commission nationale de l'informatique et des libertés,* CNIL, ECLI:EU:C:2019:772

Amazon is one of the most famous companies who benefits from the growth of Internet. Its main activity, focuses on providing everything in its site and delivering it as soon as possible, transformed its owner and creator Jeff Bezos as one of the richest men around the world.
So, clearly Amazon changed completely competition in any part of the world, due to its ability to offer goods and services at convenient price and also offer a fast and easy service for all lazy users.
On negative side, it was one of the companies which escape from paying taxes in location of its users. After an analysis of business affairs around European's territory, EU ordered at Amazon to pay 250 million of euros at Luxembourg aimed to reimburse this country from fiscal benefits receives after tax agreement established in 2003, now contrary on EU Directives.
The total amount of taxes not paid was around 3/4 of total amount, so a lot of money!
The investigation was conducted from 2014 until 2017 and as explained by Commissioner Margrethe Vestager it provided a benefit for this MNE due to aggressive tax planning.
Brussels evaluated it saying there was no further reason to justify it.
This agreement defined possibility for Amazon to move major part of profits from Amazon EU (firm subjected to Luxembourg's taxation) to Amazon Europe Holding Technologies which was a firm not subjected to any taxation from Luxembourg's authority.[136]
Royalties' movement determined it, reducing a lot taxable income and for Commission, it provides only a strategy to reduce total tax burden, without true economic interest in promoting activity.
Amazon from its part said it was all regular what it did, paying in conformity the taxes at Luxembourg authority.
Observing the implementation of ATAD by Luxembourg it emerged some doubts about whether the way Luxembourg issued CFC rules in meaningful impact. This country tries to clarify due to CFC Circular, but also other doubts arise from GAAR, especially for what concerns no tax related reasons considered as sufficient in substance terms to be classified as no secondary, determining also the absence of law's abuse for tax purposes.[137]
The dispute between the company and EU Commission ended in 2021 with the Amazon winner.
So, for this there was the need to regulate digital world, because current legislation didn't stop the multinational big firms in finding new ways to make aggressive tax planning.

[136] QUIFINANZA, 2017, *Amazon, 250 milioni di euro di stangata per evasione fiscale*. Available on: https://quifinanza.it/soldi/amazon-in-arrivo-maxi-stangata-ue-per-evasione-fiscale/144864/, visited on 19th October 2022
[137] PANTAZATOU K., 2022, *Critical Review of the ATAD implementation: The implementation of the ATAD in Luxembourg*, Intertax, Vol. 50, Issue 1, p. 65

The CJEU said there was not enough evidence to prove it in paying less taxes, especially to move profits of royalties among the two firms.[138]

"The Commission did not prove to the requisite legal standard that there was an undue reduction of the tax burden of a European subsidiary of the Amazon group"[139], the judge said on 12th May 2021.

Amazon said it had "longstanding position that we followed all applicable laws and that Amazon received no special treatment".[140]

From what regards experts, Chiara Putaturo described as a blow what happened and she said that case-by-case investigations didn't solve the issue, expressing the risk pandemic brought society into poverty, while profiteers of pandemic as Amazon continued to increase wealth without paying the right tax burden.

The Guardian also said that in 2020, despite record of sales around 44 billion of euros, Amazon didn't pay any corporation tax in Luxembourg.

Paul Monaghan spent good words for what did European Commission, saying that: "European Commission is to be applauded for pursuing Luxembourg and Amazon for what is to most people's eyes the enablement of rampant tax dodging – not least the establishment of a shell company to mop up profits that has no staff or offices and which is somehow not subject to corporation tax".[141]

So, digitalization combined shell companies to make tax avoidance in 2021 was possible. It will be nice and interesting at the same time, to study what will happen after the implementation of ATAD 3 a digitalization rule. So, 2023 will be seen "as breakthrough point" about aggressive tax planning, the future will answer us.

3.4 Results of Amazon and Google

Some studies were conducted about the case of Amazon and Google, to see in reality if they did aggressive tax planning or not and at the same time tax evasion.

[138] CVRIA, 12th May 2021, *Sentenza nelle cause T-816/17 Lussemburgo/Commissione e T-318/18 Amazon EU Sàrl e Amazon.com, Inc./Commissione*, Comunicato Stampa n. 79/21, Tribunale dell'Unione Europea

[139] NEATE R., 2021, *Amazon wins appeal over €250m EU tax bill*, The Guardian.
Available on: https://www.theguardian.com/technology/2021/may/12/amazon-wins-appeal-over-250m-eu-tax-bill, visited on 19th October 2022

[140] NEATE R., 2021, *Amazon wins appeal over €250m EU tax bill*, The Guardian.
Available on: https://www.theguardian.com/technology/2021/may/12/amazon-wins-appeal-over-250m-eu-tax-bill, visited on 19th October 2022

[141] Ibidem

Based on Hines[142], MNEs reallocate two percent of total profits from high-tax jurisdiction to low tax jurisdiction while by UNCTAD[143] this action was bigger, near to 30% of cross-border investment in “conduit countries”. Important is that this trend was reduced after ATAD’s implementation.

The study conducted by Michal Friedrich and Jana Tepperova in 2020, analysed five multinational enterprise which are active in the digital market, which are present in Europe.

Data acquisition and elimination process	Amazon	Apple	Avast	Google	Uber
Initial sample before elimination	114	29	15	61	36
Eliminated from sample	76	11	9	40	15
- Members with incomplete financial data	*54*	*8*	*8*	*16*	*11*
- Members of different branches	*14*	*1*	*0*	*3*	*0*
- Members below materiality threshold	*7*	*2*	*0*	*21*	*4*
- Members with anomalous tax rate	*1*	*0*	*1*	*0*	*0*
Final sample after elimination	38	18	6	21	21

Source*: Friedrich M., Tepperova J., data from Amadeus database (by Bureau van Dijk)*

In this study was excluded the missing data on profit and loss before tax, tax paid burden and P/L after taxes for two or more FYs. The data was on average between FYs.

It was included only the controlling entities controlled by the MNE inside the EU’s territory for Amazon and Google.

Final sample of selected MNEs	Amazon	Apple	Avast	Google	Uber
Local controlling entity	Amazon Europe Core Sarl	n.a.	AVAST PLC	n.a.	Uber International B.V.
Global controlling entity	Amazon.com Int'l Sales, Inc.	APPLE INC.	n.a.	Google LLC.	UBER INTERNATIONAL C.V.
Members	38	18	6	21	21
Countries	CZ, DE, FR, GB, IE, IT, LU, PL, SK	BE, DE, DK, ES, FI, GB, IT, NL, PL, PT, RU, SE	CZ, GB, RS	AT, BE, CZ, DK, ES, FR, GB, IE, NL, PL, RU, SE, UA	BE, CZ, DK, ES, FI, FR, GB, HR, IE, IT, NL, NO, PL, PT, RO, RU, SE, UA

Source: *Friedrich M., Tepperova J.,* data from Amadeus database (by Bureau van Dijk)

To evaluate profit shifting between the companies the authors chose the Transactional Net Margin Method, a method applicable only for publicly data.

[142] HINES J. R., 2014, *"How Serious a Problem is Base Erosion and Profit Shifting?"*, Canadian Tax Journal, Vol. 62, n. 2, pp. 443-453

[143] UNCTAD, 2015, *World Investment Report 2015: Reforming International Investment Governance*, UNCTAD, Geneva

Considering the EBIT, as variable to evaluate aggressive tax planning or not with the transfer pricing the final outcome was the following:

	Amazon	**Google**
Czech member	Amazon Logistic Prague s.r.o	Google Czech Republic s.r.o
Suspicion about profit shifiting	Yes	No
TNMM benchmark		
EBIT margin of Czech member	2,82%	7,91%
Interquartile range	3,44-4,85%	3,80%-12,21%
Final assessment		
Profit shifting tendency – global	**High**	**High**

Source: own compilation based on Friedrich M., Tepperova J. analysis

Based on the outcome. Amazon confirmed the suspicion of shifting profits. If we see the arm's length, we can denote that EBIT outcome must fall inside range 3,44%-4,85% for arm's length principle while for Google falls inside interquartile range for what regards EBIT in the Czech Republic. So, the base of arm's length principle to move profits was respected, despite the authors maintain high the tendency to move profits in other firms.

Finally, authors said that the possibility to make aggressive tax planning by the two firms with shell companies and exploiting the digitalisation world is maintained.

3.5 New BEPS and OECD solutions

The rapid expansion of digital transformation impacted in economy and in the current society, determining a global debate in legal and regulatory realms, including international taxation.

Main point of discussion was if the principles established for brick-and-mortar firm could be right also for firms work completely online as the pure and click.

The previous purpose was based on physical presence of the firm and what portion of profits should be taxed based on its location. This facilitated the MNEs who work in digital world as describe above.

The OECD's Inclusive Framework about countermeasures evolved to fight base erosion profits shifting. It was provided a two-pillar approach to fight tax avoidance, ensure coherence and uniformity of international tax rules and more transparent environment.

For this after the BEPS 2015 and the digital tax, the OECD provides a new version of BEPS called BEPS 2.0. It describes the new actions in two main pillars.

Pillar one refers to reallocation of taxation rights demonstrated the presence of many issues to solve in order to decrease tax avoidance and tax evasion. The aim was ensuring the right distribution of profits and taxing right, especially for MNEs, including companies that work with digital.

The principle of taxation was reassigned based on business activities and location where profits are made, regardless the physical presence or not of firms.

OECD is moving urgency to project in order to complete it in mid-2023. The last consultation was on 12th September 2022, after the progress report on 11th July 2022, with comment made on 19th August 2022. The public meeting defined insights from the OECD and the Task Force on the Digital Economy.

The marketing and distribution profit safe harbour remains one of the most controversial areas. The two main topics were the misalignment with the operational execution and the factoring of withholding taxes is critical divisive issue.

The second theme was mainly discussed because by one side business stakeholder support for including withholding taxes in calculation for domestic business exemption, while by other side the Trade Union Advisory suggested that including withholding taxes would be a deal breaker and spur the uncoordinated implementation of unilateral measures.

In Pillar Two Global Anti-Base Erosion proposal for what regards European Union, the European Commission decided not to undertake a public consultation. OECD wanted to establish a global minimum corporate tax rate around the 15% able to generate 150 billion USD more than the past, due to increase of stabilisation of tax system and tax certainty.

Mathias Cormann, OECD Secretary-General ensured it saying that: "after years of intense work and negotiations, this historic package will ensure that large multinational companies pay their fair share of tax everywhere".[144]

3.6 ATAD 3

Aimed to fight the challenge launched by the inappropriate use of shell companies and to regulated firms inside digital economy, the EU Tax Policy Agenda of 2021 established it as the objective of the next years. On 22nd December 2021, the European Commission made available a proposal of Directive.

The main content was to increase scrutiny of shell companies within the EU to prevent the usage of them to make tax evasion and avoidance. An important point is the presence of

[144] OECD, 2021, *130 countries and jurisdictions join bold new framework for international tax reform*. Available on: https://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.html, consulted on 19th October 2022

unanimous vote by all EU Member States and the target in timeline is to make the transposition into law for Member States by 30th June 2023.

This Directive wants to enhance the results produced by ATAD 1 and ATAD 2.

The approach was composed by three main steps:[145]

1. Which undertakings qualify as "reporting undertakings"?
2. Reporting on the substance
3. Tax consequences for those entities who lack sufficient amount of substance and automatic exchange of information

The purpose of creating ATAD 3 is referred for all considered tax resident and are eligible to receive the certificate of EU's resident in one of the Member States.

The exceptions from ATAD 3 are:

- holding activities that are resident for tax purposes in same Member State as the shareholder(s) of the ultimate parent entity
- holding activities in operational businesses in the same Member State where the beneficial owner is resident for tax purposes
- regulated financial undertakings
- Listed companies

The categories of income which are relevant in the future Directive will be:

a) All the incomes generated from financial assets
b) Incomes derived by intellectual or intangible property (royalties)
c) Dividends and income derived from property of shares
d) Income from financial leasing
e) Income from the immovable property
f) Income from movable property held for private purposes and with a book value
g) Income derived by insurance banking
h) Income from service outsourced by undertaking to other associated enterprises.

It's important the description of income categories, because if more than 75% of the revenues is provided by these categories it would be part of the shell companies, object of ATAD 3.

Other requisite is the cross-border activity which defined that more than 60% of the book value of assets mentioned and the relevant income is established outside the Member State of the undertaking for the two previous years, or at least 60% of relevant income is earned or paid by cross-border transactions.

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145 BOSCO L., CARRARA C., COLACI P., 2022, *ATAD 3-La proposta di direttiva UE contro l'abuso delle c.d. Shell Companies*, Deloitte

Then, important point is the location of daily operations and decision making on significant functions outsourced in the precedent two tax years.
The ATAD, however, leaves the possibility at firms to demonstrate the genuine business activity without creating tax benefits for itself or for the group it belongs to.
It must produce sufficient information to provide the burden of tax liabilities with and without its position. For the firms which satisfy all the conditions, they must report information in its annual tax return on whether it meets the minimum substance requirement. It needs to be accomplished with documentary evidence supplied with tax return.
In case of fail, the penalty includes at least 5% of undertaking's turnover in relevant tax year.
The necessary documentation must include:

- Address and type of premises
- The gross revenue and business expenses
- Type of business activities performed to generate relevant income
- Number of employees and the number of directors with qualifications, place of residence for taxation issues and the amount of time worked by employees.
- Bank account
- Outsourced business activities

In case all documentation is provided and it satisfies requirements, the company is not identified as shell, while if not it is considered as shell company only for Directive.
To counteract versus decision of Directive, the firm could provide additional evidence of business activities which perform to generate relevant income:

- reasons behind the undertaking
- information about employees, including responsibilities, tasks, role and position
- concrete evidence that decision making is inside Member State of the undertaking

Deloitte in its report provides a first framework about the possible consequences in case the firm is classified as shell company. The table provides a summary of it.

Member State of residence of the undertaking	Member State of residence of the undertaking's shareholder(s)	Member State where immovable property owned by the undertaking is located	Member State other than the Member State of residence of the undertaking
• **Deny** request by the undertaking for a **certificate of residence** for use outside the jurisdiction of the Member State; or • Grant a certificate of residence which specifies **that the undertaking is not entitled to the benefits** of agreements or conventions that provide for elimination of double taxation of income or capital and of the Parent-Subsidiary Directive and the Interest and Royalties Directive. • The undertaking remains taxable as a resident in its Member State. • If the undertaking's shareholder(s) are not resident(s) for tax purposes in an EU Member State, the Member State will apply **withholding tax in accordance with its domestic law**, without prejudice to any agreement or convention in force between the Member State and the third country jurisdiction.	• Tax **the relevant income of the undertaking** in accordance with its national laws as if it had directly accrued to the shareholder(s) and deduct any tax paid on such income in the Member State of the undertaking. • If the payer is not a resident in a Member State, the Member State would **tax the relevant income in accordance with its domestic law** without prejudice to any agreement or convention in force between the Member State and the third country jurisdiction. • The Member State of the undertaking's shareholder(s) would **tax a property located elsewhere** in accordance with their domestic law without prejudice to any agreement or convention in force between the Member State and the country where the property is	• Tax the property according to its domestic law **as if such property was owned directly by the undertaking's shareholder(s)** without prejudice to any agreement or convention in force between the Member State and the country of residence of the shareholder(s).	• **Disregard any agreement** or convention that provide for the elimination of double taxation of income or capital in force with the Member State of the undertaking as well as the **Parent-Subsidiary** and **Interest and Royalties Directives** (to the extent that those Directives apply owing to the undertaking being resident for tax purposes in a Member State).

Source: BOSCO L., CARRARA C., COLACI P., 2022, ATAD 3-La proposta di direttiva UE contro l'abuso delle c.d. Shell Companies, Deloitte

Last bullet point of ATAD 3 is the exchange of information; DAC is established aimed to guarantee full access at the information of EU shells for Member States at any time and without a specific need to request it. The automatic exchange of information happens if the undertaking is defined risky for Directive's purposes and if the tax administration of a Member State makes an assessment based on facts and circumstances of individual cases and decides to certify that a certain undertaking has rebutted the presumption of being a shell should be exempt from obligations under the Directive.

Here there is the summary about the evolution of Directive and which areas are covered on providing the information at Member States.

Directive on Administrative Cooperation – DAC						
DAC1 **2011/16/EU** **NON AEOI**	**DAC1** **2011/16/EU** **AEOI ITEMS**	**DAC2** **2014/107/EU** **AEOI ITEMS**	**DAC3** **2015/2376/EU** **AEOI ITEMS**	**DAC4** **2016/881/EU:** **AEOI ITEMS**	**DAC5** **2016/2258/EU** **NON AEOI**	**DAC6** **2018/822/EU** **AEOI ITEMS**
Applies:1/2013 All exchanges of info except Art. 8 ***Exchanges on request** ***Spontaneous exchanges** ***Presence in adm. offices** ***Simultaneous controls** ***Request for notification** ***Sharing best practices** ***Use of standard forms**	Applies:1/2015 1st exchanges on 2014 by: 30.6.2015 Art. 8 ***Automatic exchange of information** on **5 non-financial categories:** **Income from employment* **Directors fees* **Pensions* **Life insurance products* **Immovable property (income and ownership)*	Applies:1/2016 1st exchanges on 2016 by: 30.9.2017 Art. 8, para 3a Automatic exchange on **financial account information:** **Interests, dividends or other income generated by financial account* **Gross proceeds from sale or redemption* **account balances*	Applies:1/2017 1st exchanges by 30.9.2017 Art. 8a Automatic exchange of information (using a central directory as from 1.2018) of: ***Advance cross-border rulings** ***Advance pricing arrangements**	Applies:6/2017 1st exchanges on 2016 by: 30.6.2018 Art. 8aa **Automatic exchange of information** on **country-by-country reports** on certain financial information: **Revenues* **Profits* **Taxes paid and accrued* **Accumulated earnings* **Number of employees* **Certain assets*	Applies:1/2018 Art. 22, para 1a **Access by tax authorities to beneficial ownership information** as collected under AML rules	Applies:7/2020 1st exchanges by: 31.8.2020 Art. 8aaa and hallmarks in Annex 4 ***Mandatory disclosure rules** for **intermediaries** and ***Automatic exchange of information** on tax planning **cross-border arrangements**

Source: European Commission, Administrative cooperation in (direct) taxation in the EU

On 12th February 2020, the European Commission proposes at the European Council the codification of Directive 2011/16/EU on administrative cooperation in the field of direct taxation and its amendments.[146]

Member States also could request the Member State of de residence of the person to perform an audit in tax field when and where they have some suspect that the undertaking has not the minimal substance and it's in reality a shell.

An example of the ATAD 3 is the case where source and shell jurisdiction are bound by ATAD 3 while the shareholder lives in a country which is not Member State.

The payer pays a tax according to the treaty between EU and third country or by its domestic law.

The shell entity continues to be considered as resident for tax purposes and it has to respect all the obligations as per national law and it has to be able in demonstrating the evidence of tax applied on the payment reported.

The second possible example is the case that only shell falls in the scope and the source of the jurisdiction is not included ATAD 3. Consider for example that the parent company is located in US, while the CFC is located in Netherlands.

The payer applies national tax on the outbound payment based on what is regulated by treaty with shareholder(s) jurisdiction if it wants to look through the shell entity.

Shell entity is considered resident, so it has to fulfil all obligations per national law, including reporting of the payment received. It has to demonstrate the tax applied to the payment.

For the shareholders it may be asked to provide a treaty in force with jurisdiction of payer for any relief. Summarizing it, the key points of ATAD 3 are first to select which companies are included or excluded from ATAD 3.

The holding, financing and property companies in jurisdictions which do not include local directors miss the requisite of minimum substance and the same happens for the firms which do not present premises for exclusive use.

Also, it's fundamental to include in the report the two previous years (look-back period) and to give at authorities the necessary documentation, the necessary mean in order to occur if everything is fine.

[146] EUROPEAN COMMISSION, 2022, *Administrative cooperation in (direct) taxation in the EU*, Taxation and Customs Union. Available on: https://taxation-customs.ec.europa.eu/taxation-1/tax-co-operation-and-control/general-overview/enhanced-administrative-cooperation-field-direct taxation_en#:~:text=Exchange%20of%20Information%3A%20the%20Directive%20provides%20for%20the,in%20three%20forms%3A%20spontaneous%2C%20automatic%20and%20on%20request, visited on 19th October 2022

The desire of EU is to harmonize the concept of beneficial ownership test within EU and to take in act the principle of place of effective management under OECD definition.

The taxation will be based on gross income flow, considering also the costs sustained and also the % of income derived by the categories of the "relevant income".

The opinions of EESC give support at the Commission for fight the misuse of shell companies for tax purposes. It worries about the fact that ATAD 3 doesn't care really about digitalisation due to the fact that substance requirements are not addressed to digital side.

It highlights the good consistency with previous Anti-Avoidance Measures implemented by EU and with the DAC, complementing at the same the minimal proposal of GAAR for MNEs inside EU provided by OECD.

EESC ensures maximum collaboration for any public consultation by European Commission or national experts, despite it underlines that the interest is minimal; only 50 stakeholders were interested. It supports the action taken by EU due to the fact the aim is to stop cross-border tax avoidance and tax evasion, according to the project of ATAD 3 in terms of minimal protection of Common Market.[147]

EESC says the need to focus not only in the income generated, but look to the assets which do not generate income, defining necessary the establishment of common rules to clarify contents and declarations from entities. It recognizes that more actions should be taken in case of the company of third country trades with company or entity inside a Member State.

In its opinion EESC recommends right guidelines for the substance test, suggesting to maintain compatibility with international provisions.

Particular focus on the comment of EESC was the substantial economic activity considered broadly in harmful tax practices. Also, it says that EU's legal system must counteract the undeclared work to avoid social-security contributors.

Finally, in order to stop aggressive tax planning, it suggests an establishment of transfer pricing directive as the use of shell entities in order to regulate it.

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[147] DUKMEDJIAN R. P., GIRLEANU N., 2022, *European Economic and Social Committee's Opinion on the proposed ATAD 3 Directive*, MNE TAX.
Available on: https://mnetax.com/european-economic-and-social-committees-opinion-on-the-proposed-atad-3-directive-47298, visited on 19th October 2022

Conclusions

The Common Internal Market inside EU is one of the key blocks of this international institution, based on economic-centric view.
It is absolutely sure EU tries to take in practice its ideals during its history as demonstrated by Single European Act, the creation of the four fundamental freedoms and the Union Custom Code.
From an economic perspective it's evident the progress made over the years since the birth of EU, favouring the trade inside Common Internal Market and providing common policy for internal borders and external borders, referring to common duties.
From a juridical perspective, the elaborate evaluates carefully the action of EU aimed to satisfy the goal of uniformity among the 27 different jurisdictions.
The studies of economic experts demonstrate that if tax plays an active role could provide a negative role in distorting competition and determine the loss of the right tax burden to ensure the "social optimal level" of services by jurisdiction.
The elaborate evaluates the current integration developed for the different tax categories, determined by articles 113-114 of TFEU and intervention of CJEU.
For indirect taxes, turnover taxes it was implemented full harmonisation, aimed to give common guideline for all EU's territory. A criticism emerges around the missing common text and application of it, due to the fact, in the market we find different tax burden considering VAT around Member States for example, so also with full harmonisation it fails the principle of uniformity and neutrality of taxation.
The major weakness point of current legislation for sure it's direct taxes, if we consider it is still present only an approximation of laws among Member States, so every country could decide its tax policy for companies' income for instance. At the same time the absence or presence of tax categories among Member States, considering withholding taxes on royalties, dividends represent a threat for EU, because it enlarges the possibility of making aggressive tax planning and tax evasion.
This determines the presence of asymmetries among Member States and negative externalities.
For this, despite the criticism, CJEU's intervention at the moment is really important in fighting the abuse of law by taxpayers for decreasing own tax burden.
Halifax case was one of the main important cases of CJEU's intervention in setting limits, prohibitions of freedom inside EU.
So, through current legislation we are far from the objective of efficiency inside Common Internal Market.

Another criticism for EU was the flexibility to try to find compromise between interests of Member States, determining too much independence.
This increases the gap of what is collected and what is collectable in tax revenues terms for public finances, increasing the threat of a "race to the bottom" by Member States.
In the second chapter another important aspect studied was the role of follower played by EU and not the role of leader, considering OECD.
OECD was the first to give common guidelines about the fight against BEPS, providing 15 Actions. Only after that, EU decided to intervene, providing an anti-tax avoidance Directive in 2016. And a first question is: why did EU not intervene before OECD?
In this sense, it's clear that EU tries to find countermeasures aligned with the actions of OECD.
Second question is: why does EU implement a directive against aggressive tax planning?
If we evaluate the effects, it determines freedom at 27 Member States to decide how to take it in own jurisdiction. Another weakness point was too much time given to implement correctly at Member States.
Studying the text, it provides the fight against treaty abuse, CFC, interest limitation and exit tax but it does not provide necessary details to give a common framework to follow.
Think about at 27 jurisdictions, obviously there will be some differences from directive's implementation, and this loophole, is a sort of assist for aggressive strategies of MNEs.
Remember that the States could decide how to implement it and this determines uncertainty, uncertainty which create differences, determining disadvantages for those countries which present high tax burden inside EU's territory and at the same it could encourage the movement of investment in those countries with low tax burden as demonstrated by FDI's data in 2017 and 2021. As EU decided to implement a directive, this determines automatically an imperfection of the system.
The answer by Eurostat's data was the slow evolution to adapt at market's needs because the situation did not change over the years.
The elaborate realizes that MNEs are a real threat for the competition inside EU's territory, due to its large resources to move profits wherever they want and decrease their total tax burden.
Directive 2016/1164 tries to stop it, but it's not sufficient because the tax avoidance and tax evasion are still present. The threat is real and high.
Also, in the elaborate it emerged the scarce commitment of Member States to find common measure among them, determining an active participation in promoting aggressive tax planning by companies, and everyone is affected from this due to missing resources in guaranteeing the "welfare State" and the "small business", which does not have the resources to compete with MNEs.

A good opportunity to change the trend derives from the exchange of information developed over the years which could provide a possibility for tax authorities to find the aggressive tax strategies played inside the common internal market.

The history told us also a continuing evolution of abuse of law if we evaluated the Halifax case, Cadbury Schweppes case and the thin capitalisation rule.

So, fast decisions and interventions are crucial in order to find right countermeasures and stop this trend.

The different treaties among Member States determine possible aggressive tax strategies through shell companies and also the fight against the anonymous shell companies must be followed. Here emerges one critical point.

It was made a proposal of ATAD 3 against use of shell companies for tax purposes, and it is still two years, it has remained only a proposal, confirming this slowness in providing countermeasures and the willingness of the Member States to not participate actively in this "battle." Paolo Gentiloni, European Commissioner, tries to ensure the commitment of Commission in fighting the misuse of shell companies.[148]

Also, digitalisation is a "problem" in tax field. It demonstrates that EU did not learn from its past mistakes, due to the fact that OECD is still the leader in providing countermeasures, as explained by Pillar 1 and Pillar 2.

It studied proposals and guidelines, and what is really worrisome is that some Member States decide to implement own domestic rules to regulate digital business. So, EU is still not presenting anything to give common guideline, only proposals.

And as explained in the third chapter with the table in 2021 the domestic provisions were really different evaluating the single Member States.

This provides a lot of criticism, because it said nothing in ATAD 3 and EESC asked why does EU say anything? Which are the intentions with digital business?

Data demonstrated a different treatment evaluating tax treatment for pure and click and brick and mortar firms.

Combining the two fields, Google and Amazon demonstrated the aggressive tax planning built with these loopholes, exploiting the "Double Irish Dutch Sandwich" strategy and Luxembourg's jurisdiction, determining losses also for third countries as US.

We should stop it, in order to guarantee what laws says: "every citizen is equal in front of law".

[148] POOL MAYO V., 2021, *After Pandora Papers, EU says it plans new rules against tax avoidance*, Reuters. Available on: https://www.reuters.com/world/europe/after-pandora-papers-eu-says-it-plans-new-rules-against-tax-avoidance-2021-10-06/ visited on 19th October 2022

So, this concerns also for tax evasion and tax avoidance, we must work constantly to stop it.
The right competition must be guaranteed and ATAD 3 and digitalisation rules are necessary to ensure it. Many users now try to avoid the tax and the tax havens must be stopped.
And this determines also an increase of corporate taxation income gap, returning back to the issue of direct taxation.
Seeing the data, also public finances were damaged by it and for this we need to harmonise what concerns the firm's taxation laws, to give uniformity, clarity and genuine competition.
One relevant point for EU could be what OECD suggests in Pillar 1 for digitalization issues and at the same time think about the principle to tax MNEs of digital economy, based on the location of its profit's source, the users.
Therefore, it's necessary to review the principle of taxation based on the physical presence, because as demonstrated above, the MNEs could study instruments and actions able to make aggressive tax planning, an action legal in law's terms, but contrary to the spirit of law.
It's the moment to change this trend for EU, to become the key actor, the leader and not only the follower which adapts the OECD's rules at its territory.
EU has the means and disposals to increase its role inside this "battle" and it must remember at the Member States the reasoning about its foundation, the concept of efficiency, uniformity developed by "Founding Fathers".
One possible solution, suggested by professor Richard Murphy could be a preparation by each Member State of tax gap estimates covering all taxation based on methodologies developed by EU with top-down and bottom-up approaches.[149]
Other solution could be the reform of system in a way to participate actively, accelerating the intervention and finding common measures to take in practice for Member States in direct taxation, especially corporate taxation.
In 2021 the G7 met and tried and concorded about minimum taxation burden at MNEs.
Ursula von der Leyen explained her satisfaction to push for modernization and more international cooperation for corporates' taxation.[150]
In the same direction, David Sassoli, European Parliament's president underlined the need to exit from Covid-19 in the same direction for the countries, describing that this agreement goes in the right way.

[149] MURPHY R., 2019, *The European Tax Gap, a report for the Socialists and Democrats Group in the European Parliament,* Tax Research UK
[150] SIR AGENZIA DELL'INFORMAZIONE, 2021, *G7: tassazione multinazionali, reazioni dall'Ue. Von der Leyen, "passo avanti verso equità e parità di condizioni". Sassoli, "uscire dalla crisi con più uguaglianza".* Available on: https://www.agensir.it/quotidiano/2021/6/5/g7-tassazione-multinazionali-reazioni-dallue-von-der-leyen-passo-avanti-verso-equita-e-parita-di-condizioni-sassoli-uscire-dalla-crisi-con-piu-uguaglianza/, consulted on 19th October 2022

It's the moment to change the trend, the world runs fast.

Fairness of taxation, in sense to ensure equality is fundamental in modern tax systems and it must be protected because beyond the distributional impact and ethical implications, unfair tax system increase inequality between taxable persons and not incentive the economic growth.

Sergio Mattarella launched in 2019 a message that the institutions together with social parts should support economic growth and digitalization with an overall strategy, favouring entrepreneurship and sustainable development with simple rules, efficient and equal jurisdiction, which do not distort competition between the parts.[151]

The future will answer us.

[151] SABLONE L., 2019, *Mattarella alla Cna: "Fisco più equo e regole semplici per le imprese"*, ilGiornale.it. Available on: https://www.ilgiornale.it/news/politica/mattarella-cna-fisco-pi-equo-e-regole-semplici-imprese-1775224.html consulted on 20th October 2022.

The Italian President of Republic's speech: "Le istituzioni, insieme alle parti sociali, debbono accompagnare» il percorso di innovazione e digitalizzazione delle piccole imprese «con una strategia complessiva, assicurando un ambiente che favorisca l'imprenditorialità e lo sviluppo sostenibile, incluse regole semplici, amministrazioni efficienti ed una fiscalità equa, che non distorca la concorrenza tra operatori".

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