

## Tax Avoidance, Tax Evasion and Tax Havens

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## Index of Abbreviations

AIE	Automatic Information Exchange
ACP	African, Caribbean and Pacific countries
Art.	Article
BEPS	Base Erosion and Profit Shifting
BMF	Federal Ministry of Finance
CCCTB	Common Consolidated Corporate Tax Base
CDC	Commonwealth Development Corporation
CHF	Swiss franc
CRS	Common Reporting Standard
CTA	Corporation Tax Act
D	Directive
DTA	Double Taxation Agreement
DfID	Department for International Development
Ecofin	Economic and Financial Affairs Council
EStG	Income Tax Act
EU	European Union
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FSI	Financial Secrecy Index
G-8	Group of 8
G-20	Group of 20
GFI	Global Financial Integrity
GDP	Gross Domestic Product
HNWI	High Net-Worth Individuals
ICIJ	International Consortium of Investigative Journalists
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
LIC	Low-Income Country
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Cooperation and Development
OeEB	Austrian Development Bank
OJ	Official Journal of the European Union
TFEU	Treaty on the Functioning of the European Union
TIEA	Tax Information Exchange Agreement
TJN	Tax Justice Network
UN	United Nations
UNO	United Nations Organisation
USD	United States Dollar
VIDC	Vienna Institute for International Dialogue and Cooperation

**Contents**

- 1. Introduction..... 1
- 2. Tax Havens, Definitions ..... 2
  - 2.1. Tax Avoidance, Tax Evasion and Aggressive Tax Planning, Definitions..... 4
- 3. The Financial Secrecy Index..... 6
  - 3.1. Switzerland.....10
  - 3.2. Austria.....11
  - 3.3. Luxembourg .....11
- 4. The Development of Tax Havens.....11
- 5. Legal or Illegal – Avoidance vs. Evasion .....13
  - 5.1. The Non-Identifiable Grey Area .....13
  - 5.2. Double Non-Taxation through Double-Taxation Agreements.....13
  - 5.3. The Development of Digital Products .....14
- 6. Profiting from Tax Havens .....14
  - 6.1. Wealthy Private Individuals .....15
  - 6.2. Companies and International Corporations.....17
    - Auditing Companies and Private Banks .....20
  - 6.3. The Tax Tricks of Corporations in Practice .....24
- 7. How Tax Havens Work .....27
  - 7.1. Base Company (Mailbox Company) .....27
    - Example of a Base Company (Invoice) .....28
    - Example of a Base Company (Royalties) .....29
  - 7.2. Flow-Through Entity .....30
    - Example of a Flow-Through Entity (Stepping-Stone Strategy).....31
    - Example of a Combination of a Base Company and a Flow-Through Entity.....32
  - 7.3. The Case of Starbucks .....33
  - 7.4. Ikea’s Tax Tricks .....33
- 8. Current Developments in the EU .....35
  - 8.1. Harmonisation of Business Taxation within the EU.....38
  - 8.2. Taxing the Digital Economy .....41
  - 8.3. Automatic Information Exchange within the European Union .....41
  - 8.4. The Role of the European Commission .....42
- 9. International Development .....43
  - 9.1. OECD Measures .....43
  - 9.2. Measures to Combat International Tax Evasion .....46
  - 9.3. G20 Measures.....48
  - 9.4. IMF.....48

9.5. Individual State Measures .....	49
9.6. Summary of International Developments .....	50
10. Is Austria a Tax Haven?.....	53
10.1. Banking Secrecy .....	53
10.2. Private Foundations .....	54
10.3. Group Taxation.....	54
10.4. Largely Absent External Tax Law .....	54
10.5. Possible Solutions .....	56
11. Demands of the Chamber of Labour .....	57
12. Summary .....	58
Appendix.....	60
I. The Importance of Taxes and the Effects of Tax Evasion and Tax Avoidance on the “Developing Countries” .....	60
The Situation in the Countries of the South .....	60
The International Tax System .....	62
Tax Evasion .....	63
Tax Havens, Jurisdictions, Financial Secrecy Locations – Many Names, One Problem .....	64
The Example of Mauritius – Tax Paradise or Sluice for Development Funds? .....	64
The Major Reform Players: G20 and the OECD.....	66
Automatic Information Exchange (AIE) .....	66
BEPS – An Action Plan Against (Legal) Tax Loopholes for Corporations .....	67
Necessary Measures .....	69
II. EU Measures to Combat Tax Avoidance and Tax Evasion .....	70
The Starting Point .....	70
The Parent-Subsidiary Directive.....	73
The Merger Directive .....	74
The Interest and Royalties Directive.....	74
The Savings Directive .....	74
Code of Conduct and State-Aid Law to Combat Tax Avoidance.....	76
EU State-Aid Law.....	76
The EU Action Plan.....	78
OECD Measures.....	80
III. Money Laundering .....	84
Example of Money Laundering with the Aid of Tax Havens.....	84
Literature.....	86

## 1. Introduction

In combination with sluggish economic development, the financial crisis and the debt crisis that it triggered have contributed to the fact that tax evasion, tax fraud and tax avoidance are recognised as a serious problem. The revelations by “Offshore Leaks” through the International Consortium of Investigative Journalists (ICIJ) and investigative journalism on the one hand and the work of NGOs, for example by the Tax Justice Network, on the other have provided essential contributions that have increasingly brought the discussion out into the public. As a result the dimensions of the massive offshore fortunes have become known and the resulting tax shortfalls in the nation states have been expressed. The rapid escalation of offshore wealth also seems threatening. After the financial crisis, an increase of 28% was recorded in a period of just five years, between 2008 and 2013.

The increasingly unequal international distribution of wealth is now leading economists to comprehensive research work and preliminary estimates. There is hardly any data on the costs caused by tax havens, in particular through the massive tax shortfalls. The necessary data is taken as a basis from various available scientific sources. Filling the gaps in the data and making the information available should not just be task of scientists, but rather also of politics.

Tax evasion and tax fraud by well-known personalities from politics, sport, the arts and commerce also attract intensive coverage in the media. Although such people have been sentenced in court (if there was sufficient evidence) the public regards this crime as a trivial offence rather than fraud. There is also understanding for tax-avoiding actors, tennis players or Formula 1 drivers and managers when they move their place of residence to Monaco or Switzerland. In contrast to tax fraud, moving one’s place of residence is a completely legal approach. Wealthy individuals use this opportunity for tax avoidance. In between there is a not-easily identifiable grey area. Since as a rule activities are indeed organised in accordance with the law, but on the margins of legality. Here ambiguities and discrepancies are exploited in order to achieve corresponding tax advantages that were not originally envisaged in this form by the legislators. This is also the area favoured by auditors, tax consultancies and banks. These are the most significant players in the system of tax avoidance.

Wealthy private individuals do not find it difficult not to declare their wealth at home and to move it to offshore bank accounts. Trusts or foundations serve as a preferred and practical vehicle for this. The lack of transparency rules here make it possible for owners and beneficiaries to use trusteeships to remain anonymous. Capital flight would not be possible without the aid of private banks and auditing companies – they are in any case present in all significant tax havens.

In the companies sector, internationalisation makes it easier for global corporations to shift their profits to low-tax countries and thus to minimise their tax bill. Almost without exception they have been mentioned in the media for their “aggressive tax planning”, multinational corporations such as Google, Apple, Starbucks, Amazon, Ikea etc. Two thirds of cross-border trade already takes place within corporations and more than half of world trade flows go through tax havens. This scale should alarm the international community into developing effective measures with regard to fair taxation. Because, with their nation-state legislation,

individual states on their own are powerless in the face of tax havens. Individual state measures have thus far remained ineffective. Both the EU member states as well as those in the OECD have repeatedly debated the issue of international tax avoidance and reacted with various action plans. Their implementation is incumbent upon the individual nation states; it is indeed urgently necessary, but is not sufficiently ambitious.

In this report we describe the way in which tax havens function. The opportunities for tax evasion and avoidance are highlighted from the perspective of the various players, companies, corporations and wealthy individuals – the methods, the instruments used and the tricks that can be applied, not least owing to the loopholes in the tax systems.

Current developments in the European Union represent an important chapter, which contains proposals for the necessary adaptation of directives, for proposals and measures of the EU action plans, in particular the essential automatic information exchange and its evaluation. Measures to combat international tax evasion to be worked out by the OECD and the G20 are also presented. In this context, the confrontation with the special problematic situation in connection with the “developing countries” also needs to be included.

## 2. Tax Havens, Definitions

There is no standard definition of the term tax haven. In its 1998 report *Harmful Tax Competition: An Emerging Global Issue*, the OECD defined characteristic features to identify tax havens. With the aid of established criteria, the aim is to identify general practices of tax regimes that favour financial or other economic activities in particular locations and consequently distort trade and investment or generally undermine the trust in tax systems.<sup>1</sup> This harmful tax competition not only has negative effects on the individual nation states but, seen in a global context, on the one hand the competition between states to cut tax rates is problematic and on the other hand tax incentives and tax exemptions differentiated according to sector are offered as investment incentives (see EU code of conduct). Numerous countries have established special economic zones for this purpose, for example, which offer this incentive effect in the field of real production, as part of so-called production zones. This is used in particular in threshold countries, facilitated by the low level of social regulations, of labour protection or environmental constraints. Trade union organisation is hindered, with the assistance of the countries themselves, who in this way however continue the spiral of exploitation in their own countries and cannot counteract the pressure from the rich countries and corporations. The utilisation of the international tax differentials through the diversion of transactions in order to exploit tax reductions and exemptions is interpreted only as legal tax planning. In most cases tax havens are not independent. Either they belong directly to industrialised countries such as Britain, the US, France, the Netherlands or Luxembourg, or there is a close connection with an important financial location, which is indispensable for these constructions.<sup>2</sup>

A tax haven is a country or also just part of a country that offers low tax rates or even no taxes at all for foreign investors. The tax havens themselves are in competition for the far more mobile finance capital. Because tax havens cannot just refer to a country but also to much smaller units, such as the City of London, in the English-speaking world they are often referred to as “jurisdictions”, which describes the area of authority of the legal responsibility or the legal system.

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<sup>1</sup> OECD 1998, 8

<sup>2</sup> Shaxson 2011, 15

The OECD in any case defines four criteria that a tax haven fundamentally fulfils:<sup>3</sup>

- The tax system in the respective country provides for zero or low nominal tax rates.
- There is no effective information exchange with other countries.
- There is a lack of or inadequate transparency with regard to disclosure requirements. Basic regulations and their implementation are not clearly defined and regulated.
- Economic activity is not a necessary precondition. This results in the conclusion that investments or transactions are carried out purely for taxation reasons.

Further features that lead to tax incentives are identified in connection with these criteria. Frequently, special conditions are offered for non-resident taxpayers in order to attract investment. The measures listed here indicate the variants relating to this:

- Offering the most varied forms of confidentiality, banking secrecy, trusts<sup>4</sup> etc.
- Offering off-shore services for non-residents (e.g. zero tax rates for foreigners). To a certain extent these types of conditions correspond to protection from financial market regulations
- A disproportionate financial sector in comparison to the local economy
- The politics of the country do not really interfere in companies' business activity. This makes it easy for taxable persons to evade their countries' tax laws and regulations.
- Political stability is important in these countries.
- An industry of professional consultancy companies provides support.

In view of the criteria mentioned, the OECD report assumes extensive effects that not only affect financial services but also the whole service sector. Investment and trading structures which for their part erode the tax base in other countries are distorted at a macro level too. Reduced to an individual level, the tax-paying population's trust in the tax system is increasingly undermined.<sup>5</sup>

At EU level, "harmful, unfair" tax competition through low effective tax rates is primarily defined in the field of corporate taxation. To some extent measures are being adopted, for example through bilateral agreements as part of the TIEA (tax information exchange agreements) or to accelerate information exchange between the financial authorities.<sup>6</sup>

As a further consequence various organisations are attempting to name the countries in question. The OECD drew up a list of countries that do not or only inadequately cooperate with the OECD standards. It began in 1998 with 41 countries and territories. Above all Austria, Luxembourg, Belgium and Switzerland initially saw their banking secrecy as being endangered and attempted to block it.

Immediately afterwards these countries backed down and announced a minimum level of cooperation and thus came onto the so-called grey or white lists, so that since 2009 the OECD blacklist of "Uncooperative Tax Havens" has paled for lack of entries. In October 2008 Andorra, Liechtenstein and Monaco were on this list, which was to be supplemented by other countries, among others Switzerland. In 2009 Liechtenstein and Andorra announced a

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<sup>3</sup> OECD 1998, 21f

<sup>4</sup> With the establishment of a trust, the original owner transfers the wealth to a trustee who administers it and is obliged to distribute the wealth to the beneficiaries in accordance with the deed of trust. There is no public register and the identity of the owners remains secret.

<sup>5</sup> Palan 2010, 212f

<sup>6</sup> Bendlinger, 538

relaxation of banking secrecy and more transparency. Austria, Belgium, Switzerland and Luxembourg joined them, in order to be taken off the grey list.

During the 2009 G20 summit in London a new OECD list was published in relation to income and wealth tax. The white list contained countries and territories that have largely implemented the international tax standards. The grey list includes territories that formally accept the international standards but have not yet implemented them, for example Liberia, Montserrat, Nauru, Niue, Panama, Vanuatu, Costa Rica, Guatemala and the Philippines.<sup>7</sup>

The various lists of the OECD and other organisations are not without controversy with regard to their criteria. The negotiation process of agreements between tax havens and high-taxation countries varies according to economic but also political power.<sup>8</sup> A tax haven's readiness to cooperate falls as its negotiating power rises. Conversely, unsurprisingly the degree of cooperation increases when the negotiating power of high-taxation countries rises. These are the hypotheses of the analysis. According to this, countries with a high degree of cooperation should sign double-taxation agreements, and likewise those with a moderate degree of cooperation. Indicators such as GDP, per-capita GDP or the extent of international financial flows are included in the calculation of the model. The empirical analysis is based on all possible pairs of 27 OECD countries and 49 tax havens. At the time of the survey, in 2011, 15% of 1,323 pairs of countries have a double-taxation agreement and 26.9% have concluded an information-exchange agreement, with 76% of all agreements between 2000 and 2011 being signed in the period from 2009 to 2011. In fact, agreements were reached with economically weak tax havens. It requires essentially greater political pressure to come to corresponding agreements with economically stronger tax havens. All the theoretical hypotheses have thereby been empirically proven. However, the pressure can only be as great as the extent of bilateral relations. For a detailed analysis the existing direct investments and portfolio investments were investigated on the basis of agreements agreed before 2000. Only in these cases can significant cooperation between OECD countries and tax havens be determined.

## 2.1. Tax Avoidance, Tax Evasion and Aggressive Tax Planning, Definitions

The following definitions by Alfred Hacker of tax avoidance, tax evasion and aggressive tax planning are greatly abridged but get to the heart of the problem:

*"If under tax avoidance one understands the legal possibilities of avoiding tax and under tax evasion the illegal (i.e. punishable) activities to reduce the tax burden, there remains a relatively large grey area between the two in which so-called 'aggressive tax planning' assumes a large role."*<sup>9</sup>

The words of the IMF<sup>10</sup> on this are unusually clear and critical: *There are broadly two sets of issues. One – discussed in the next subsection – is (illegal) evasion by individuals. The other is avoidance by multinationals – legal (or cynics might say, not obviously illegal)".*

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<sup>7</sup> OECD 2010, 16

<sup>8</sup> Elsayyad 2013, 16

<sup>9</sup> Hacker, Alfred: Herausforderungen der Finanzverwaltung im Lichte vermehrt bekannt gewordener Abgabenvermeidungen – aggressiver Steuerplanungen (ATP), in ÖStZ 2013, 302f.

<sup>10</sup> IMF(2013): Fiscal Monitor: Taxing Times



On its website on the subject of combating tax fraud and tax evasion the European Commission gives the following definitions:

*“Tax evasion generally comprises illegal arrangements where tax liability is hidden or ignored, i.e. the taxpayer pays less tax than he/she is supposed to pay under the law by hiding income or information from the tax authorities.”*

*“Tax fraud is a form of deliberate evasion of tax which is generally punishable under criminal law. The term includes situations in which deliberately false statements are submitted or fake documents are produced.”*

*“Tax avoidance is defined as acting within the law, sometimes at the edge of legality, to minimise or eliminate tax that would otherwise be legally owed. It often involves exploiting the strict letter of the law, loopholes and mismatches to obtain a tax advantage that was not originally intended by the legislation.”*

Aggressive corporate tax planning usually happens when international corporations exploit tax loopholes that essentially arise because the individual states' profit-tax systems are not harmonised. There is likewise no generally accepted definition of the term “aggressive tax planning”.

Despite the absence of a conclusive definition, particular features that are characteristic of the term “aggressive tax planning” can be established. In its recommendation of 6 December 2012 concerning aggressive tax planning, the European Commission defined it as follows:

*“Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. Aggressive tax planning can take a multitude of forms. Its consequences include double deductions (e.g. the same loss is deducted both in the state of source and residence) and double non-taxation (e.g. income which is not taxed in the source state is exempt in the state of residence).”<sup>11</sup>*

Ehrke-Rabel and Kofler say that *“aggressive tax planning is characterised by the fact that the taxpayer, deliberately and exploiting all national and international opportunities, organises his economic life in a way so as to procure him the lowest possible tax burden.”<sup>12</sup>*

Less scientifically but all the more striking is a quote from an article in Die Zeit: *“Das Motto: Gesetze nutzen, Gewinne verschieben, Steuern sparen’ die Rede, in dem die Niederlande als das größte legale Steuerparadies der Welt bezeichnet werden” [“The motto: use laws, shift profits, save tax’ is mentioned and the Netherlands is described as the biggest legal tax paradise in the world.”]<sup>13</sup>*

According to the definition, aggressive tax planning usually concerns methods that operate within the bounds of legality. Nevertheless the boundaries are fluid and it is noticeable that tax-avoidance measures are constantly probing the boundaries. The OECD also comes to this conclusion in its BEPS Report, where it states *that “A number of indicators show that the tax practices of some multinational companies have become more aggressive over time, raising serious compliance and fairness issues”<sup>14</sup>*

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<sup>11</sup> C(2012) 8806 final, 6.12.2012: Commission Recommendation of 6.12.2012

<sup>12</sup> Ehrke-Rabel, Tina / Kofler Georg: Gratwanderungen in ÖStZ 2009/19, 456 ff.

<sup>13</sup> Die Zeit, “Holländische Geldschleuser” [Dutch Money Sluices], 20 f, 3.7.2014

<sup>14</sup> OECD (2013): *Addressing Base Erosion and Profit Shifting*, 6.

### 3. The Financial Secrecy Index

The Tax Justice Network (TJN) has drawn up the Financial Secrecy Index FSI, a ranking based on specific criteria. This index establishes the degree of tax evasion in the individual territories, the ease with which the respective tax systems and regulations permit this, but also the significance of the financial sector in the countries or territories investigated. 82 tax havens are regularly ranked, most recently 2013.<sup>15</sup> The TJN uses different terminology. Thus the term “tax haven” is not so much used as “dark places” or “financial secrecy places”. The most apt is the English expression “secrecy jurisdiction”. “Secrecy jurisdictions” are defined as territories that create special regulations for non-residents. At the same time laws in other territories and states are undermined. Secrecy practices are offered that also help to obscure – thus dark places – and which cannot be identified outside the secrecy jurisdictions or in their states of residence.

In the FSI methodology the assessment basis is derived from a combination of quantitative and qualitative data that reveal the degree of participation in the financial markets and the secrecy practices. For the qualitative part, laws, regulations and information-exchange processes are graded in order to obtain the secrecy score. Secrecy jurisdictions with a high score are less transparent with regard to the activities they facilitate and less involved in information exchange with other states. As a result the attractiveness for illegal financial transfers or the hiding of corrupt or criminal activities increases.

Quantitative data from each secrecy jurisdiction is used to determine the global scale weighting. This uses public data on trade in international financial services, for countries where this data is not available it is complemented and adjusted by data from the International Monetary Fund. The highest weighting is for those with the greatest share of the market for financial services for non-residents. Only the combination of the secrecy value and the global weighting produces the Financial Secrecy Index. Thus, for example, a financial location with a high share of international financial services with simultaneously high level of transparency can have the same overall score as a smaller but non-transparent secrecy jurisdiction. The ranking expresses not only lack of transparency but also the global significance of the secrecy jurisdiction. Estimates of the tax losses and damage to national economies can be arrived at on this basis.

The 2013 FSI covers 82 countries and territories; for 2011 it was just 73 countries which had been taken from previous rankings.<sup>16</sup> Each was complemented by the countries with a high share in the financial services sector that had previously not been regarded as traditional tax havens (Denmark, Germany, France, India, Italy, Japan, Canada, Korea and Spain) and those with typical characteristics of a secrecy jurisdiction, such as Botswana, Ghana, Guatemala and San Marino. New additions in 2013 are Sweden, Curacao, the Russian Federation and Lebanon. Using this selection process it was possible to overcome the deficiencies of the OECD lists from the year 2000 or those in the black/grey/white shades of 2009. For example, Britain was not included in earlier lists, although the City of London is presumed to play one of the most important roles in the financial secrecy system. The US was also absent, despite transparency problems in states such as Delaware, Nevada and Wyoming. Methodologically, all existing lists covering tax havens, secrecy jurisdictions or offshore financial centres are equally applied.

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<sup>15</sup> <http://www.financialsecrecyindex.com>

<sup>16</sup> Consisting of a selection of internationally available lists by the IMF, OECD, FATF, and TJN.

It is noticeable that most of the important financial locations are not in the Caribbean or Asia. The 21 top rankings include 13 OECD states or their dependent territories. Despite increased efforts from the OECD or the G-20 countries, public enterprise and foundation registers or actual cooperation and automatic information exchange have still not been implemented, even with the EU countries.

The FSI is composed of 15 indicators in order to give a secrecy score to each secrecy jurisdiction. The assessment process can be understood on the basis of the available source data.<sup>17</sup>

The fifteen secrecy indicators are ordered according to the following criteria:

- Knowledge of beneficial ownership.
  - o Is there banking secrecy and does it have a legal basis. Are banking and credit institutions required to record details of their clients and is there a retention period. Can bank data be used for information exchange.
  - o Is there a public register of trusts and foundations?
  - o Are details on company ownership submitted to a government authority and is it kept up to date.
  
- Key indicators on the regulation of corporate transparency
  - o Are the details of the company ownership available on public record and accessible at a reasonable price (max. €10).
  - o Do company financial statements have to be submitted to the responsible authorities, are they publicly accessible and available over the internet at a reasonable price.
  - o The fulfilment of country-based accounting standards for publicly listed companies. Detailed disclosure of the balance sheets in the individual countries.
  
- Efficiency of tax and financial regulation
  - o State of information exchange. Do all paying agents involved (banks, financial institutions, funds and trusts etc.) automatically have to report money transfers (interest and dividend payments) to non-residents to the financial authorities?
  - o Efficiency of financial administration: are taxpayers identified and tax numbers issued?
  - o Measures that promote tax evasion. Are there tax incentives for dividends and interest payments in the double taxation agreements?
  - o Harmful legal vehicles. Is it possible, for example, to create “protected-cell companies”. These company constructions consist of many different impenetrable “cells”, which can exploit the advantages of risk transfer through their own insurance companies. This indicator also examines whether “flee clauses” are facilitated for trusts.
  
- International standards and cooperation
  - o Assessment of measures against money laundering according to the standards of the Financial Action Task Force (FATF), the international organisation to counter money laundering.
  - o Does the territory/country participate in the automatic information exchange as part of the EU Savings Tax Directive or is there taxation at source as an alternative.

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<sup>17</sup> [www.secrecyjurisdiction.com](http://www.secrecyjurisdiction.com)

- How many double taxation conventions and treaties on information exchange in taxation affairs (TIEA) have been concluded. According to the OECD standard at least 46 agreements should have been concluded.<sup>18</sup>
- International conventions, such as the 1988 OECD Convention on Mutual Administrative Assistance in Tax Matters, the 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, the 1999 UN Terrorist Financing Convention, the 2000 UN Convention against Transnational Organised Crime, and the 2003 UN Convention against Corruption.
- International judicial cooperation with established structures, from investigation to the seizure of criminal assets.

Among other things, the points-based secrecy score also provides for credit for transparency or good international cooperation with other countries. For example, a country in which its banking secrecy is not protected by law is accorded bonus points. The spectrum of the secrecy component of the FSI index ranges from 0 (for absolute transparency) to 100 (for absolute secrecy).

Internationally comparably IMF balance of payments data are used as a basis. Missing data are complemented and estimated from the inventories of financial investments.<sup>19</sup>

For the 2011 FSI more than half of the territories provided sufficient data, the remainder, with one exception (Nauru) could be estimated. Nauru is indeed characterised by a high level of secrecy, but the extent of international financial transactions there is insignificant.

A simple ranking of financial locations according to their import and export of financial services measured by GDP produces a list of the “usual” islands and countries specialising in incentives for non-residents. As a next step, in order to arrive at a global balance, the ranking is made according to the extent of involvement in global trade in financial services, not in comparison to GDP. As mentioned above, this list is unsurprisingly headed by the “big players” of the OECD states. Only through the combination with the secrecy score does a final ranking according to the Financial Secrecy Index emerge, which provides the actual extent of potential harm.

The FSI produces a picture of how secrecy jurisdictions hollow out the transparency of global financial markets. The bonus points awarded for more transparency are intended to create an incentive to remove obstructions to transparency either through the elimination of banking secrecy or the strengthening of publishing regulations. The FSI is regularly updated in order to achieve this. From the FSI, every financial location can read the harm it causes to national economies and to the public in general.

The result shows a heavy concentration of international financial-services transactions. Thus 60% of all transactions take place in just ten countries and territories, including Switzerland, Luxembourg, Hong Kong, the Cayman Islands and Singapore.

Austria is ranked as high as 18th place. It is also interesting that Britain is in 21st place, supported by the City of London, which for its part has a great influence on the Cayman Islands (4th), Jersey (9th), Bermuda (14th) and Guernsey (15th).

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<sup>18</sup> Average number of double taxation and information exchange agreements of the G20 states.

<sup>19</sup> Data: IMF, Coordinated Portfolio Investment Survey (CPIS) in: Search of an Operational Definition (IMF Working Paper), Washington.

Germany, surprisingly, is in eighth place. This result is based on the great significance of the finance location in Frankfurt. Obviously the exchange of tax-relevant information with other countries is inadequate.<sup>20</sup> One clue may likewise be the low taxation of assets – at 0.8% Germany is well below the OECD average of 1.8% of GDP.<sup>21</sup>

Table 1  
Financial Secrecy Index 2013 – results of a selection of countries

<i>Rank</i>	<i>Country/ Jurisdiction</i>	<i>FSI Value</i>	<i>Secrecy Score</i>	<i>Global Weight</i>
1	Switzerland	1,765.3	78	4.916
2	Luxembourg	1,454.5	67	12.049
3	Hong Kong	1,283.4	72	4.206
4	Cayman Islands	1,233.6	70	4.694
5	Singapore	1,216.9	70	4.280
6	USA	1,213.0	58	22.586
7	Lebanon	747.9	79	0.354
8	Germany	738.3	59	4.326
9	Jersey	591.7	75	0.263
10	Japan	513.1	61	1.185
11	Panama	489.6	73	0.190
12	Malaysia	471.7	80	0.082
13	Bahrain	461.2	72	0.182
14	Bermuda	432.4	80	0.061
15	Guernsey	419.4	67	0.257
16	UAE (Dubai)	419.0	79	0.061
17	Canada	418.5	54	2.008
<b>18</b>	<b>Austria</b>	<b>400.8</b>	<b>64</b>	<b>0.371</b>
19	Mauritius	397.9	80	0.047
20	Br. Virgin Islands	385.4	66	0.241
21	United Kingdom	361.3	40	18.530

Source: [www.taxjustice.net](http://www.taxjustice.net), 7 Nov. 2013.

The index, resulting from a combination of the level of secrecy and the weighting according to the extent of global financial transactions, is regularly updated. In 2011 Switzerland rose from third to first place, pushing Delaware – in 2009 in first place – back to fifth, although Delaware plays a more important role as a global financial location.

<sup>20</sup> TJN 2013, 2

<sup>21</sup> OECD 2012, 121

### 3.1. Switzerland

Switzerland is a country with a long banking tradition. The massive rise in financial asset administration in Swiss banks began after the First World War. Alongside decades of experience, the distinctive strict banking secrecy is also an advantage as well as the country's general political stability. Often stability is put forward as an argument – the investors have had to flee to Switzerland owing to oppression in their home countries. Actually, an estimated 60% of the assets invested in Switzerland belong to citizens of EU countries. Originally the investors largely came from France (43% of foreign assets), Spain (8%), Italy (8%) and Germany (4%).<sup>22</sup>

The composition of the assets is also interesting. At the beginning of the 20th century the overwhelming part consisted of foreign securities, such as shares in German industrial companies, American railway companies or French and English government bonds. Swiss securities played a subordinate role, because the Swiss capital market was far too small and consequently could not provide such high yields. The accounts in Switzerland thus only existed to invest the money in other countries. Largely it was not invested in Switzerland, the banks assumed only the role of intermediaries. Because Swiss banks did not publish any information, owing to banking secrecy, these incomes are not found in tax returns.<sup>23</sup>

According to FSI estimates a third of worldwide private wealth is invested in Switzerland; according to the Swiss Bankers' Association estimates this is around \$2tn. The total banking assets are estimated at 820% of Swiss GDP.<sup>24</sup> There is no comparable country where the banking sector makes up such a high share.

Nevertheless, clear specialisations are also noticeable in the banking sector. A close look at the banking institutes reveals a remarkable phenomenon in the distribution of financial assets. Thus more than half of the financial assets are concentrated in just two banks: UBS and Credit Suisse.

In recent years Switzerland too has come under increasing international pressure. Supported by the emergence of "tax CDs" or the extremely comprehensive sets of data from "Offshore Leaks", the need for action has also become evident in Switzerland. Nevertheless, only a few agreements and conventions have been concluded, which primarily focus bilaterally on individual countries, in weakened form on neighbouring countries. The terms did not contain a general relaxation of banking secrecy. Only the US was able to achieve extensive changes at a bilateral level. The US FATCA taxation act contains regulations that compel US taxpayers to provide automatic data transfer from foreign financial institutions. In October 2013, Switzerland signed an agreement with the OECD on the exchange of tax data, in which it committed itself to cooperation with foreign authorities as part of the fight against tax fraud. A desirable automatic information exchange is largely not yet provided for in this however. There is also extensive preferential treatment in the company sector. According to this, holding companies are subject to special regulations through the reduction of the amount of tax or the assessment basis, even if the focus is on foreign assets.

Only in the 1980s did centres belonging to London as a financial location develop into important tax havens, such as Hong Kong, Singapore, Jersey, Luxembourg and the

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<sup>22</sup> The geographical classification is not completely reliable, as investors do not always give a home address but that of a hotel in Switzerland.

<sup>23</sup> Zucman 2014, 31

<sup>24</sup> <http://www.secrecyjurisdictions.com/PDF/Switzerland.pdf>

Bahamas. But despite this competition the assets in Switzerland were also able to increase massively. The foreign assets in Switzerland are estimated at €1.8tn (Swiss National Bank statistics, 2013),<sup>25</sup> of which €1tn is ascribed to Europeans. The latter corresponds to 6% of the private financial assets in the European Union. In addition, the competition that has arisen in Asia and the Caribbean is only ostensible, as for banks it frequently concerns subsidiaries of Swiss institutions.

### **3.2. Austria**

Austria is 18th of a total of 82 countries in the FSI 2013 ranking, relatively unchanged from the 2011 analysis of 17th. For Austria the focus of the score distribution is in the field of secrecy – concerning banking secrecy – with 64 points out of 100. In contrast to this is the vanishingly small share of financial transactions, which in Austria is less than one per cent. The high level of secrecy is compensated by a less than one-percent share in all global financial transactions. In this context the two extremes also show how weighty the existence of banking secrecy is, alongside a relatively low volume of financial transactions.

### **3.3. Luxembourg**

Luxembourg has concentrated on corporate taxation. Holding companies have been zero-rated for income tax, wealth tax and capital gains tax since 1929.<sup>26</sup> The law in this comprehensive form was only withdrawn under pressure from the EU. Nevertheless, multinational companies use sometimes very complex structures to minimise their tax bill. Major world-famous companies repeatedly make headlines with their tax avoidance practice. The NGO Attac describes this structure in detail using the example of the furniture company Ikea. This sophisticated tax-avoidance regime is made up of a combination of various corporate groups and foundations in numerous different countries. Even tax officials find the systems difficult to see through – see later in the chapter on “Ikea’s Tax Tricks”.

## **4. The Development of Tax Havens**

In some cases tax avoidance and evasion supposedly goes back to antiquity, but certainly not to the extent that we find it today. Seen historically it concerns a relatively new and thus far little researched phenomenon. According to Palan, the foundations for the development of tax havens were laid in the 19th century. The methods of tax havens that emerged and still exist today can be discerned in the different development contexts in the various different countries. On the one hand, in the US corporate law, which for taxation purposes went over to treating companies differently from natural persons, was decisive. At the same time in Europe the Netherlands introduced the first holding companies.<sup>27</sup> The initial phase of the emergence of tax havens can be located in the period from the late 19th century to the 1920s. Originating in Britain, after the First World War increased offshore activities through British colonies made it possible for international companies to escape taxation. The new focus shifted towards the financial markets and demanded the construction of the necessary instruments, supported by Switzerland through the introduction of banking secrecy in 1934.

Even before this, in the 1920s, Switzerland can be accorded a key role in the offshore world, as the majority of the funds invested there were owned by non-residents. Britain on the other hand meanwhile concentrated on a modern tax system in the corporate sector, modelled on

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<sup>25</sup> Zucman (2013, 1329f) states that there is no satisfactory possibility of a correction here and consequently that foreign assets deposited in Switzerland may also range from €2tn to €2.2tn.

<sup>26</sup> Palan 2010, 119

<sup>27</sup> Ötsch 2012, 28

the US, and was pioneering for the present-day international corporate taxation. British jurisdiction had an important influence on this process through decisions that permitted international companies to remain tax free despite being resident. The concept of residence was interpreted in the sense that foreign companies registered in Britain were not subject to tax if the business was managed from abroad. The application was extended to Bermuda, the Bahamas, and ultimately to the Cayman Islands and Hong Kong. This presumably unintentional non-taxation of international companies has now become the focus of the offshore problem.

The period from the end of the First World War to the 1970s can be described as being relatively stable in the offshore world, without significant change. With the City of London as the centre and its British colonial countries, an important hub developed in the 1950s.<sup>28</sup> From the 1970s the number of countries and territories increased massively. The centres extended their structures and other countries joined the offshore business.

Essentially a division into three zones can be made.<sup>29</sup> The European one, with the most important tax havens of Switzerland, Luxembourg and the Netherlands, specialises in corporate headquarters, finance houses and banking. The second zone Palan identifies is British, based on the City of London with its associated crown dependencies and overseas territories, and Singapore and Hong Kong. The third influential group centres on the United States. The weightiest of these zones is the British one. London uses it skilfully to deal with non-permitted financial business through the inner ring, i.e. in the crown dependencies of Jersey, Guernsey and the Isle of Man. For business that is no longer allowed there either, the wider circle is activated, with the Cayman Islands, Bermuda, the British Virgin Islands, the Turks and Caicos Islands and Gibraltar. Britain has a close political relationship with these territories. A further ring in the network stretches to Hong Kong, Singapore, the Bahamas, Dubai and Ireland. These countries may indeed be independent, but historically they have a close connection with London.

Zucman<sup>30</sup> describes the well-functioning network of tax evasion for Europe as “trio-infernal”, specifically, the British Virgin Islands, Switzerland and Luxembourg. Their specialisations put them at the centre of European tax avoidance and tax evasion. The British Virgin Islands make financial asset management available through trusts and mailbox companies, Luxembourg facilitates tax-free status in particular for investment funds, and Swiss banking secrecy throws a large protective blanket over it.

The role of the US has only become more public through the work of the Tax Justice Network. Owing to federal law and their own state regulations individual states such as Delaware, Wyoming and Florida in particular function as vehicles in the financial markets. To a decisive extent the deregulation of the financial markets began in the US. The foundation of trusts was facilitated by comprehensive non-transparency and confidentiality provisions. What was decisive in this area were the corresponding provisions that facilitated the establishment of shadow banks and limited creditor protection.<sup>31</sup>

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<sup>28</sup> Palan 2010, 128

<sup>29</sup> Palan 2010, 146; Shaxson 2011, 25f

<sup>30</sup> Zucman 2014, 46

<sup>31</sup> Shaxson 2011, 173



## 5. Legal or Illegal – Avoidance vs. Evasion

Within the legal framework of the countries in which they are active wealthy individuals and companies have the ability to organise their “tax planning”. For the majority of the world’s population, however, the concept of “tax planning” is meaningless. But a wealthy minority of private individuals and in particular companies have considerable advantages. In taxation affairs, the terms “permanent tourist” or “permanent, not currently present” were coined for them. Three strategies can be distinguished. “Tax compliance” is understood as the endeavours on the part of companies and individuals to calculate and pay taxes according to regulations. In contrast to this is tax evasion, which is an illegal activity undertaken by an individual or company to reduce their tax payments. Taxable income and capital is not or is only partly declared, information is withheld. In most countries, such action is a criminal offence, only in a few countries such as Switzerland or Liechtenstein is it a civil offence (Palan 2010, 9). Accordingly, the different legal approaches lead to different consequences. Thus in cases of civil law, foreign enquiries can hardly be dealt with and cooperation remains extremely poor. Above all, the actions of the taxpayer that run counter to the intention of the legislators are essential for a political-economic consideration of the phenomenon; politically intended tax adjustments should be differentiated from this. Here, however, not every tax-planning measure has to be illegal. But also if much may be legal, this does not yet make it legitimate.<sup>32</sup>

### 5.1. The Non-Identifiable Grey Area

In between there is a grey area that is not easy to identify and establish. As a rule activities are carried out in conformity with the law, but on the margins of legality. This means that ambiguities and discrepancies are exploited in order to achieve corresponding tax advantages that were not originally envisaged in this form by the legislators. This is the preferred area where primarily an industry of tax consultants, commercial auditors, banks and other tax experts are employed. Although an overwhelming number of supreme court rulings have already been made and some of them even seem like the legalisation of tax evasion, the reality is still far more complex. With general rules, a precise differentiation of tax evasion and tax avoidance is impossible. Also the length of investigations and processes themselves, which with international corporations are necessarily drawn out over a long time, is problematic. The above-mentioned forms of company and company holdings, the foundation of trusts in connection with impenetrable business practices make an essential contribution to this. These forms of action are justified by terms such as legal tax optimisation, protection of assets and efficient company structures.

### 5.2. Double Non-Taxation through Double-Taxation Agreements

Above and beyond this, there is the problem of double non-taxation through the leverage of double-taxation agreements. Originally the aim of double-taxation agreements was to bilaterally harmonise tax law between individual states in order to avoid double taxation. Through increasing internationalisation, UN model double taxation conventions were drawn up within the system of double taxation agreements. These, however, were favourable to developing countries, something with which the OECD’s industrial policy approach did not agree. As a result the OECD drew up a model convention to serve as a basis for states’ bilateral treaties. With advancing globalisation, however, ever more problems arose. Ever more frequently the previous system of taxation of transnational business activity led to double non-taxation of corporate profits.<sup>33</sup> Profits from cross-border transactions are

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<sup>32</sup> Henn 2013

<sup>33</sup> Troost 2013

sometimes not taxed in any of the states involved, because the tax law is not optimally harmonised. Complex company structures and the freedom easily to establish company headquarters anywhere in the world and at reasonable costs (also without undertaking any economic activity in a country) make it possible for companies to use loopholes and gaps to their advantage that have not been blocked (or undone) by bilateral treaties. This is favoured by the fact that whole tax systems are largely based on an age in which companies pursued little or no cross-border business activity and in the meantime many double-taxation agreements are over 80 years old. Many tax laws are now simply no longer up to date, they have been overtaken by globalisation.<sup>34</sup>

### **5.3. The Development of Digital Products**

On top of this, there are new developments and innovations, such as the constantly expanding “digital product” sector, which throws up many questions, high-tech companies or the general expansion of the service sector, which is putting ever more intellectual and intangible goods into circulation that are somewhat more difficult to value than physical goods. Patents or other types of intellectual property can quickly be transferred across state borders. All this makes it far easier for companies to operate their business at least on paper at a geographic distance from the physical address of their consumers.<sup>35</sup>

For many states the question of how to organise the taxation of transnational companies is therefore now posing itself again, which is welcome in view of the size of the problem. It is no longer a side issue. Internationally, two thirds of cross border trade already takes place within multinational corporations and – on paper at least – more than half of all world trade goes through tax havens. The question of the proper and fair taxation of these global players is more topical than ever. All the more so, as precisely in periods of crisis it should be recognised that contributions from these financially strong and powerful social groups can no longer be dispensed with. Both the EU as well as the OECD have thus concerned themselves with the issue of “international tax avoidance” and in the last year have reacted to the existent problem with action plans. The implementation of urgently necessary measures, however is ultimately the responsibility of the individual national states and is anything but ambitious.

## **6. Profiting from Tax Havens**

In general, as already mentioned, tax havens among other things offer protection from detailed tax inspections or security against regulated finance markets. The special “flee function” exists both for individuals as well as for companies that give up their responsibility but also the costs to the general public in their country of origin, primarily in order to accumulate their wealth. Special terms and incentives are in particular related to non-resident taxpayers, from which the term “offshore” is derived. An essential feature is the exclusion of the local population with the simultaneous preferential treatment of wealthy foreign interests. In consequence, massive democratic deficits that have hardly any chance of being changed entrench themselves.

So who do tax havens benefit and who do they harm? The data on existing wealth and financial flows has so far been extremely poor. On various levels an approach can be made to the assets of private individuals, of companies and corporations, of countries and territories, but also on the level of various branches in the financial services sector, such as

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<sup>34</sup> *ibid.*

<sup>35</sup> OECD 2013, 7

banks, insurance companies and the “consultancy industry”, who develop customised tax saving models.

## 6.1. Wealthy Private Individuals

The estimates in James Henry’s study published by TJN in 2012 on offshore private financial assets come to \$32tn (c. €26.23tn) for 2010.<sup>36</sup> These sums are in any case inconceivable, if size-wise they are comparable to the combined GDP of the US and Japan.<sup>37</sup> The comparison of data from 2005 and 2010 shows an acceleration that gives an enormous rise of almost 10% for this period. Assuming moderate returns of 3% and a 30% income tax rate, the annual tax shortfall is up to \$280bn (€230bn). This is not taking the inheritance taxes or capital gains taxes related to these asset values into account, which naturally further increase the tax shortfall. It not only concerns offshored financial assets, but corporate tax avoidance through profit shifting is likewise not contained in it. For Germany, Troost estimates that the losses through non-taxation of corporate profits are twenty times the amount of that caused by private tax evasion in tax havens.<sup>38</sup>

The estimates in a study by Helvea<sup>39</sup> (*Swiss Banking Secrecy and Taxation: Paradise Lost?*) come to similar conclusions. According to this, the EU states invest a total of €600bn in Switzerland. 80% of EU citizens’ asset values are not declared to the financial authorities. The estimate values for Austrians are up to €14bn, of which only 11% are declared. The biggest volumes come from Germany (€194bn). Germans declare almost a third of their wealth. It has been established that the national differences in the willingness to declare wealth varies greatly. Whereas Germans very willingly provide information, in Italy, Spain and France the financial authorities are rarely informed.

Henry’s estimates are based on taxation-at-source revenues, three-quarters of which are transferred to the financial authorities of the countries of origin of foreign investors. For portfolio investments and financial products that are not subject to savings tax (on interest from savings), average values are assumed and included in the calculation.

Zucman’s calculations on private financial assets in Switzerland result in a similar order of magnitude. The basis of the analysis are the official, generally accessible statistics from various data sources. The estimates are based on the comparison of securities statistics of the countries’ national banks. In these, the securities issued abroad are entered as liabilities in the respective country in which they are issued as securities. If the securities are acquired by foreigners through a tax haven, these values do not appear as assets in the balance of the state of the foreign buyer at all. Owing to the banking secrecy in the tax haven this country receives no information. The assets affected by the purchasing process are absent, the asset value of the country affected therefore remains incomplete. The complete securities portfolio can be seen in the administration, the remainder has disappeared. Furthermore, securities that are administered in bank deposits do not appear in the banks’ balance sheets. Likewise there is no information on non-financial assets, such as artworks or palaces.

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<sup>36</sup> TJN 2012, 5

<sup>37</sup> According to the authors the result is probably an underestimate, because only financial assets are taken into account. It was not possible to cover numerous pieces of real estate, yachts or pieces of art etc. belonging to the richest individuals.

<sup>38</sup> IP/12/1325 vom 6.12.2012; [http://europa.eu/rapid/press-release\\_IP-12-1325\\_de.htm](http://europa.eu/rapid/press-release_IP-12-1325_de.htm) 17.11.2014

<sup>39</sup> A Geneva-based company specialising in financial research.

For example, an Austrian has a securities deposit in Google shares with a Swiss Bank. From a US perspective, a foreigner has thus bought a share of a US company. This asset appears as a commitment on the liabilities side of the asset balance. Now the counter-entry of a different national bank is absent. For the Swiss it is solely a question of a transitory item, and is therefore not to be entered in the books. The Austrian national bank, however, cannot post a receivable, because owing to Swiss banking secrecy the Austrian's ownership of the shares is unknown to them.

### The Dynamics of the Super-Rich

Based on total world wide financial assets of €73tn, Zucman estimates that internationally 8% of private financial assets are offshore, i.e. €5.8bn. According to his estimate 80% of this is untaxed. A third is in Switzerland, the remainder is spread over other tax havens. Based on estimates, Zucman can calculate an offshore asset value of c. €8tn or 10-11% of worldwide financial assets. The Boston Consulting Group came to a similar result on the basis of interviews with asset managers (2014).

A long-term decline in assets has not been noticeable with the financial crisis. In 2013 €1.8tn in foreign assets was deposited in Switzerland. Between 2009 and autumn 2013 foreign assets, that is the assets of non-resident foreign-currency holders, had risen by 14%. Global estimates for all tax havens, including Switzerland, give an increase of 25%.

On this basis Zucman assumes that the estimate of €1.8tn foreign assets in Switzerland is an underestimate. True, it includes all Swiss-based banks and the deposited assets, but the real owners have not been ascertained. This means that credits that are ascribed to Swiss nationals belong to foreigners. It is thus completely realistic to assume that this amounts to assets of €2tn to €2.2tn. After correction this produces another interesting finding. 60%, that is €1tn, can be ascribed to Europeans, not to the often mentioned oligarchs or dictators. The structure of the investments shows that some €200bn is invested in the banks as fixed-term deposits, the remaining €1.6tn is made up of securities, that is shares, bonds and investment funds. Of the total assets managed in Switzerland, 40% are in investment funds, with the majority flowing into Luxembourg funds.

The revenue shortfall largely consists of income tax and profit tax, inheritance tax and a smaller amount of wealth tax. The basis is the current tax rates. The calculations relate exclusively to tax evasion owing to banking secrecy, not to untaxed income from undeclared work, corruption, narcotics trading or value-added-tax fraud. Neither does it include the share that would be saved by the tax-optimisation by multinational corporations.

To protect presumably even higher revenue shortfalls, various countries wanted to create incentives to keep capital in the country. For this reason, the individual countries were engaged in an intensive tax-cutting competition. The reduction in tax rates, however, did not lead to the desired result. Ultimately they brought about the harm twice, once through revenue shortfalls owing to tax evasion and once through the low tax rates.

The individual tax havens are in competition with one another, but they also complement each other. The different specialisations of each tax haven range from traditional asset management to preferred investment forms to the complete system of shadow banking – the existing diversity of possible activities in the offshore centres is considerable and normally completely legitimate. Employees on the other hand do not use tax havens at all. In the

calculation of wages and salaries income tax is deducted directly, any transfer beforehand is impossible – unequal distribution also in tax evasion.

In general it has been possible to make only small advances in combating tax havens and secrecy instruments. According to the OECD standard, automatic information exchange is to be implemented by 2016. The regulations and institutions that hinder transparency and thus the disclosure of ownership, income and wealth relations still remain untouched. One of Zucman's<sup>40</sup> main demands envisages the creation of an international financial register as the basis for an automatic information exchange that lists the actual economic owners. Zucman regards the IMF as the institution that has the technical means to build up such a register. The IMF already has sufficient information on capital flows and securities holdings in almost every country. As a further step the databases of national central depots would have to be compared and verified with other available data sources, such as balance sheets.

Although the problems in relation to tax fraud, tax avoidance and tax havens have long been known, it is actually surprising that there is so little data material available and that it took until 2012 for the comprehensive data material here to be published. It is also strange that international organisations such as the IMF, the World Bank, G20, OECD or the central banks of the leading industrial states, which have well-founded data material and the necessary resources, have so far contributed so little. This is a strong indicator that in the past not much more than lip service was paid to the political will to combat tax fraud, aggressive tax planning and tax havens.

There are no official estimates, neither from international financial institutions nor from governments. Thus the above-mentioned data sources underlying the calculations are used.<sup>41</sup>

## **6.2. Companies and International Corporations**

Apart from high-net-worth individuals (HNWI), the heaviest users of tax havens are large companies and corporations.

For 2008 the US Government Accountability Office established that 83 of the 100 biggest corporations in the US have subsidiaries in tax havens. At the European level, owing to the broader definition of offshore, it was ascertained that even 99 of the 100 biggest corporations in Britain, France and the Netherlands have subsidiaries in tax havens.<sup>42</sup>

Without the aid of private banks and auditing companies capital flight would not be possible. They ensure that the tax haven does not become a mirage. Here too there is a strong concentration of asset values in the ten biggest banks, which hold more than half of the asset values of the top 50. The top three are UBS, Credit Suisse and Goldman Sachs. Documents of the German Bundestag for June 2009 contain the information that six of the largest banks in Germany together had 1,636 branches in tax havens, 1,064 of them alone belonging to Deutsche Bank. The results of this analysis are consistent with other studies or surveys.<sup>43</sup>

As in Switzerland, the banks have also assumed the safekeeping, administration and consultancy offshore. They thus guaranteed the assets against any taxation. The services on offer in the tax havens may indeed compete with one another, but they also supplement each

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<sup>40</sup> Zucman 2014, 102 f.

<sup>41</sup> Sullivan 2007, Murphy 2008, Henry 2012, Zucman 2013, i.a.

<sup>42</sup> Shaxson 2011, 371

<sup>43</sup> e.g. Scorpio 2005; Piketty and Zucman 2012; Atkinson and Saez 2011

other. Usually it concerns subsidiaries of Swiss institutes. The various stages of asset management are specialised so that they complement each other well.

The “Big Four” among the auditing companies, Deloitte, PricewaterhouseCoopers, Ernst&Young and KPMG, are the most important players in the tax avoidance system.<sup>44</sup> Their expertise forms the core of the gigantic offshore world. They are present in all important tax havens, so that the tax haven does not become a mirage. They are also keen to offer their consultancy services to governments. Making use of these can assist their work through relevant legislation, for example the 2006 Trust Law in Jersey.<sup>45</sup> During a public hearing of the Public Accounts Committee of the British parliament it became known that PWC, one of the four biggest international consultancy companies, was offering tax-saving models that offered only a 25% probability of success. There was thereby a 75% chance of being categorised as illegal. The practices of the other three members of the “Big Four”, who in this context readily admitted marketing such tax-avoidance strategies when the probability of success was at least 50%, are evidently little better.<sup>46</sup>

Economists at the Swiss bank Crédit Suisse recently particularly concerned themselves with the advantages that big corporations in the OECD area generate through the use of loopholes. For this, the economists drew attention to the difference between the taxes actually paid and the legally prescribed tax rates. For the selected 390 Multinationals in the OECD alone there is a difference of over €75bn. The biggest differences, that is the biggest tax savings, were in the pharmaceuticals industry and in the IT sector. Both are business sectors in which intangible asset values play a particular role and as a result of which profit shifting to low-tax countries or tax havens is easier.<sup>47</sup>

Through the growing internationalisation and the resulting international interconnections, tax fraud and tax avoidance have become phenomena that nation states cannot combat alone. Rather, international coordination against the problem of tax evasion, tax avoidance and tax fraud will be needed. In all these activities tax havens play an essential role. Despite all the professions of the desire to fight tax fraud and tax evasion, tax policy in the industrialised countries itself plays an essential role in facilitating tax fraud and tax evasion.

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<sup>44</sup> Palan, 102

<sup>45</sup> Murphy 2009

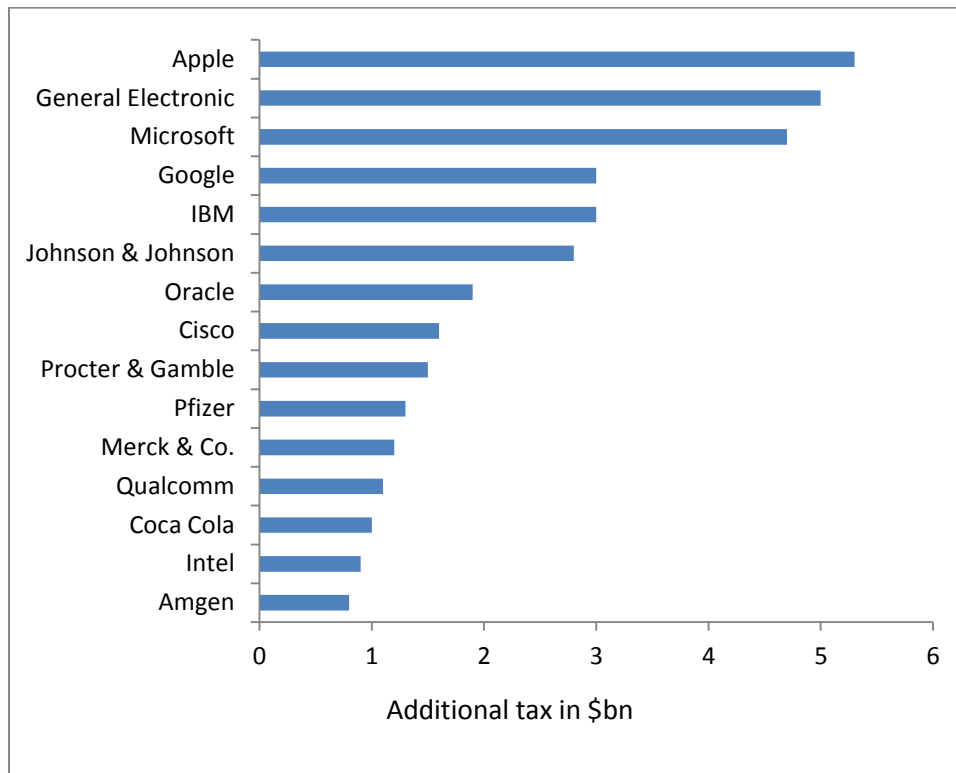
<sup>46</sup> <http://theconversation.com/big-accountancy-firms-have-a-human-rights-problem-28630> : Prem Sikka, Prem: Big accountancy firms have a human rights problem

<sup>47</sup> Szigetvari 2013

Fig. 1

### A world without tax loopholes

If the tax paid were in line with the statutory tax rate it would hit these 15 corporations the hardest



Sources: Crédit Suisse, OECD, Datastream, IBES, *Der Standard* 23.10.2013

Thus while multinational corporations are subject to one of the lowest corporate tax burdens, small and medium-sized enterprises usually pay the full nominal rate – a clear distortion of competition on top of everything else.

In addition there are also some prominent examples: Troost<sup>48</sup> describes the electronics producer Apple as a pioneer. The corporation has its headquarters in California and alongside the loopholes in tax law in the US also uses those in Ireland and the Netherlands in order to shift its corporate profits to the Caribbean, where the tax rate on overseas profits is just 1.9%, in comparison to the 35% that would apply to profits in the US, a clear saving. In 2011, for example, Apple made a profit of \$22bn and paid only \$10m in corporation tax. Another example is Amazon. In Germany in 2012, despite a turnover of €8.7bn the mail-order company paid only €3.2m in corporation tax.<sup>49</sup> This is possible by transactions through Luxembourg. According to the *Financial Times*, Google too shifted €8.8bn in royalty revenues through Ireland and the Netherlands to Bermuda, and thereby cut its average foreign tax rate by approximately five per cent.<sup>50</sup> According to the *Frankfurter Allgemeine Zeitung*, the Swedish furniture company Ikea parked €11bn in a Liechtenstein foundation.<sup>51</sup>

<sup>48</sup> Sustala 2013

<sup>49</sup> Troost 2013

<sup>50</sup> *Financial Times* 2013

<sup>51</sup> *FAZ* 2011

From there, a credit for the purchase of its own trademark rights at the fictional value of €9bn was transferred to its own subsidiary. The interest payments from the subsidiary to the foundation made it possible for €500m a year to remain untaxed and flow into the family foundation.<sup>52</sup> Starbucks in Germany has never paid any tax on profits in Germany since 2002 – completely legally. In all, in 2011 Starbucks paid a foreign tax rate of 13%.<sup>53</sup>

In April 2013 the media intensively analysed the report about “Offshore Leaks”, the International Consortium of Investigative Journalists (ICIJ). The first estimates were published – although only a small amount of a few percent – from the thus far most extensive amount of data, with 2.5 million documents totalling 260 gigabytes. The bundle of data is an excerpt from the 400 gigabytes of data handed over to US, British and Australian tax authorities in 2010.<sup>54</sup>

### Auditing Companies and Private Banks

Asset values are not only concentrated in private individuals and large corporations. The supporting auditing companies and private banks are specialised. Here too there is a heavy concentration of asset values in the ten largest banks, which have more than half of the asset values measured against the top 50. As the following table shows, the top three are UBS, Credit Suisse and Goldman Sachs.

Table 2  
Top 50 global private banks, 2005-2010

<b>TOP 50 GLOBAL PRIVATE BANKS, 2005-2010</b>							(1/2)
<b>(\$Billions, Assets Under Management)</b>							
		Jun-05	Mkt%	Dec-09	Mkt%	Dec-10	Mkt%
<b>Top 10 - Total</b>		<b>\$2,272.8</b>	<b>42.2%</b>	<b>\$3,660.8</b>	<b>45.5%</b>	<b>\$6,182</b>	<b>51.2%</b>
<b>Rank</b>		<b>Next 10 - Total</b>	26.2%	<b>\$2,319.9</b>	28.8%		<b>2005-2010</b>
		<b>Next 30 - Total</b>	31.6%	<b>\$2,069.4</b>	25.7%		<b>AAGR%</b>
<b>2005</b>	<b>2010</b>	<b>Top 50 - Total</b>	<b>\$5,391.3</b>	<b>100%</b>	<b>\$8,050.1</b>	<b>100%</b>	<b>\$ 12,066.4</b>
							<b>15.8%</b>
1	1	UBS	\$1,349.2	\$1,627.6	\$1,789.0	5.8%	
2	2	Credit Suisse	\$469.2	\$770.1	\$932.9	14.7%	
7	3	Goldman Sachs	\$166.0	\$220.5	\$840.0	38.3%	
19	4	Bank America	\$108.5	\$433.8	\$643.9	42.8%	
5	5	HSBC	\$183.0	\$250.0	\$390.0	16.3%	
6	6	Deutsche Bk	\$180.9	\$464.2	\$367.5	15.2%	
9	7	BNP Paribas	\$158.0	\$293.0	\$338.0	16.4%	
24	8	Wells Fargo	\$78.0	\$187.3	\$300.0	30.9%	
8	9	Morgan Stanley/ SSB*	\$165.0	\$365.0	\$297.0	12.5%	
4	10	JPMorganChase	\$187.0	\$266.0	\$284.0	8.7%	
11	11	Pictet	\$150.0	\$236.6	\$270.0	12.5%	
12	12	Bank Leumi	\$138.0	\$202.5	\$251.0	12.7%	
13	13	Barclays	\$135.3	\$230.0	\$238.3	12.0%	
38	14	Commerzbank	\$30.2	\$207.1	\$225.0	49.4%	
10	15	ABN Amro	\$150.8	\$199.1	\$218.4	7.7%	
32	16	TD Canada	\$49.4	\$65.0	\$183.0	29.9%	
34	17	Banque Julius Baer	\$46.8	\$160.2	\$181.0	31.1%	
16	18	Credit Agricole	\$114.1	\$215.2	\$171.0	8.4%	
23	19	Bk of New York	\$82.6	\$84.0	\$166.0	15.0%	
17	20	Northern Trust	\$111.5	\$141.5	\$154.0	6.7%	

Source: J. Henry 2013, from: bank financials, private banking industry interviews, JSH analysis

<sup>52</sup> Attac 2014

<sup>53</sup> Handelsblatt 2012

<sup>54</sup> [https://www.credit-suisse.com/who\\_we\\_are/corporate\\_campaign/clients/de/bam/index.jsp](https://www.credit-suisse.com/who_we_are/corporate_campaign/clients/de/bam/index.jsp)



Corporations have more extensive opportunities to avoid tax or use room for manoeuvre than comparable individuals. In particular the arrangements of various company constructions whose transactions range across international borders open up numerous avoidance opportunities. What is clear is that the governments are not achieving the envisaged revenues through existing legislation. Consequently the political will is a necessary precondition to counter these developments.

The problems caused by tax avoidance strategies of international corporations go even further, however. The low tax burden in comparison to national companies who are unable to make use of these arrangements lead to massive distortions of competition, which are also harmful to the whole economy. And these obvious opportunities for the big multinational corporations lead to the undermining of the tax morality of all those who cannot make use of them, essentially workers, pensioners and smaller national companies. Even the economist Clemens Fuest, who is essentially very positive with regard to tax competition, explained in an interview with the *Frankfurter Allgemeine Zeitung* that the large multinational corporations can use the tax loopholes much more extensively and thereby reduce their tax payments to close to zero. In all, according to his findings, it leads to the tax burden on the subsidiaries of multinational corporations being on average 20% to 30% below that of comparable purely national companies.<sup>55</sup> This phenomenon, that multinational corporations exploit international tax arbitrage opportunities and thereby cut their tax burden, has long been empirically proven.<sup>56</sup> Trust in the rule of law falls and in the long term leads to serious threats to democracy and the rule of law.

After years of discussion, in 2011 the European Commission finally presented a draft Directive for the introduction of a common consolidated corporate tax base. The draft essentially included the standardisation of the tax base for international corporations. The profits are to be spread across the member states according to a particular formula. Until now – almost four years later – however, it has not been possible to reach agreement on the draft Directive at the political level. In the meantime an action plan has been presented by the OECD (Base Erosion and Profit Shifting, BEPS) that includes a joint international approach to fight against corporate tax manipulation.

The words of the OECD general secretary Angel Gurría on the occasion of the presentation of the OECD BEPS report in early 2013 are unusually sharp, in that he warns against an enormous social problem, and continues: *“The anger over the unequal distribution of the burden is growing. Many citizens’ trust in the institutions is crumbling. I am afraid that if we do not act it may come to riots in the inner cities.”*<sup>57</sup>

Tax havens not only deprive nation states of urgently necessary revenues and lead to increased tax burdens on consumption and labour, but also essentially contribute to unequal distribution of wealth and further exacerbate this unequal distribution. The opportunities for minimisation of tax on the one hand lead to a big increase in financial assets and on the other to a distortion of investment flows, because the utilisation of tax loopholes in tax havens gives an advantage to investment in financial assets by comparison with investment in fixed assets. And precisely this unequal treatment of financial investments and fixed investments and the resulting unequal distribution was again an essential reason for the

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<sup>55</sup> FAZ: “Multis zahlen 30 Prozent weniger Steuern”, 13.11.2014, 18 f.

<sup>56</sup> Haufler (2006): *Die Besteuerung multinationaler Konzerne*, 1 f.

<sup>57</sup> <http://www.spiegel.de/wirtschaft/soziales/oecd-chef-blaest-zum-kampf-gegen-die-steuertricks-der-weiltkonzerne-a-883094.html>

outbreak of the financial and economic crisis and the resulting debt crisis, because wealthy individuals regularly also invest speculatively and thus shared the responsibility for the boom in highly risky hedge funds and other highly speculative financial products.<sup>58</sup> In addition, tax havens are also essentially responsible for the fact that many countries have budget problems, because the shifting of immense wealth means that urgently necessary tax revenue is lost to these tax havens. This also leads to the fact that the tax burden on less mobile elements is rising in order to compensate for the lost revenues. The tax burden on work or consumption has thus reached a disturbingly high level, which has negative effects on growth and employment.

Combating tax havens must therefore be a primary objective in order to give countries room for manoeuvre for urgently necessary growth- and employment-friendly structural tax reforms. Alongside the known tax havens that fulfil the above-mentioned criteria and which are generally well-known, there are also special tax regulations in individual states that at first glance are not to be identified as tax havens in the classical sense, but which essentially share the responsibility for the current problems. Here the European Union or actually its member states also play a decisive role. Despite the general profession that they now wish to take the fight against tax fraud and tax evasion seriously, it should also not be overlooked that the tax legislation of the individual nation states is also responsible for the fact that tax fraud and tax avoidance on this scale is possible at all in the first place. The latest revelations from the Consortium of Investigative Journalists<sup>59</sup> on the tax practices in Luxembourg clearly show where the problems lie.<sup>60</sup> As a result of these revelations the Consortium of Investigative Journalists has evaluated and published an enormous amount of data approaching 28,000 pages, which shows that the tax authorities in Luxembourg approved complex tax saving models for international corporations in advance, which through the corresponding mechanisms is supposed to have enabled these corporations to pay zero or almost no tax on profits. According to media reports, the corporations that are said to have profited from this include prominent names such as Amazon, Pepsi, Eon, FedEx, Procter & Gamble, Deutsche Bank, Ikea and many others. These models were developed by the PricewaterhouseCoopers (PWC) consultancy company and approved by the Luxembourg financial authorities. All those affected do indeed emphasise that it concerns legal constructions. This would also correspond to what we have defined under the term aggressive taxation planning. Because according to the definition it usually concerns legal mechanisms. Whether in these cases everything was always legal, however, remains to be seen. Because, as mentioned above, the tax saving models used by multinational corporations often represent a balancing act, and as likewise mentioned, the consultancy industry has also admitted that it regularly probes the boundaries and offers models that have only a 25% chance of success. It should also not be overlooked that the European Commission has already initiated a formal investigation process concerning Luxembourg and Amazon, because there are considerable concerns as to whether certain agreements between Luxembourg and Amazon concerning transfer pricing are permissible under state-aid law. This means there are already very possibly considerable suspicious factors in this field in Luxembourg that are evidently not always completely legal.<sup>61</sup>

Luxembourg is no isolated case. And it is clearly evident that reforms are urgently needed. When legal mechanisms mean that large, highly profitable multinational corporations have to

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<sup>58</sup> Stockhammer (2011): in wirtschaftspolitische Standpunkte 03/2011, 2 ff.

<sup>59</sup> [www.icij.org](http://www.icij.org)

<sup>60</sup> *Süddeutsche Zeitung*, 6.11.2014: Luxemburg ein Land im Zwielficht, 1 f.

<sup>61</sup> IP/14/1105 vom 7.10.2014

pay as good as no taxes on their profits then the current regulations are obviously no longer fit for purpose and need to be amended. Many experts who have intensively analysed the issue are also not really surprised by the revelations.<sup>62</sup> <sup>63</sup> But what has surprised most of them is the extent. Because the revelations list documents on the tax saving models of more than 340 multinational corporations. And this did not just concern companies that were advised by consultancies. Just in the case of Luxembourg the Consortium of Investigative Journalists speaks of tax shortfalls at the level of billions being lost to other states through these mechanisms.<sup>64</sup> It can however be fundamentally assumed that many other international corporations that draw on the consultancy services of other specialist consultancy companies have used similar mechanisms and that the extent is even considerably larger than has previously been recognised. There are special regulations for corporations practically everywhere in the world. In the Netherlands, with the “participation exemption” there are tax exemptions for dividends and capital gains that are accrued outside the Netherlands. In connection with the double-taxation agreements that the Netherlands has agreed with many tax havens, which envisage no essential taxation at source for dividends, interest and royalties, this leads to the Netherlands playing a special role in the shifting of profits to tax havens. The Tax Justice Network reports of more than 20,000 mailbox companies based in the Netherlands purely for this purpose.<sup>65</sup> In 2014 the weekly newspaper *Die Zeit* also wrote about the Netherlands tax haven.<sup>66</sup> Ireland likewise plays a decisive role in the tax avoidance strategies of international corporations. With the “double Irish”, a tax loophole in Ireland, it is possible for international corporations to use a special arrangement of two companies in order to shift their taxable profits into tax havens more or less without paying any tax. A prominent but no means the only example of this is Apple. With the aid of this model, despite profits in the billions, Apple has managed to pay as good as no corporate tax. By using this loophole over the years the multinational corporations have saved a total of billions of euros in taxes on profits.<sup>67</sup> True, as a result of international pressure Ireland and the state-aid investigation initiated by the Commission, Ireland has announced that it wishes to close this tax loophole, but the corporations that are already using this model have been promised a four-year transition period. As compensation for the expiry of the above-mentioned loophole Ireland has likewise announced that it wishes to introduce a “patent box regime”.

With group taxation in Austria there is the opportunity for international corporations to calculate foreign losses against profits made in Austria.<sup>68</sup> But there are also such regulations in many other European member states. In Britain, too, there is a tax incentive for returns on earnings from patents and particular other innovations. With this “patent box” regulation, these profits are taxed at only 10%,<sup>69</sup> significantly less than the nominal corporation tax that would normally be applied. But Britain has at least announced its intention to introduce limitations. In addition to the legally established incentives, the so-called “rulings” also regularly give rise to criticism in connection with tax dumping. Rulings or preliminary ruling procedures are legally binding information by financial administration authorities in

<sup>62</sup> Falk, Rainer (2009): Zur Debatte um Steueroasen – Der Fall Luxemburg

<sup>63</sup> *Der Standard*, Zucman, 6.11.2014

<sup>64</sup> “Secret Tax Bills Save Billions”, <http://www.icij.org/project/luxembourg-leaks>, 13.11.2014

<sup>65</sup> SOMO(2006): The Netherlands: A Tax Haven

<sup>66</sup> *Die Zeit*: Holländische Geldschleuser, 20 f., 3.7.2014

<sup>67</sup> *The Guardian*: “Ireland to close double Irish tax loophole”, <http://www.theguardian.com/business/2014/oct/13/ireland-close-double-irish-tax-loophole>, 22.10.2014

<sup>68</sup> § 9 KStG

<sup>69</sup> *The New York Times*: Ireland, Still Addicted to Tax Breaks: [http://www.nytimes.com/2014/10/20/opinion/ireland-still-addicted-to-tax-breaks.html?\\_r=0](http://www.nytimes.com/2014/10/20/opinion/ireland-still-addicted-to-tax-breaks.html?_r=0)

connection with tax questions concerning companies and – at least wealthy – individuals. At first sight this sounds harmless and fundamentally is also sensible in order to create legal certainty as it is possible to clarify in advance how particular complex tax situations are to be dealt with before they actually arise. Austrian tax law also has this binding information in the form of the standardised information notification in § 118 of the Austrian Federal Fiscal Code, under which the tax office on written application, with an information notification has to inform and agree upon circumstances concerning legal questions in connection with reorganisations, company groups (this concerns Austrian group taxation) and internal transfer prices that have not yet been put into practice if the enquiry is associated with significant effects in tax law.<sup>70</sup> It is obvious that it is essentially sensible if complex legal questions can be clarified in advance in order to offer legal and planning certainty to all those involved. But it also has to be ensured that this information is within the framework of current law and that this advance information does not create any preferential treatment. It is therefore problematic if these agreements are not publicly accessible, as is the case in Austria and most other countries that use such instruments. This lack of transparency is usually explained on the grounds that publication would reveal too many commercial secrets and can therefore not be justified. This cannot be disputed and it does not appear to be urgently necessary to make everything publicly accessible. But it is likewise urgently necessary that at least the most important points have to be published in an anonymised form.

### **6.3. The Tax Tricks of Corporations in Practice**

The annual loss of revenue to states as a result of the tax planning models of the multinational corporations is considerable. The fact that multinational corporations are able to reduce their tax burden on profits through tax-saving plans has been known for decades. There are several reasons for the massive increase in this phenomenon in recent years. On the one hand there has been increasing globalisation, on the other corporate structures have also changed massively in recent decades. The OECD<sup>71</sup> estimates that some 60% of international trade consists of internal company transactions. These changes in corporate structures are on the one hand caused by economic changes, on the other hand, however, corporate structures have also deliberately been created in order to keep corporate tax quotas as low as possible. Apart from this, as a result of technological development there has been an increasing digitalisation of the economy, which again has led to completely changed general conditions. And the nation states regularly offer multinational corporations preferential treatment that supports these tax avoidance strategies.

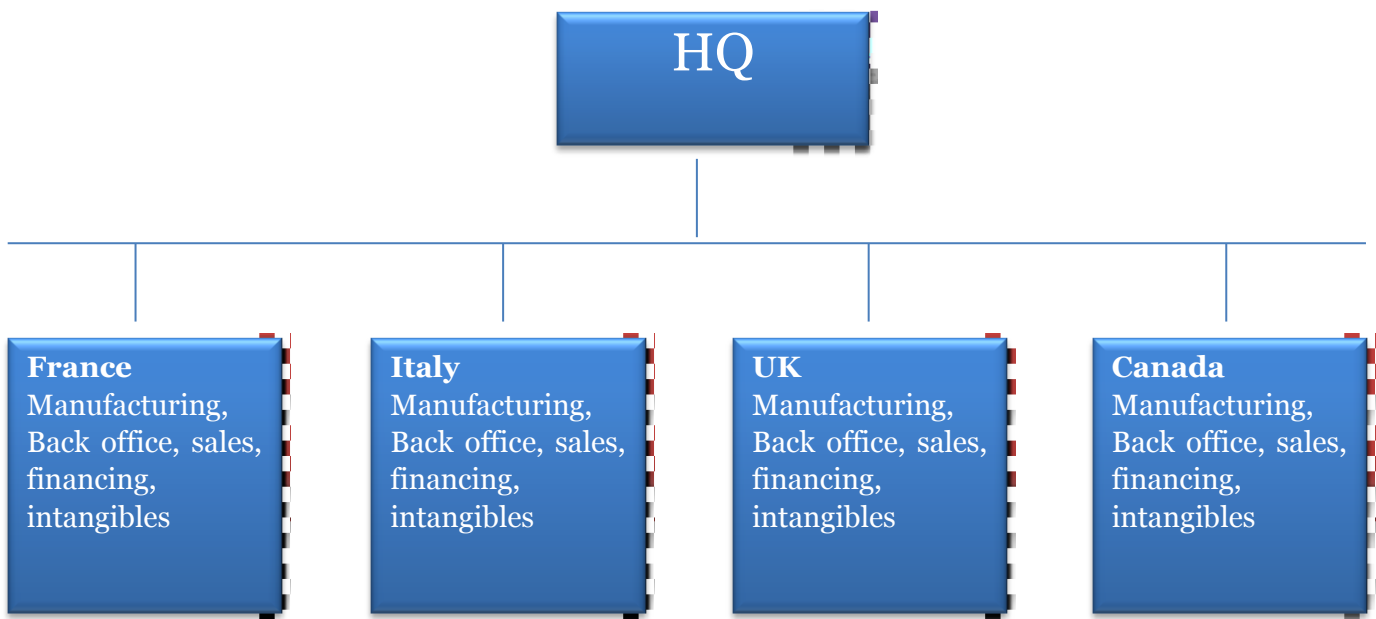
In the past corporations were usually structured in such a way that there was a parent company (a holding company), which held and administered the participants in various subsidiaries in different countries. All economic activities, from the purchase of raw materials to production to the sale of the finished product were then carried out in these subsidiaries. The individual companies were largely independent of one another and commercial transactions within the corporation were relatively limited.

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<sup>70</sup> § 118 Federal Fiscal Code

<sup>71</sup> OECD 2012

Fig. 2  
Traditional corporate structure



Source: ITUC 2013

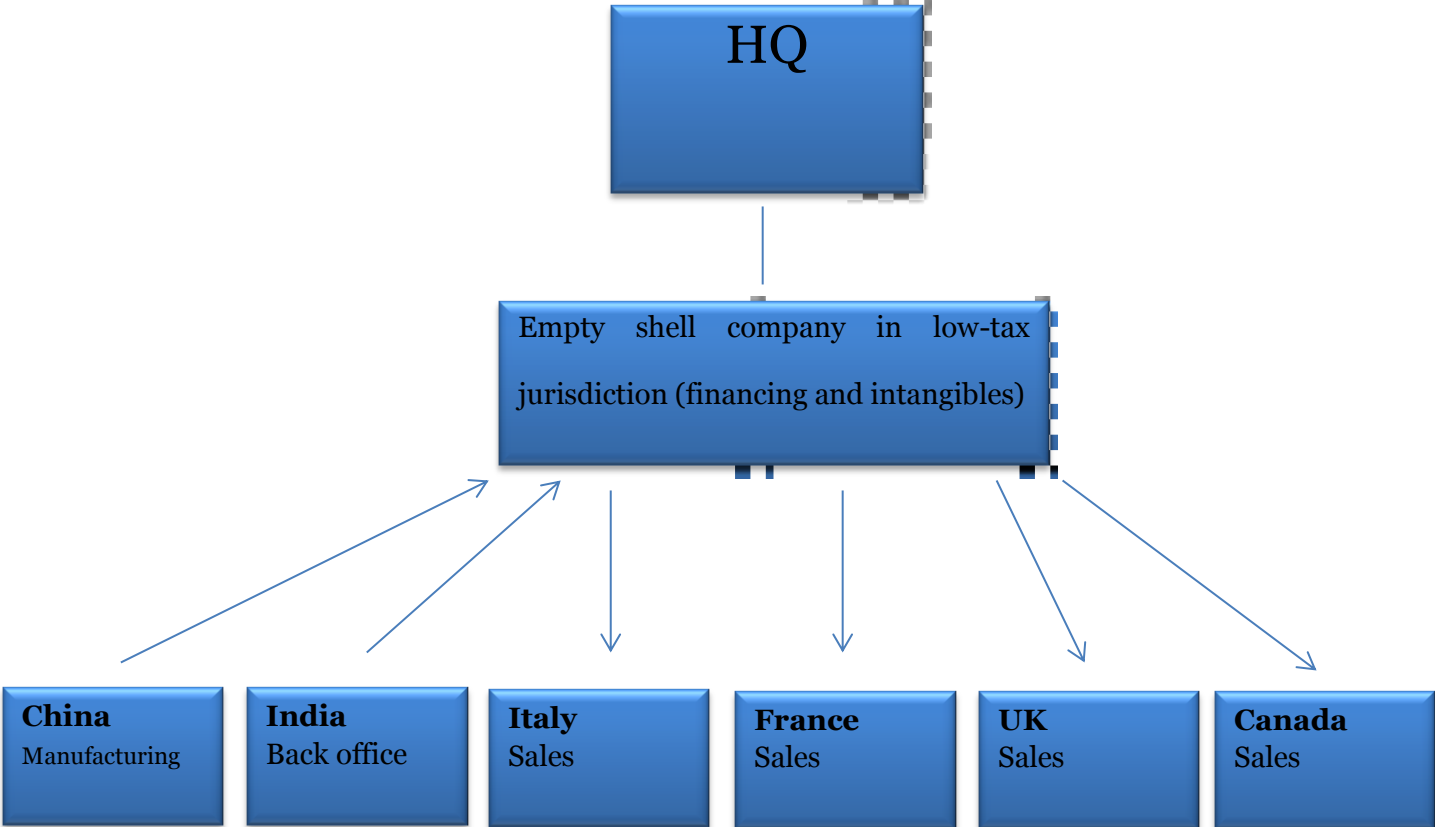
In the meantime, however, these traditional structures are a thing of the past. Corporate structures have changed dramatically. In practice corporate structures are often far more complex and also hardly understandable for outsiders, although in simplified form one can find the following corporate structures.

The parent company holds a large number of subsidiaries, although these now only have sub-tasks in the various states in which they are based. This means that there is one subsidiary in country A that is responsible for production, another that looks after the administration and many subsidiaries that are responsible for marketing in the respective countries. These organisational structures are usually still based on business management. But they also create the basis for tax planning. The entity to which the corporate profit accrues is essentially dependent upon how the internal company services are calculated and what prices are applied for internal company trade. The OECD has developed transfer-pricing guidelines. A transfer price is the price that is placed on the exchange of goods and services between the various corporate companies within a group. In 2010 the OECD transfer-pricing guidelines were published in revised form.<sup>72</sup> Here the arm's length principle assumes particular importance. This is actually intended to ensure that all countries involved can tax the share of profits that would have been made by the company based in the respective state if it had been a legally completely independent company. The transactions between the individual corporate companies are thus to be organised in such a way as if they were legally independent companies. This is "arm's length principle". "Standard transaction-related methods" or "profit methods" can be used to establish transfer prices. The transfer-pricing guidelines are intensively concerned with these methods and offer extensive

<sup>72</sup> OECD(2010): OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations; <http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm>

definitions and explanations of how to proceed in individual cases. Despite every effort, however, it is clear that these transfer-price guidelines are insufficient to hinder profit shifting to low-tax countries or tax havens.

Fig. 3  
Corporate Structure



Source: ITUC 2013

By adding other corporate companies that are accorded special tasks, and purely motivated by taxation considerations, however, it then becomes possible to plan the corporate tax burden in such a way that it is liable for no or almost no tax on profits.

Nothing in the above corporate structure actually changes, but additional companies based in low-tax countries or tax havens and responsible for corporate financing, for example, are incorporated into it. Or the intangible assets are located in these companies. Or the intermediate company is responsible for the purchase of raw materials or it handles the sale of the end product. There are hardly any limits to the organisational opportunities here. There are indeed guidelines for internal company transactions, but in practice these prove to be inadequate to combat the aggressive tax planning models of multinational corporations effectively. The OECD has developed guidelines for how transfer pricing is to be applied inside corporations.<sup>73</sup> Transfer prices are usually described as the prices that are calculated for deliveries and services between the companies of a corporate group. By planning the transfer prices in such a way that the goods and services of the corporation's companies based in low-tax countries are estimated at higher prices, while those based in high-tax

<sup>73</sup> OECD(2010): OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

countries are calculated at lower prices. These can indeed not be established arbitrarily, but in practice it is in many ways difficult to check whether a reasonable price has been charged for these goods and services. Fundamentally it is the case that the arm's length principle has to be applied, i.e. that the prices have to be structured as if they were between independent business partners. The OECD member states have in principle agreed on this approach. The OECD has also published transfer pricing guidelines giving a detailed explanation of the practical requirements that have to be fulfilled.

In practice, the tax-saving models that are applied here often show a considerable degree of complexity, but the underlying principles are just as often surprisingly simple and can be reduced to a few points. As a basic rule one can state that multinational corporations seek to transfer their profits to countries where the tax burden is extremely low or ideally – from the corporation's perspective – is zero.

This is achieved when corporate transactions are carried out internally by using intermediate companies in low-tax countries or tax havens. It is possible to shift profits to these intermediate companies by using inflated transfer prices.

This is achieved when subsidiaries that hold intangible assets such as patent rights, royalty rights or marketing rights for the whole corporation are established in low-tax countries or tax havens. The other companies in the corporation then have to pay the corresponding royalties for these intangible assets, which can range from company names to software licences. These are tax-deductible as operating expenses for the corporation's companies that have to pay for them, and reduce the taxable profit.

Financing companies are also based in low-tax countries or tax havens. These are funded with capital and provide the other corporate companies with outside capital in the form of interest-bearing credit or loans. The interest paid by the other companies are then tax-deductible operating expenses for these companies and reduce their taxable profit.

And differences in national tax regulations are also regularly exploited. Particular financial instruments, for example, are regarded as equity capital in one country, while in another country they are treated as loan capital. This can lead to the fact that payments in one country reduce taxable profit, but corresponding payments in another country then do not increase it, so particular internal transactions can achieve non-taxation.

With these essentially simple basic principles it is possible to keep the corporation tax quota very low. The latest documents published by the Consortium of Investigative Journalists on the role of Luxembourg clearly show that the profit-tax burden of many international corporations is less than 1%.<sup>74</sup>

## **7. How Tax Havens Work**

Terms such as base company (mailbox company) and flow-through entity are mentioned in In connection with the mechanics of tax planning.

### **7.1. Base Company (Mailbox Company)**

The term base company corresponds to the colloquial mailbox company and describes a company that is founded in a tax haven for operations in third countries.

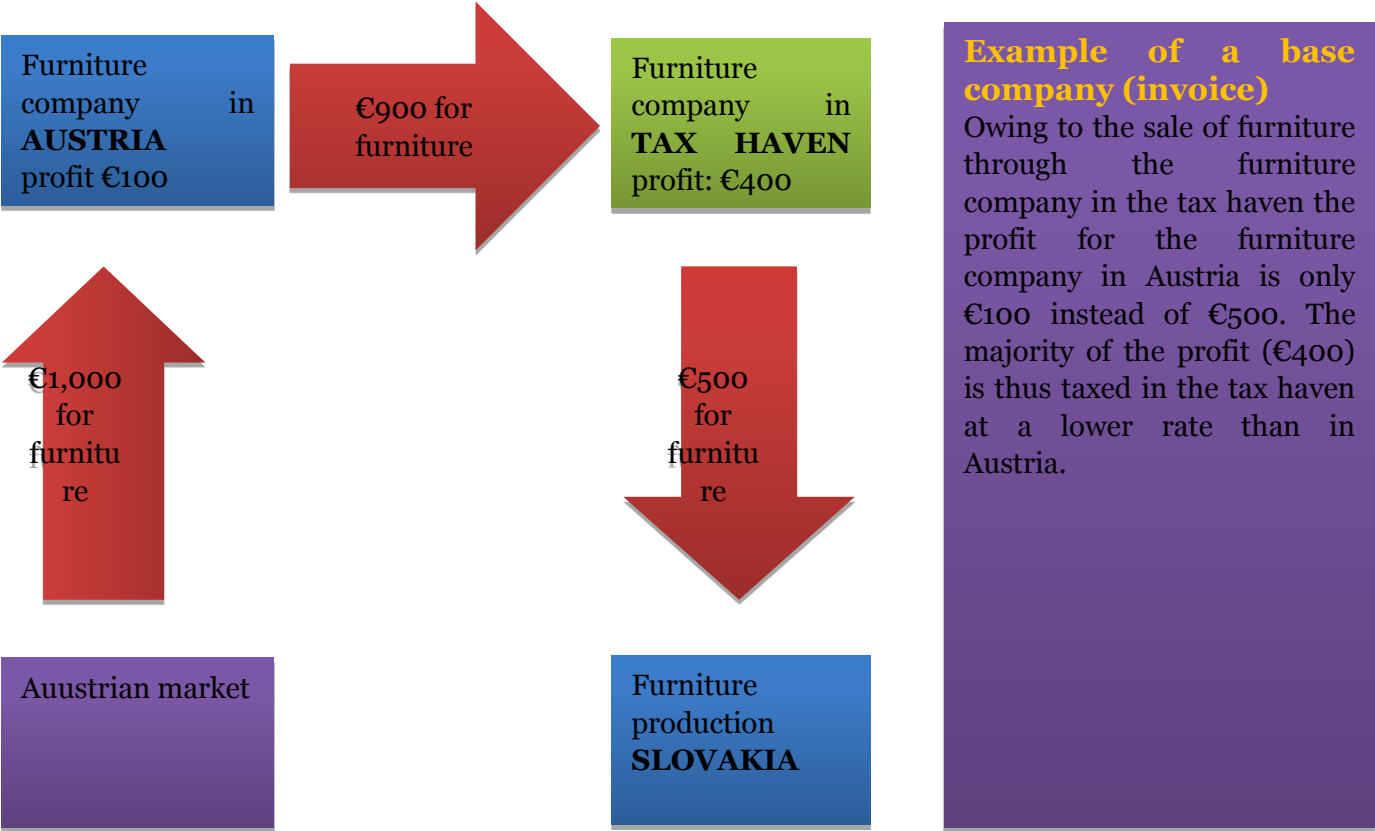
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<sup>74</sup> [www.icij.org](http://www.icij.org)

**Example of a Base Company (Invoice)**

A furniture company in Austria has its production in Slovakia. The furniture produced in Slovakia is sold to a tax-haven company. This tax-haven company sells the furniture on to the Austrian company. Most of the price mark-up and thereby the the profit goes to the tax-haven company. The Austrian company sells the furniture with the remaining limited mark-up. Thus the majority of the profit (€400 of €500) is passed on to the tax haven and thereby removed from Austrian taxation.

Fig. 4  
Base Company



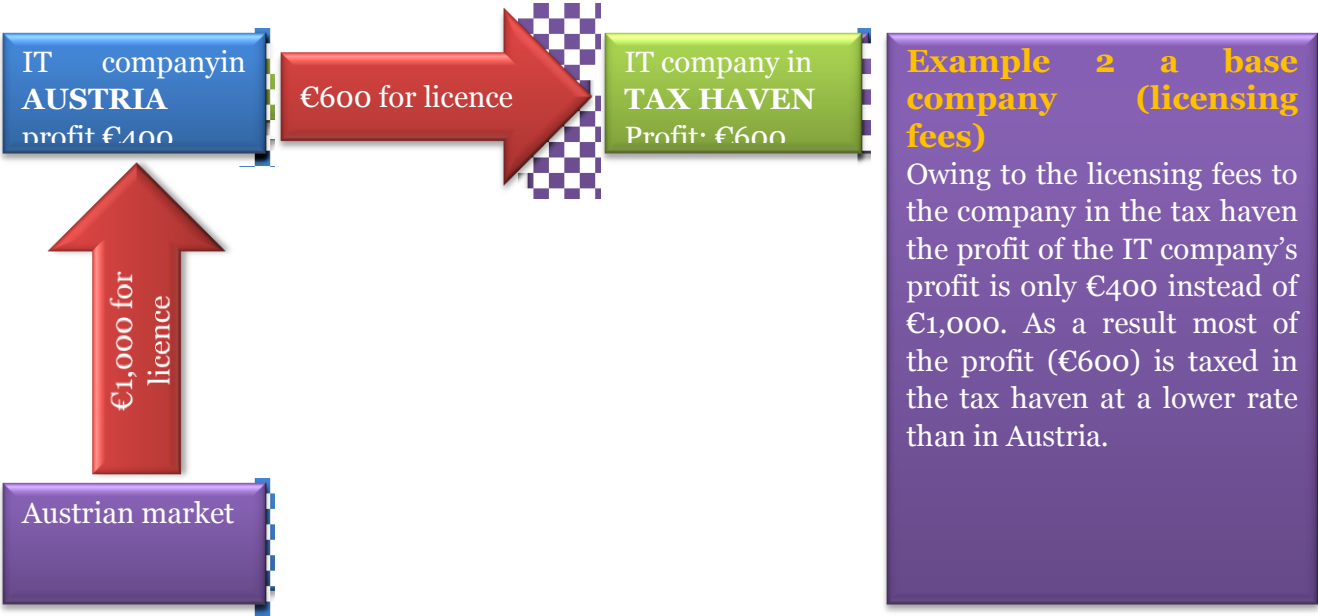


However, if the tax haven company is just a mailbox company through which the work is invoiced but where no work is performed then according to Austrian law the profit must be ascribed to the Austrian furniture company. Otherwise the company would be prosecuted for tax evasion.<sup>75</sup> The system is not so simple, because if there is a finishing process in between it becomes more complex. Only in individual cases can the tax office establish the value of this finishing process. Many business procedures simply remain unchecked.

**Example of a Base Company (Royalties)**

Royalties are paid in order to use rights. If a user “buys” a computer programme it does not belong to him, but he receives only the right to use the programme – thus paying royalties. If an Austria-based IT company produces a programme this is used by its customers under a license. The royalties for this increase the company’s profits. Consequently the rights to the programme are transferred to a company based in a tax haven. For example, through the fact that the company in the tax haven gives the Austrian IT company the contract to develop a program and makes only minimal charge for this work – e.g. assumes the wages of the Austrian programmers.<sup>76</sup> The Austrian company pays royalties to the tax-haven company to use the programme. The revenue that the Austrian company earns through this programme is thereby largely diverted to the tax haven.<sup>77</sup> See also example 1 of a flow-through entity.

Fig. 5  
Base Company and Royalties



<sup>75</sup> Leitner et al., 2007, 145

<sup>76</sup> Djanani, 1998, 306

<sup>77</sup> Dreßler, 2007, 15

The profit shifted in the two examples can then be passed on to a recipient by means of a loan (see “example of money laundering”).

However such payments are subject to a prohibition on deductions under § 12, para. 1, line 10 of the Austrian Corporate Tax Act if the receiving entity is subject to “low taxation”. If royalties are paid in a tax haven (with an effective corporate tax of 10%) they are no longer tax deductible. This change was made by the 2014 second Tax Amendment Act. This is intended to prevent corporations creating tax advantages by using interest and royalty payments to shift profits to low-tax countries. What is particularly important, however, is the interpretation of the criteria on the basis of which the “low taxation” that triggers the deduction prohibition is established. The OECD Transfer Pricing Guidelines ban fantasy prices. The problem, however, is that for licenses there is no market price and it is difficult for the tax authorities to verify.

## 7.2. Flow-Through Entity

As particular income of non-resident taxpayers (people with no residence in Austria) from an Austrian source can be taxed, these taxes are called “withholding tax”. Interest, dividends and licence fees that are paid by an Austrian company to a non-resident taxpayer are subject to withholding tax. As it is difficult for the Austrian state to collect the tax abroad, it is deducted at source, i.e. from the disbursing party. If the state in which the taxable person is resident is also taxing this income, then there is double taxation. In order to avoid this, double taxation agreements are concluded between states, laying down how much each state may collect.

If, for example, a person resident in Germany (non-resident taxpayer) draws dividends on shares in an Austrian company, according to the double taxation agreement Austria may collect 15% of the dividend as tax. Germany collects 25% tax, but takes into account the 15% paid in Austria. Thus there is a tax of 10% in Germany. In sum the tax is 25% (15% Austria and 10% Germany). Flow-through entities primarily serve to exploit double taxation agreements to avoid taxation in the source country from which the income is drawn.<sup>78</sup> Here a limited liability company procures the advantages of a double taxation agreement although it is not based in the the treaty state concerned. This takes place by using a flow-through entity.

For international corporations it is no problem to shift profits to low-tax areas or where there is no tax on profit at all. Tax havens play an important role in this context and there is practically no global player without branches in tax havens. Internal company sales are then booked through tax havens without any basis in the real economy in order to shift profits there. Or royalties and similar payments for intangible assets, whose reasonableness cannot practically be verified, are paid to the corporation’s companies based in low-tax countries or tax havens. There are no limits to creativity here and international consultancy companies offer tailor-made solutions that make it possible de facto not to have to pay profit tax despite real profits. Resounding names such as the “double Irish Dutch sandwich” ensure that taxes remain low. With this mechanism company profits are as a matter of course booked to one of the corporation’s companies based in Ireland. Royalties paid to a Netherlands company ensure that none of this profit remains in Ireland. The Netherlands company then pays royalties to another of the corporation’s Irish companies that is based in a tax haven and thanks to special tax incentives is no longer liable to pay tax in Ireland but in the tax haven

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<sup>78</sup> Bendlinger ua, 2002 S369

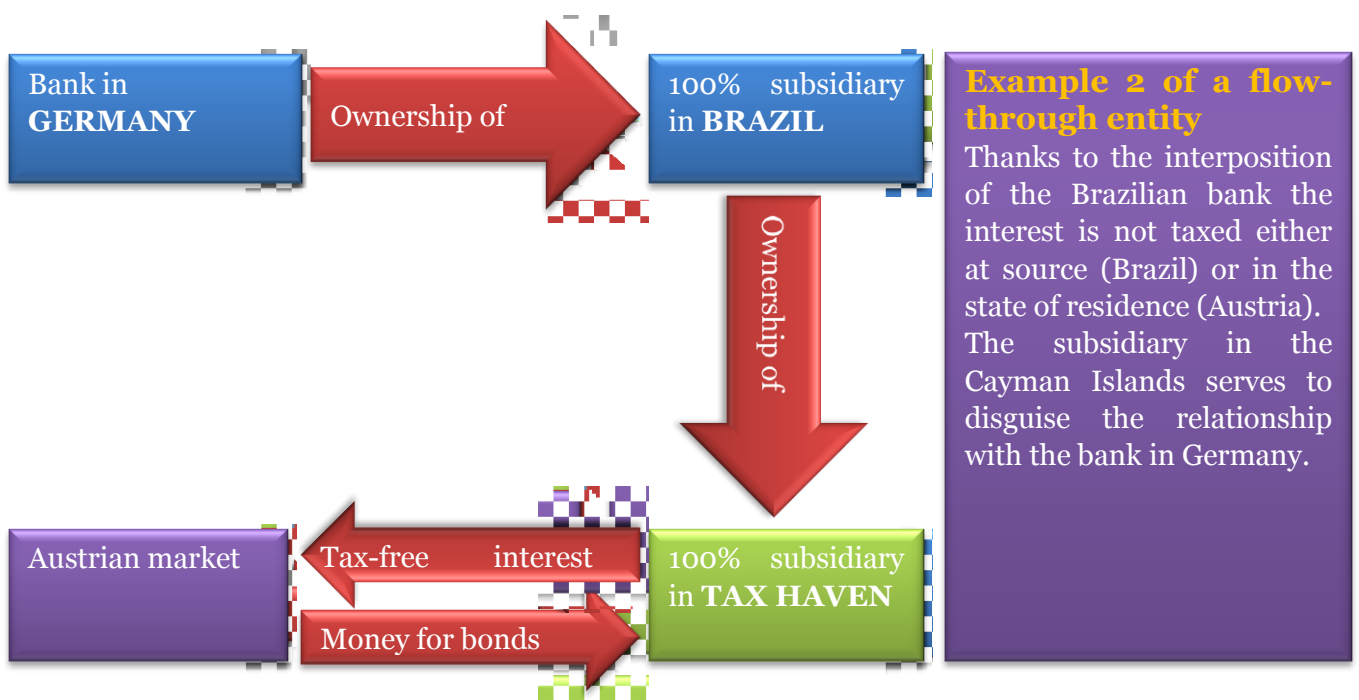
where the company has its headquarters. Obviously there is no tax worth mentioning payable there. According to media reports, in 2011 Google managed to save around €1.5bn in profit taxes by using such a mechanism.<sup>79</sup>

### Example of a Flow-Through Entity (Stepping-Stone Strategy)

A bank based in Germany would like to issue a bond with its Austrian bondholders being shielded from the 25% Austrian capital gains tax on the interest. To this end the German bank founds a 100% subsidiary bank in Brazil, which for its part opens a branch in a tax haven (e.g. the Cayman Islands), which finally formally issues the bond. Purely formally, the Austrian bond holders are drawing interest from a Brazilian bank, which should lead to the fact that under the double-taxation agreement with Brazil the Austrian bondholders can book a non-levied 25% Brazilian withholding tax against Austrian tax.<sup>80</sup>

Note: Article 23 para 5 of the Brazilian double taxation agreement envisages a 25% Brazilian tax rate. In some DTAs these “matching tax credits” or “tax sparing credits” that oblige the state of residence (Austria) to credit the withholding tax themselves, if it is not collected there at all, are intended to ensure that the tax incentives of a developing country benefit the foreign investor and are not lost again in the taxation in the investor’s country of residence (Austria).<sup>81</sup>

Fig. 6  
Flow-Through Entity



<sup>79</sup> <http://www.welt.de/newsticker/bloomberg/article111963449/Google-Steuerparadies-und-spart-Milliarden.html>

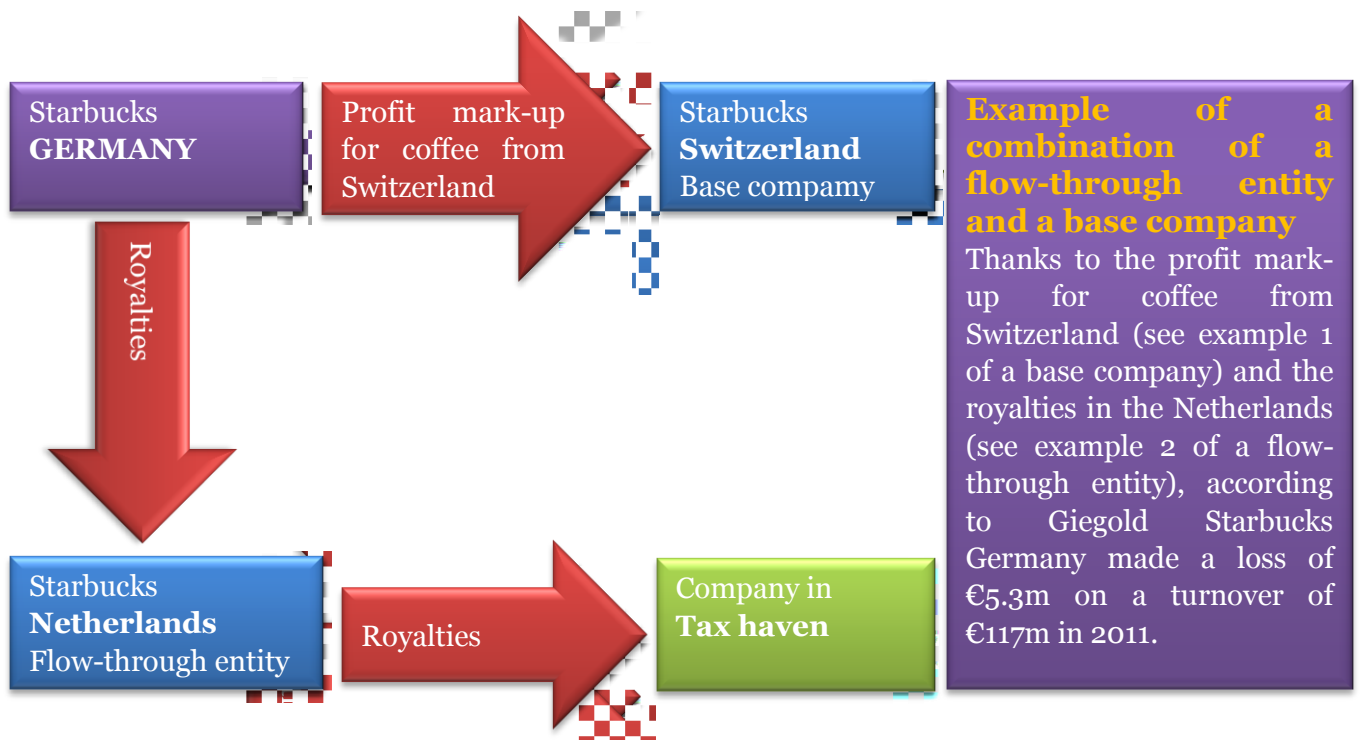
<sup>80</sup> EAS 2100 by the Austrian Finance Ministry

<sup>81</sup> Bendlinger, 2011, 87

## Example of a Combination of a Base Company and a Flow-Through Entity

Naturally, both types of company mentioned are also used together. Here is an example from the practice of Starbucks, according to a presentation by Sven Giegold from the Greens' electoral platform "Bündnis 90 die Grünen".

Fig. 7  
Combination of a flow-through entity and a base company



There are inner-state measures against the use of flow-through entities in §§ 21 ff of the Austrian Federal Tax Code and in § 94 of the Income Tax Act. According to this the real economic content and not the external appearance of the situation is decisive for taxation purposes (Federal Tax Code) and under EU Parent-Subsidiary Directive the exemption from tax liability is prohibited on suspicion of misuse.

The inner-state measures against the use of base companies are laid down in §6 Z 6 of the Income Tax Act. On this basis the arm's-length nature of companies is checked according to a functional analysis. If the tax haven company has no function, then it can provide no service and no income can be ascribed to it either.

Primary correction: the part of the remuneration (e.g. royalties) that is contrary to the arm's length principle is entered as increasing profit in the primary correction.

Secondary correction: as part of the secondary correction, part of the profit (profit mark-up in furniture sales) that is contrary to the arm's length practice is considered as profit-increasing hidden capital.<sup>82</sup>

Inner-state measures against VAT carousels are primarily in the field of prohibited pre-tax deductions. Under this, a company is obliged to pay regard to the reliability of its suppliers.

<sup>82</sup> Bendlinger et al., 2002, 372.

The attention demanded of companies depends on the grounds for suspicion listed as follows:<sup>83</sup>

- Low purchasing prices
- High turnover or profit without risk
- Instructions on buyers and prices
- Multiple circulation of goods
- Unusual circumstances in movement of goods
- Personnel interconnection with the “missing trader”

### 7.3. The Case of Starbucks<sup>84</sup>

In 2011 Starbucks made a profit of €30m in Europe, Africa and the Middle East. The parent company in the Netherlands, however, paid only some €900,000 in profit tax on this. If one assumes an average corporate tax of some 25% then tax of €7.5 should be due. This is only possible because the subsidiaries based in the individual states, which carry out the operative business, are financed by loan capital from the Netherlands-based parent company. Interest, which is tax-deductible, has to be paid on this. In addition these companies also have to pay royalties to the parent company. These are also tax deductible. Withholding tax for these payments cannot be levied owing to the Directive on interest and royalty payments.<sup>85</sup> And the coffee beans have to be purchased expensively from the Swiss branch<sup>86</sup>

### 7.4. Ikea's Tax Tricks

The Ikea conglomerate consists of three formally independent company groups, which are indeed interlinked as far as their business activities are concerned, but are not legally incorporated into one individual corporate group.<sup>87</sup> Alongside the operative business, however, the three parts are connected through their owner. All three groups are controlled by the Kamprad family. The three groups of the conglomerate are the *IKEA Group* (formerly the *INGKA Group*), the *Inter IKEA Group* and the *IKANO Group*. The first is owned by the *Stichting INGKA Foundation* based in the Netherlands, the second is owned by the *Interogo Foundation* based in Liechtenstein and the third is owned by *IKANO S.A.* based in Luxembourg. In addition there is the foundation *Familjen Kamprads stiftelse* based in Sweden. This is independent of the three groups and primarily serves to maintain the image of Ikea. The head of the Kamprad family, Ingvar Kamprad has lived in Switzerland since the 1970s but announced his return to Sweden in 2013. Many countries simply give rise to many tax opportunities and advantages. The fact that the countries of residence include tax havens such as Switzerland or Liechtenstein is certainly no accident. But how exactly does the system function?

The following illustration gives a graphic description of the whole Ikea conglomerate with its three groups of companies and their sophisticated connections.

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<sup>83</sup> UFS Journal 2013, 208

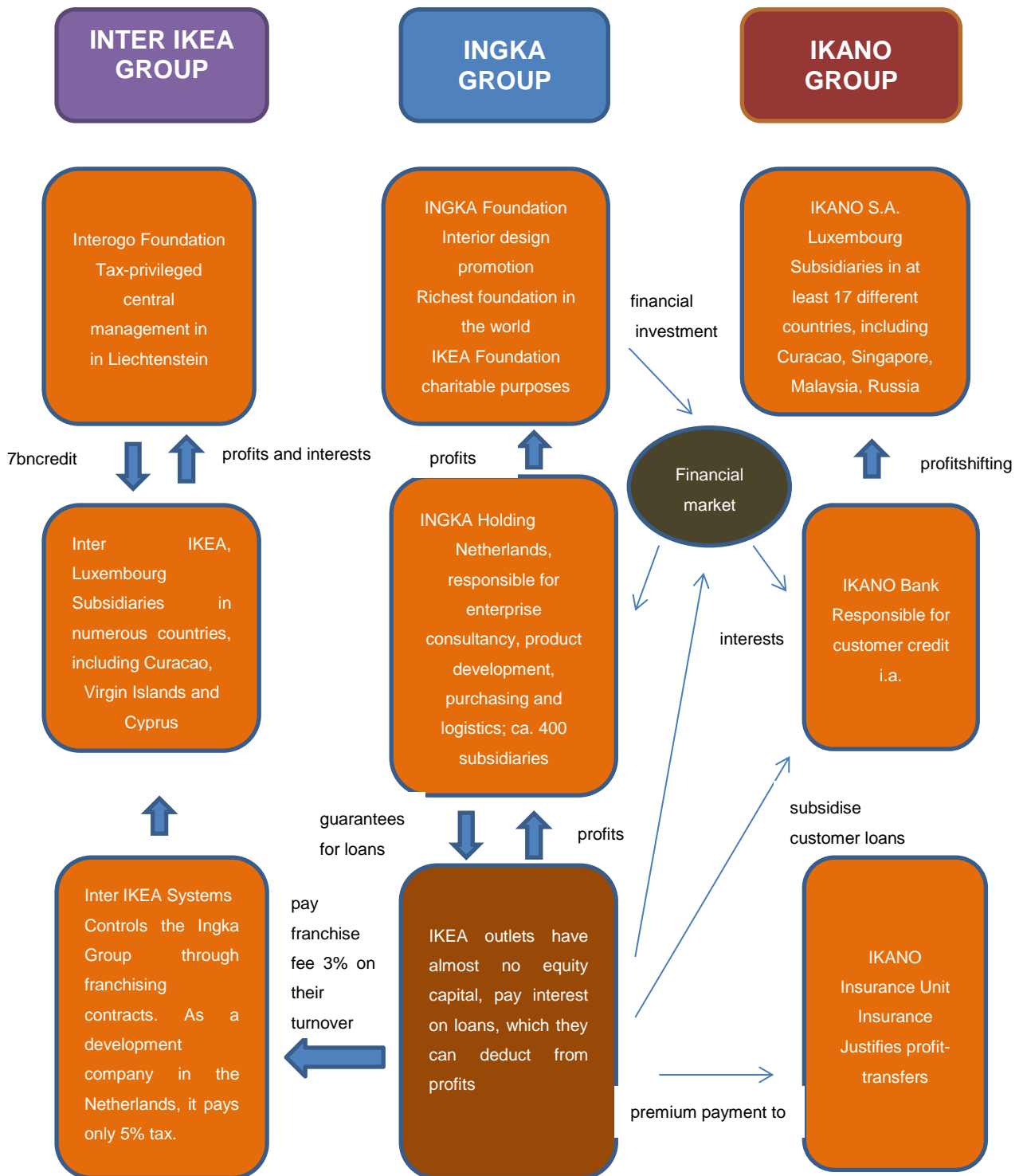
<sup>84</sup> Steuergerechtigkeit in Europa? Der Fall Starbucks; <http://www.sven-giegold.de/wp-content/uploads/2013/02/130220-Präsentation-Starbucks-Steuervermeidung.pdf> accessed on 13.11.2014

<sup>85</sup> Directive 2003/49/EC, 3.6.2003

<sup>86</sup> *Der Standard*: OECD sagt Steuerschlupflöchern den Kampf an, 13.2.2013

<sup>87</sup> attac 2013

Fig. 10  
The Ikea conglomerate and its three groups of companies.



Source: Attac 2013

The turnover of the whole Ikea conglomerate is unknown. The Attac study mentions at least €36bn in 2012, €30.3 of which come from the Ikea group and the Inter Ikea group together.

Pre-tax profit is given as €3.9bn for the Ikea group in the 2012 business year; naturally the transfers to the other groups in the conglomerate, which count as expenditures and therefore reduce the profit, are not given. In 2012 the Inter Ikea group disclosed a profit of €0.5bn. The “operating result” was somewhat higher, the difference is the above-mentioned interest payments which resulted from the big coup in 2012.

The profits of the Ikano group are not known. In all, however they may generate an overall profit for the conglomerate of some €6bn.

In contrast to this, in 2012 the Ikea group paid only €695m in income tax, which equates to a tax rate of 18.7%. The Inter Ikea group paid only €58m, which equates to 11.6% related to profits. Together this gives a tax rate of 15.4%, without taking the rather opaque Ikano group into account. However, this also includes the latent (purely accounting) taxes that were not paid at all. As Ikea is not a public limited company these do not have to be explicitly disclosed. The actual tax quota is accordingly presumably even considerably lower.

In many of the countries in which Ikea is active in the furniture market the nominal rate of tax on profits is well above these effective tax rates.

These are not isolated cases, however, and as the “LUX-Leaks”<sup>88</sup> revelations have shown, obviously the majority of multinational corporations use such tax-saving models in order to minimise their tax burden.

## 8. Current Developments in the EU

At the European Council meeting in March 2012 the member states called on the Commission to develop concrete measures for the fight against tax fraud and tax avoidance. In June 2012 the Commission announced a Communication on ways to reinforce the fight against tax fraud and tax avoidance.<sup>89</sup> The Commission, too, essentially assumes that increasing globalisation means that individual state measures are not sufficient to get a grip on the problem of tax fraud and tax evasion, but that it is indispensable to find a solution at the international level. A three-stage approach has been proposed for this. Based on the national level, the Commission here recommends the extension of administrative capacities for collecting tax. Apart from this, measures for improving tax honesty are suggested. At the EU level there is to be a revision of the guideline on the tax on interest. In addition measures such as uniform cross-border tax identification number, a rapid-reaction mechanism for VAT fraud and the introduction of EU-wide minimum standards and minimum penalties for tax fraud and tax evasion. As the third stage at international level, measures for dealing with tax havens and measures to take action against aggressive tax planning are recommended. The Commission also announced that it was presenting an action plan for fighting tax fraud and tax evasion as well as initiatives for dealing with tax havens and aggressive tax planning by the end of 2012. The Communication from the Commission of June 2012 still did not contain developed proposals for solutions. It is positive to mention, however, that the problem was recognised and reference is made to necessary measures to solve the problem. Algirdas Semeta, the commissioner responsible for tax questions, also took a clear position in a press statement:

*“Let there be no illusion: tax evaders steal from the pockets of ordinary citizens and deprive Member States of much-needed revenue. If we want fair and efficient tax systems, we must stamp out this activity. The political will to intensify the battle is there. Now it is time to translate that into action. As a Union of 27, we have a powerful advantage – strength in*

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<sup>88</sup> [www.icij.org](http://www.icij.org)

<sup>89</sup> COM(2012) 351 final, vom 27.6.2012

*numbers. If we play as a team, with a common strategy, we can defeat the fraudsters and evaders, and reclaim vast sums of money that are legitimately due.”*

As announced, in December 2012 the action plan to reinforce the fight against tax fraud and tax evasion<sup>90</sup> was presented and two recommendations adopted with which the member states were called on to adopt EU measures for dealing with tax havens<sup>91</sup> and were asked for proposals to stop aggressive tax planning.<sup>92</sup> The action plan contained 34 measures on fighting tax fraud and tax evasion. These are subdivided into four main groups. These include existing instruments that are to be better used, or long-term future initiatives, for example. Without wishing to go into all these measures in greater detail, here very meaningful measures have been listed.<sup>93</sup> The EU Savings Directive is to be revised and loopholes that facilitate circumventions are to be closed. Measures for fighting VAT fraud, such as the introduction of the rapid-reaction mechanism or the optional introduction of a reverse-charge system for critical areas are also cited. Apart from this, there are to be negotiations with third countries in order to encourage them to take responsible action on tax issues and to ensure that certain minimum standards are adhered to in this area. The Parent-Subsidiary Directive is to be revised and automatic information exchange is to be implemented as an international standard. The Code of Conduct for Business Taxation is also to be intensified and an extension to the rules concerning natural persons is likewise to be considered. Considerations on the introduction of a general anti-abuse rule have also been raised and proposals to intensify cross-border company audits and similar other measures. The proposals are thoroughly sensible. However, one has to point out that here it concerns proposals and that these largely still have to be implemented, and it should be pointed out that the unanimity principle applies for decisions on taxation within the EU. And the past has clearly shown how difficult it is to find solutions here.

The fight against tax fraud and tax evasion was one of the main issues at the European Council on 22 May 2013. The fact that this issue is on the political agenda of the heads of state and government of the EU states is welcome. Owing to the murky growth prognoses and the necessary consolidation measures in most EU states, tax fraud and tax evasion are evidently being recognised as a serious problem. As already mentioned, the member states are losing around a billion euro in tax revenue per year. This corresponds to approximately the total revenues of Spain, the fifth largest EU economy, or the EU budget for the next seven years. In his speech to the European Council on 22 May 2013, Martin Schulz, President of the European Parliament, stated: “If all taxes due were actually to be collected, the debts of all EU states could be redeemed within a decade.”<sup>94</sup> In the conclusions of the European Council the importance of combating tax fraud and tax evasion is justified as follows: “In times of tight budgetary constraints, combating tax fraud and tax evasion is more than an issue of tax fairness – it becomes essential for the political and social acceptability of fiscal consolidation.”<sup>95</sup>

Anyone who had been waiting for the big hit, however, was disappointed, because apart from a range of announced measures no specific measures for effectively combating tax fraud and tax evasion were implemented.

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<sup>90</sup> COM(2012) 722 final, 6.12.2012

<sup>91</sup> C(2012) 8805 final, 6.12.2012

<sup>92</sup> C(2012) 8806 final, 6.12.2012

<sup>93</sup> MEMO 6.12.2012

<sup>94</sup> See Infobrief

<sup>95</sup> EUCO 75/13 vom 22.05.2013, 6f



In all, the conclusions contain ten points on which the Council hopes to make rapid progress. In the conclusions<sup>96</sup> the European Council emphasised automatic information exchange at EU level and also at a global level should be a matter of priority. Here it concerns the proposal for a Directive on the cooperation between administrative authorities to be published by the Commission in June. At global level, too, the work on automatic information exchange is to be intensified within the G8, G20 and OECD. Negotiations between the EU and Switzerland, Liechtenstein, Monaco, Andorra and San Marino on automatic information exchange are likewise to come to a rapid conclusion and the revised Savings Taxation Directive is to be decided by the end of 2013. Essentially it is a question of bringing income from innovative financial instruments, pension funds, insurance and trusts and foundations under the sphere of application of the directive. To combat VAT fraud the Directive on the rapid reaction mechanism and the reverse-charge procedure is to be agreed by the end of June 2013 and the member states are to deal with the specific follow-up measures on the action plan to reinforce the fight against tax fraud and tax evasion as a matter of priority. In the business taxation field consultations on profit shifting and aggressive tax planning are to be continued; by the end of the year a proposal for a revised parent-subsidiary directive is to be presented and discussions are to be held on strengthening the code of conduct on business taxation. The fight against tax-base erosion and profit shifting is to be continued on the basis of coordinated EU positions and fighting tax fraud and tax evasion within the EU as well as through third countries is to be continued. It was also announced that the revised money-laundering directive was to be agreed by the end of the year. Country-by-country reporting is to be considered for major companies and corporations<sup>97</sup> in order to provide greater transparency and the taxation problems and challenges that are arising through the increasingly digital economy are to be further examined and discussed.

In his speech on the results of this summit, the EU Commission President José Manuel Barroso said: *“This European Council has made good progress on our European approach to energy policy and tax evasion and fraud. On both issues we know what we have to do, most of the proposals are already on the table. But indeed the pace of implementation has been too slow.”* And he continued: *“Tackling tax evasion and fraud was the other issue on the meeting of European Council today. This is also about fairness, because we estimate €1 trillion lost each year to tax evasion and avoidance, the equivalent of a year’s health spending across all member states.”*

But here too a great deal was announced but the implementation is currently still being awaited. It is positive that the European Council announced that automatic information exchange should be a priority both at EU and global level. A revised Directive on the cooperation between administration authorities that is to fundamentally extend automatic information exchange within the EU was announced.<sup>98</sup>

It was also announced that work on automatic information exchange in the framework of the G8, G20 and the OECD is to be intensified. Negotiations between the EU and Switzerland, Liechtenstein, Monaco, Andorra and San Marino on automatic information exchange are also to come to a rapid conclusion. It was also announced that the revised EU Savings Directive (on the taxation of savings interest) was to be agreed by the end of 2013. This was to ensure

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<sup>96</sup> EUCO 75/13 vom 22.5.2013

<sup>97</sup> Multinational corporations are to be obliged to publish their annual reports, to list separately the important figures such as turnover, results and tax paid and also the countries in which they are active, in order to provide more transparency with regard to the tax they pay depending on their economic performance.

<sup>98</sup> EUCO 75/13, 22.5.2013

that income from innovative financial instruments, pension funds, insurance, trusts and foundations is covered by the area of application of the Directive. Measures to combat VAT fraud, such as the introduction of a rapid-reaction mechanism and the use of the reverse-charge procedure should be able to be rapidly implemented through draft directives. The Council also confirmed that the work on profit shifting and aggressive tax planning is to continue. Here there should also be a revision of the Parent-Subsidiary Directive. The proposed revised Directive was announced for the end of 2013. Apart from this there were discussions on the strengthening of the Code of Conduct for Business Taxation. The fight against tax-base erosion and profit shifting is to be continued on the basis of coordinated EU positions. The third Money Laundering Directive was also to be agreed by the end of 2013. Country-by-country reporting is being considered for large corporations in order to create greater transparency. Country-by-country reporting is country-related reporting as part of the publication of international corporations annual reports. Multinational corporations usually have to publish a consolidated annual report. Publicly listed companies in the European Union fundamentally have to draw up a corporate report on the basis of International Financial Reporting Standards (IFRS).<sup>99</sup> Important country-specific figures cannot usually be read from these reports, however. In order to create greater transparency on the business activities in the respective states it is necessary to establish regulations that ensure that country-specific information also has to be disclosed in these corporate reports. For this it is necessary also to publish the labour costs, the number of employees, the financing costs, information on investment assets (including details on physical investment assets, intangible assets and investments) the pre-tax profit, the accrued tax liabilities and the tax actually paid are itemised according to the individual countries in which the corporation has business activities. As a result it will be far easier for the financial authorities to recognise aggressive tax planning methods and establish whether the appropriate taxes are being paid.

The taxation problems and challenges arising from the growing digital economy are also to be further examined.

Soberly assessed it can be stated that the results of this much-heralded summit meeting contain no specific measures beyond announcements. There is room for optimism, however, to the extent that the issue of tax fraud and tax evasion in all possible facets is on the agenda of political decision-makers and that at least – as it appears – they are also aware of the severity of the situation. The announcements also contain thoroughly workable measures for combating the problems. What is important now, however, is that these announcements also lead to specific measures. The announcement of the desire to make automatic information exchange in tax affairs a general standard can in any case be regarded positively.

Why a common corporate tax base was not addressed at all, however, is not understandable. Because precisely a common regulation for corporate taxation is absolutely necessary in order to be able to effectively combat the problems linked to the aggressive tax planning models of multinational corporations.

## **8.1. Harmonisation of Business Taxation within the EU**

As already mentioned, within the EU there is no real harmonisation in the field of business taxation. The problems resulting from this have already been described in detail. What is less well known is that as early as the 1960s the first initiatives to harmonise business taxation within the then European Community were undertaken. It is well known that these

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<sup>99</sup> Regulation (EC) No. 1606/2002

had few chances of being implemented. Even in the Neumark Report<sup>100</sup> that the Commission presented in 1962 and in the 1970s van den Tempel Report<sup>101</sup> measures for harmonisation of business taxation were regarded as advisable and finally in 1988 the Commission even developed a draft for the harmonisation of the corporation tax base, which however was not implemented because the member states could not be convinced of the need for harmonisation.<sup>102</sup> Nor, despite clear statements, did the Ruding Report 1992<sup>103</sup> lead to any harmonisation in business taxation. However, as early as 1992, the expert groups chaired by Otto Ruding, who drew up the report, recognised that there were essential differences within the European Union with regard to the corporate taxation systems, the corporate tax base and corporation tax rates in all individual member states that led to distortions in competition. The danger of a significant erosion in revenue from corporation tax was indeed still regarded as limited. Nevertheless it was recognised that tax competition between member states leads to the creation of special tax regimes that in particular are intended to attract mobile companies or company subsidiaries.

Competitive distortions were recognised as obstacles to a functioning single market and ultimately it was recommended that discriminating and distorting regulations should be removed so that a minimum corporate tax rate and minimum standards with regard to the corporate tax base should be introduced in order to avoid excessive tax competition and ultimately an erosion of corporation tax revenue. It was also recommended that tax incentives in the member states for the promotion of investment activity should fulfil transparency criteria and should only apply for a limited period and also be placed under the state-aid control of the Commission. The complete harmonisation of business taxation was not regarded as necessary at the time. However, the report stated that in the long term the introduction of a common corporate tax system should be striven for as the best possible solution. These recommendations ultimately remained unconsidered, but the current development clearly shows that action is more necessary than ever.

As early as 2001 the European Commission had announced its intention to pursue a strategy for a unified consolidation of the corporate tax base within the European Union. At the Ecofin meeting on 11 September 2004 the EU finance ministers agreed to introduce a common corporate tax base within the European Union. At this meeting the establishment of an expert group to deal with the technical aspects of a common corporate tax base was also agreed. Based on the results of this working group and lengthy political negotiations, on 16 March 2011 the Commission finally presented a proposal for a Directive on the Introduction of a Common Consolidated Corporate Tax base (CCCTB).<sup>104</sup> This draft directive envisages that cross-border corporations within the EU can apply a common regulation for tax reporting that forms the basis for corporation tax. As a first step, the individual, legally independent corporate companies report their tax results, i.e. their profit and loss, according to the regulations prescribed in the proposed Directive on profit reporting. In a second step, the total profits and losses of the individual corporate companies are then consolidated with the parent companies. In a third step, this corporate profit is then allocated to the states in which the corporation is active. This allocation takes place on the basis of an apportionment formula that is also laid down in the proposed Directive. This formula envisages the apportionment according to three equally weighted factors of assets, labour and sales. And

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<sup>100</sup> <http://www.steuerrrecht.jku.at>, accessed 10.12.2014

<sup>101</sup> <http://www.steuerrrecht.jku.at>, accessed 10.12.2014

<sup>102</sup> Saringer / Lunzer (2007)

<sup>103</sup> <http://www.steuerrrecht.jku.at>, accessed 10.12.2014

<sup>104</sup> COM (2011) 121/4, Proposal for a Council Directive on the Introduction of a Common Consolidated Corporate Tax base (CCCTB)

in a fourth step the member states concerned can tax the share of the profits apportioned to them at the respective corporation tax rate. The proposed Directive sets out the regulations for determining profit in relative detail in articles 9 to 43.<sup>105</sup> The Commission states that the tax base is on average 7.9% wider than the tax bases based on national profit reporting regulations. The apportionment formula is given in article 86. The formula for sharing the consolidated tax base, i.e. the corporate profit, between the individual member states is:

$$\text{Share A} = \left( \frac{1}{3} \frac{\text{Sales}^A}{\text{Sales}^{\text{Group}}} + \frac{1}{3} \left( \frac{1}{2} \frac{\text{Payroll}^A}{\text{Payroll}^{\text{Group}}} + \frac{1}{2} \frac{\text{No of employees}^A}{\text{No of employees}^{\text{Group}}} \right) + \frac{1}{3} \frac{\text{Assets}^A}{\text{Assets}^{\text{Group}}} \right) * \text{Con'd Tax Base}$$

One third respectively of sales, labour and assets are included. When it concerns goods, the point of delivery or destination is decisive for the location of the sales. In the provision of services the point at which the service is rendered is decisive. For labour, on the one hand the total pay and on the other hand the number of employees is used. These two sub-factors are weighted at 50% each. The assets include the total fixed assets including rented or lease asset objects. Intangible asset values essentially play no role. As a suitable proxy, however, in the first five years after joining the group the total expenditure on research, development, marketing and advertising in the six years before joining the group are taken into account.

The proposal also lays down how the corporate group is defined and also makes clear that corporate groups from third countries can apply the common consolidated tax base. To prevent abuse there are also regulations that prohibit the arbitrary shifting of assets and there is also a general anti-abuse clause and special rules to combat abuse, such as the limitation of tax-deduction of interest payments in low-tax countries, and much more.

The Proposal for a Council Directive on the Introduction of a Common Consolidated Corporate Tax Base was long overdue and should essentially be welcomed. Nevertheless there are considerable points of criticism. The decision of whether an enterprise group applies the CCCTB or as before reports taxable earnings according to the regulations of the individual states is left to the discretion of the enterprise. This has the result that in individual cases enterprise groups will chose the more favourable variant. In addition, the establishment of the corporate tax rate will continue to be at the discretion of the member states. This only leads to tax competition between the member states being shifted to the tax rates. In order to be able to take effective steps against the aggressive tax-planning models of the multinational corporations it is therefore necessary for the application of the CCCTB to be obligatory inasmuch as the application criteria are fulfilled and a minimum tax rate for corporate tax must also be prescribed. However, the Commission has explicitly declared itself against the establishment of a minimum tax rate and justifies this with the fact that competition leads to effective tax rates, which the Commission regards as essentially positive. Here in any case there is a need for action.

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<sup>105</sup> COM (2011) 121/4, Proposal for a Council Directive on the Introduction of a Common Consolidated Corporate Tax base (CCCTB)

But despite the ambitious attempt by the Commission to introduce a common regulation for corporate taxation in the European Union there has so far been no agreement on this. Some member states such as Britain and Ireland regularly declare themselves to be strictly opposed to harmonisation. As tax provisions within the EU require consensus, the efforts at harmonisation have so far proved fruitless and from the current perspective, despite all recognition of the need for a comprehensive reform, no implementation can be expected in the short term.

## **8.2. Taxing the Digital Economy**

In October 2013 the Commission announced its intention to establish an expert group to work out measures to curb aggressive tax planning in connection with the “digital economy”. This group is to prepare proposals for solutions that ensure that the “digital economy” too provides its appropriate share of tax revenue. As with aggressive tax planning in general, here too it is true that alongside general fairness considerations, the appropriate taxation is important for purely economic reasons, as inequitable tax treatment that cannot be economically justified leads to distortions of competition, which disadvantages those who are not internationally active. The Expert Group on Taxation of the Digital Economy presented its report to the Commission in spring 2014.<sup>106</sup> In it the group states that from the present perspective the digital economy does not require any special tax regulations but that possibly the existing provisions should be adapted in order to meet the requirements of the digitalisation of the economy. The expert group also emphasised that cross-border business activities are made easier through digitalisation and that the elimination of tax barriers in the single market and the creation of a business-friendly environment through neutral, simplified and coordinated tax regulations is more important than ever. The planned conversion of VAT to the host-country principle is welcomed and the OECD’s BEPS project for combating aggressive tax planning is also considered to be of essential importance. The common consolidated corporate tax base is at least seen as a chance to introduce a standard that leads to simplification. But also more extensive reforms such as the introduction of the Home State Taxation for corporate taxation are seen as worthy of consideration.

## **8.3. Automatic Information Exchange within the European Union**

The new Administrative Cooperation Directive<sup>107</sup> envisages obligatory automatic information exchange between member states on income from employment, director’s fees, life insurance products, pensions, and income from immovable assets. This Directive came into force on 1 January 2015.

On 12 June 2013 the Commission presented a proposal<sup>108</sup> for the development of extended information exchange between the tax authorities within the European Union. Under this proposal, dividends, capital gains and all other kinds of financial income and account balances should become part of the automatic information exchange. The aim is that the European Union should implement the most comprehensive automatic information exchange in the world.

On 24 March 2014 the EU Council of Ministers agreed a strengthening of the Directive on savings taxation. The EU member states’ national tax authorities will greatly extend the information exchange on profits and earnings of non-EU citizens. The non-EU states of Switzerland, Liechtenstein, Monaco, San Marino and Andorra are also to be closely involved

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<sup>106</sup> European C., Commission Expert Group on Taxation of the Digital Economy Report, 28.05.2014

<sup>107</sup> D/2011/16/EU

<sup>108</sup> COM(2013)348, 12.6.2013

in this. Specifically the area of application of the EU Savings Tax Directive is to be extended to trusts, foundations and insurance.

It was also announced that from 2017, with the introduction of the automatic information exchange, banking secrecy is to cease. It is also intended to conform to the OECD standard on automatic information exchange. The automatic information exchange for tax affairs envisages that the EU member states collect all data on incomes that are drawn by persons not resident in this state. The income data are then automatically communicated to the states in which those persons are resident, in order to ensure that they can be taxed according to the tax regulations in their countries of residence. Tax evasion will thereby be made far more difficult. The implementation of automatic information exchange was agreed by the EU finance ministers at the Ecofin meeting on 14 October 2014. The implementation is to take place as part of the revision of the Administrative Cooperation Directive and be applied from 2017. For Austria it was agreed that the automatic information exchange only has to be introduced from 2018.<sup>109</sup> Comprehensive automatic information exchange will mean that the Savings Tax Directive will actually be superfluous. There are therefore already plans to allow it to lapse. However, it must be ensured that no new loopholes are opened up in the legal formulation of the new revised Administrative Cooperation Directive. The exact procedure here is still unclear.

#### **8.4. The Role of the European Commission**

The Luxembourgier Jean-Claude Juncker was elected as the new Commission President on 15 July 2014. Even though taxation policy is a matter for the member states and the existing unanimity principle on taxation issues makes major changes considerably more difficult, the role of the Commission in taxation policy issues should not be underestimated either. Through exercising its right of initiative also in the field of taxation the Commission has considerable room for manoeuvre as to which proposals are actually presented and in what form. It is positive that Juncker has also spoken in favour of a minimum tax rate in taxation policy and also announced measures to combat tax fraud. However, one should not forget that, as a long-serving prime minister of Luxembourg, Jean Claude Juncker also shared responsibility for Luxembourg's tax policy in recent decades, and Luxembourg – also not entirely unjustifiably – was considered as a “tax haven inside the European Union.”<sup>110</sup> The publication of secret documents by the International Consortium of Investigative Journalists shortly after the appointment by the Commission in November 2014 put Juncker under even greater pressure and its questionable what consequences this affair will have.<sup>111</sup>

On the presentation by the Commission in September 2014 it was announced that the former French finance minister Pierre Moscovici was envisaged as the commissioner responsible for taxation. Moscovici in any case emphasised that the fight for a fairer tax on businesses would be at the top of his political agenda. In this connection he announced that he also wanted to press ahead with the work on the common consolidated corporate tax base again. And he also emphasised the need for the fight against tax fraud, tax avoidance and aggressive tax planning at EU level. According to Moscovici the automatic information exchange of financial data is to be implemented as quickly as possible. These statements on future EU tax policy are fundamentally to be welcomed. However, here too it remains to be seen what deeds will actually follow these announcements.

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<sup>109</sup> MEMO/13/591, 15 October 2014

<sup>110</sup> Rainer Falk (2009): Zur Debatte um Steueroasen – Der Fall Luxemburg Fragen aus entwicklungspolitischer Sicht

<sup>111</sup> *Wiener Zeitung*, 7.11.2014: Geld auf der Flucht

In a speech to the European Parliament, Commission President Juncker announced that in future an automatic information and data exchange between EU member states on tax rulings for corporations will be established. Pierre Moscovici, the commissioner responsible for tax policy will draft a Directive. Juncker will also campaign for the extension of this data exchange at the coming G20 summit.

The EU action plan covers existing initiatives, new initiatives for the current year, initiatives for the following year and longer-term measures. In all the action plan includes 34 measures. There is a table of the initiatives relevant to corporate tax avoidance in the appendix.

## 9. International Development

### 9.1. OECD Measures

The OECD likewise has long concerned itself with the issues of tax fraud and tax avoidance. In 1996 the G7 heads of state and government tasked the OECD with analysing the problem of unfair tax competition. The result of this task was the 1998 report *Harmful Tax Competition*.<sup>112</sup> This report describes the problems and lists 19 counter-measures. Tax competition between states is still fundamentally regarded positively here. Only harmful tax competition is seen as an unwanted problem that also has to be combated and halted. According to the OECD report, harmful tax competition largely concerns member states creating tax conditions that make tax evasion and tax fraud possible for non-residents. Ultimately this report can be seen as a starting point for a more intense and more serious analysis by the OECD of the issue of tax avoidance and tax fraud. We will dispense with a comprehensive analysis of the interim work here. In summary one can say that a certain awareness of the problem has arisen and that the OECD has essentially committed itself to more transparency and international cooperation between the individual member states and has proposed counter measures to stop the problems. In the OECD's 2011 annual *Current Tax Agenda*, for example, one finds the following:

*“OECD members seek to establish standards that encourage an environment in which fair competition can take place. In the tax area this means promoting principles that are designed to enable countries to apply their own tax laws without the interference of practices that operate to undermine the fairness and integrity of their respective tax systems.”*<sup>113</sup>

This does not yet sound particularly promising, but positively one should note that the OECD is dealing increasingly intensively with the issue of aggressive tax planning. The results of this work are the reports *Tackling Aggressive Tax Planning through Improved Transparency and Disclosure*, 2011,<sup>114</sup> *Corporate Loss Utilisation through Aggressive Tax Planning*, 2011,<sup>115</sup> and *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, published in 2012, in which measures to eliminate international tax loopholes were recommended.<sup>116</sup>

In February 2013 the OECD ultimately published the highly regarded report *Addressing Base Erosion and Profit Shifting*.<sup>117</sup> The words of the OECD general secretary Angel Gurría on the occasion of the presentation of the OECD BEPS report in early 2013 are unusually sharp:

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<sup>112</sup> OECD 1998

<sup>113</sup> OECD 2011, the OECD's *Current Tax Agenda*

<sup>114</sup> OECD 2011, *Tackling Aggressive Tax Planning through Improved Transparency and Disclosure*

<sup>115</sup> OECD 2011, *Corporate Loss Utilisation through Aggressive Tax Planning*

<sup>116</sup> OECD 2012, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*

<sup>117</sup> OECD 2013, *Addressing Base Erosion and Profit Shifting*

*“We are facing a huge social problem. The anger over the unequal distribution of the burden is growing. Many citizens’ trust in the institutions is crumbling. I am afraid that if we do not act it may come to riots in the inner cities.”<sup>118</sup>*

In its BEPS report the OECD comes to the conclusion that multinational corporations’ aggressive tax planning practices have increased and become ever more aggressive in recent years. It is also noted that the current standards and principles for the taxation of multinational corporations no longer conform to the current demands that have arisen from changed economic conditions either. The growing importance of intangible assets and the rapid growth of the digital economy are leading to a situation where new general conditions will have to be created. In recent years it has become significantly easier for companies to be economically active in countries without actually having to be resident there.

For the question of tax on profits, the current standards and principles of international tax law usually assume residency. Accordingly, profit and earnings taxes are generally only due if they can be allocated to a company’s business premises. Increasing globalisation and digitalisation, however, are leading to the questioning of these basic principles.

The finance ministers of the G20 gave the OECD the task of drawing up an action plan on the issue of base erosion and profit shifting, which should present coordinated measures to combat it and a timetable with deadlines for their implementation. The *Action Plan on Base Erosion and Profit Shifting* was presented by the OECD in July 2013.<sup>119</sup> As part of the presentation, at an event in Moscow on 20 July 2013, the OECD Secretary-General Angel Gurría said: *“The joint challenges of tax evasion and tax base erosion lie at the heart of the social contract. Our citizens are demanding that we tackle offshore tax evasion by wealthy individuals and revamp the international tax system to prevent multinational enterprises from artificially shifting profits, resulting in very low taxes or even double non taxation and thereby eroding our tax base.”*

The OECD essentially assumes that new international standards will have to be created in order to harmonise the taxation of multinational corporations at international level. Fundamentally it is a question that taxation should take place where the added value is generated. The action plan gives 15 measures for combating the most urgent problems and a timetable by which they should be carried out. In summary, the main emphasis in all these measures is to implement standards that prevent non-taxation or absent or low taxation in cross-border circumstances that are created by artificial measures. Specifically 15 points are identified that need to be worked out for the appropriate measures (see appendix).

The first recommendations on the individual measures in the BEPS project were published by the OECD in September 2014. Here it is a question of the recommendation on the first measure concerning problems in connection with the taxation of the digital economy.<sup>120</sup> The OECD comes to the conclusion that certain digital business models can heighten the risk of BEPS. A special category of tax treatment is not regarded as advisable however. The recommendation on the second measure concerns neutralising the effects of hybrid

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<sup>118</sup> <http://www.spiegel.de>

<sup>119</sup> OECD 2013, Action Plan on Base Erosion and Profit Shifting

<sup>120</sup> OECD 2014, OECD/G20 Base Erosion and Profit Shifting Project: Addressing the Tax Challenges of the Digital Economy – Action 1: 2014 Deliverable



mismatch arrangements<sup>121</sup> by introducing national regulations, which are listed. According to the report, changes in the OECD model convention could also contribute to a solution to the problem. In the recommendation on the fifth measure on countering harmful tax practices more effectively, taking into account transparency and substance, it is stated that effective measures are needed and that a new orientation in the work of the forum on harmful taxation practices is necessary.<sup>122</sup> The recommendation in the sixth measure concerning preventing abuse of the treaty<sup>123</sup> lists issues that should be taken into account on the conclusion of tax agreements. Here it is also noted that double-taxation agreements should not serve to achieve double non-taxation. The recommendation in the eighth measure concerns problems related to transfer pricing and contains revised guidance on transfer pricing aspects of intangibles.<sup>124</sup> The recommendation on measure 13, concerning the checking of documentation on transfer pricing and country-by-country reporting,<sup>125</sup> contains new standards on better documentation of transfer prices and a proposal on how multinational concerns should in future report on a country-by-country basis on profits, taxes paid and their economic activity. Measure 15 on the development of a multilateral instrument to modify bilateral tax treaties<sup>126</sup> also recommends the quickest possible conclusion of a multilateral instrument as a supplement to the bilateral double taxation agreements in order to implement the measures agreed in the fight against BEPS more quickly.

The timetable is in any case ambitious. Fortunately, the OECD has managed to present the first recommendations on time. Here there is a fundamentally justified cause for optimism that the still outstanding recommendations will be presented on time. But no estimate can yet be made of how these recommendations will actually be taken up by the nation states and how they will be implemented in practice. Nor is it yet possible to estimate the extent to which these recommendations will then actually be sufficient actually to curb the problems in the field of international corporate taxation. Because despite the ambitious recommendations, there are still essential points of criticism.

In summary, the BEPS project and the counter-measures developed out of it seek to ensure that multinational corporations' profits are taxed in the countries in which they are actually generated. Based on the BEPS recommendations, a large number of individual measures will arise which, however, will then still have to be legally implemented in the individual countries. The reports presented so far, however, also show how difficult it is to come to common solutions at international level, and frequently the recommendations involve obvious compromises that do not go far enough to actually eliminate the problems. On the one hand this is dependent on adequate cooperation by the countries involved and despite all the endeavours there will still be room for loopholes and circumvention measures. Above and beyond this it is also to be feared that despite all commitments the implementations in some states will also take place quite deliberately in such a way that the loopholes and possibilities for circumvention remain open, in order again to create presumed competitive advantages

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<sup>121</sup> OECD 2014, OECD/G20 Base Erosion and Profit Shifting Project – Neutralising the Effects of Hybrid Mismatch Arrangements – Action 2: 2014 Deliverable.

<sup>122</sup> OECD 2014, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Item 5: 2014 Deliverable

<sup>123</sup> OECD 2014, OECD/G20 Base Erosion and Profit Shifting Project: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2014 Deliverable

<sup>124</sup> OECD 2014, OECD/G20 Base Erosion and Profit Shifting Project: Guidance on Transfer Pricing Aspects of Intangibles – Action 8: 2014 Deliverable

<sup>125</sup> OECD 2014 OECD/G20 Base Erosion and Profit Shifting Project: Guidance on Transfer Pricing Documentation and Country by Country Reporting – Action 13 – 2014 Deliverable

<sup>126</sup> OECD 2014, OECD/G20 Base Erosion and Profit Shifting Project: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties – Action 15 – 2014 Deliverable

here. To this extent the thoroughly ambitious BEPS project may also ultimately remain nothing more than an interim solution. And it should also be clear that it will take years until the measures proposed by the OECD are actually implemented in the national tax law of the individual states. If one wishes actually to get a serious grip on the problems related to international corporate taxation, a comprehensive reform in this area is needed. Sol Picciotto, a proponent of “unitary taxation” was quoted in an article in the *New York Times* in September 2014 saying: “*They are trying to repair an old motorcar, but what they need is a new engine.*”<sup>127</sup> In defence of the OECD, however, one has also to recognise that such comprehensive reform can probably only come if the nation states are really ready for it. And despite all the lip service to the readiness to fight tax fraud and tax avoidance, no such readiness is currently apparent. Ultimately, clear signals for the comprehensive change in the taxation of multinational corporations to open the way for unitary corporate taxation would also have to come from the OECD (unitary taxation, CCCTB).

## 9.2. Measures to Combat International Tax Evasion

Alongside the planned measures to combat aggressive tax planning, the OECD is also attempting to implement measures to combat international tax evasion. Inadequate transparency makes international cross-border tax evasion much easier. Here tax havens or countries with financial centres with strict banking secrecy, such as Switzerland, Liechtenstein, Luxembourg, the Channel Islands and also Austria, play a decisive role. The OECD has also repeatedly emphasised that lack of transparency also plays a decisive role in cross-border tax evasion. The national financial authorities’ international information exchange on cross-border banking relations and financial transactions is a decisive instrument in curbing cross-border tax evasion. There have already been discussions for years inside the OECD on the implementation of an effective standard for a corresponding exchange of information.

On 13 February 2014 the OECD presented its new standard on the automatic information exchange, and on 6 May 2014 after long discussions it was finally agreed as an OECD standard, published on 21 July 2014.<sup>128</sup> Cross-border transfers of illicit funds to untaxed foreign accounts in tax havens are thereby to be made far more difficult. This standard still requires implementation within the individual states and in the respective double-taxation agreements. If everything goes smoothly it is expected to come into force from 2017. With the new standard for automatic information exchange an automatic cross-border data exchange on financial information between the national tax authorities will be put into place. Financial information is defined as information on all kinds of financial transfers such as interest payments, dividends or income from particular insurance products, but also information on account balances and particular revenues from sales. This financial information has to be reported to the financial authorities by the respective financial institutions, which includes banks and depositories, but also brokers and particular insurance companies. These report the information to the financial authorities in the state of residence of the respective account holders, which are natural persons and intermediary legal entities such as foundations or trusts. The fact that the reporting obligations for trusts and funds does not go far enough, because under the current position only one founder of these structures needs to be reported, is seen critically. In order to meaningfully prevent abuse, however, it is indispensable that all those involved in these legal entities, originating from founders or operators up to all the beneficiaries, are recorded. And it is also worrying that deposit boxes,

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<sup>127</sup> *New York Times*: “OECD Calls for Coordinated Fight Against Corporate Tax Avoidance”, 16.9.2014; <http://www.nytimes.com> 17.11.2014

<sup>128</sup> OECD (2014) Standard for Automatic Exchange of Financial Account Information in Tax Matters,

free ports and other alternative storage possibilities that can likewise be used for concealment are not covered by the standard.

*“Today’s publication brings us closer to a world in which tax fraudsters will no longer have any hiding places,”* said Angel Gurría, the OECD Secretary-General on the occasion of the presentation of the OECD standard on the automatic exchange of information on 21 July 2014. As already mentioned, this standard may be implemented starting in 2017. According to the OECD, 67 states and juridical territories and the European Union have committed themselves to implementing the OECD standard.

It is welcome that the OECD has now nevertheless presented a standard on the automatic exchange of information that attracts broad agreement. The US has also contributed to the fact that there will be relatively swift agreement at OECD level. In 2010, with the Foreign Account Tax Compliance Act (FATCA) the US obliged financial institutions outside the US to comply with automatic information exchange. Essentially it is a question of worldwide financial institutions being forced to transfer information on account data, earnings and other tax-relevant information to the US tax authorities. Originally, from a US perspective the agreement was unilateral. Together with the US, however, Germany, Britain, France, Italy and Spain drew up a model agreement, under which bilateral agreements were concluded with the US that exempt financial institutions in the respective states from their direct information obligations to the US. Instead, information will be exchanged between the respective states and the US. However, the financial institutions concerned have to provide the respective national tax authorities with the appropriate information to permit the exchange of information between the states.<sup>129</sup> Alongside this model to implement the information exchange, the FACTA agreement also envisages a second possibility under which information exchange can take place. Switzerland and Austria among others have opted for this second variant. Here there is a direct information exchange between the financial institutions in the respective countries and the US Internal Revenue Service. With the agreement of the US clients affected, the financial institutions report the relevant data direct to the American tax authorities. The account information of clients who do not agree to data reporting has to be requested by the US authorities through the proper administrative channels.

The OECD standard was adapted to the US FACTA provisions, but it is assumed that it goes further than those provisions. In summary it should be noted that it can be regarded as a success that automatic information exchange has become the OECD standard. This development was long overdue. Nevertheless, points of criticism remain, because with this standard too there is still room for loopholes and circumvention because it does not provide for sanctions if the standard is not implemented appropriately or not adhered to. The current development, however, should be regarded in any case as positive and on the occasion of the annual conference of the Global Forum on Transparency and Exchange of Information for Tax Purposes in Berlin on 29 October 2014 more than 30 finance ministers signed the global OECD standard on the automatic exchange of information on financial accounts in the form of a multilateral convention. The way for automatic information exchange in tax issues now seem to have been finally cleared. As already mentioned, the standard is to enter into force in 2017, although it is already intended to exchange data for 2016.<sup>130</sup>

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<sup>129</sup> Kreienbaum, aktuelle steuerpolitische Entwicklungen, Die Wirtschaftsprüfung 9 /2014, 498f

<sup>130</sup> <http://www.bundesfinanzministerium.de>, accessed on 30.10.2014

### 9.3. G20 Measures

At the summit meeting in London on 2 April 2009 the G20 heads of state and government announced their intention to take measures against tax havens, signalling the end of banking secrecy worldwide.

At the G20 summit in St Petersburg in September 2013 the heads of state and government announced that automatic information exchange on tax affairs would be introduced as a common standard.<sup>131</sup> The implementation is to take place at the latest by the end of 2015. This announcement gives cause for hope. But it should also not be overlooked that this is purely an announcement. Details of how this information exchange is actually to be implemented by the G20 states are not yet known. What tax information is to be exchanged and in what form it is to be passed on to the other states has not yet been clarified. Nor should it be overlooked that here the announcement only concerns automatic information exchange between G20 states. The announcement did indeed mention that the aim is to recruit other states to take part in the automatic information exchange too. And it is also completely clear that automatic information exchange on tax affairs only makes sense if as many states as possible take part. At this summit the OECD Action Plan Against Base Erosion and Profit Shifting by multinational corporations was also agreed.

Essentially the announcement should be regarded as positive. However, one must consider that the worldwide end of banking secrecy was already announced in 2009 and that to date this measure has obviously not been achieved. How rapidly and to what extent the urgently necessary measures for worldwide automatic information exchange will actually be implemented in practice therefore remains to be seen. And it likewise remains to be seen how the Action Plan against Base Erosion and Profit Shifting will actually be implemented by the nation states in practice.

At the the G20 summit in Brisbane the above-mentioned reports on the individual problem areas that were presented as part of the BEPS project were essentially accepted. An attempt by the EU Commission President Juncker to codify an automatic exchange on practices between states was not accepted however. And here too it is true that the G20 efforts to effectively combat the tax avoidance strategies of the multinational concerns do not go far enough. Because at G20 level too the issue of a common consolidated corporate taxation is not seriously discussed.

### 9.4. IMF

In its October 2013 fiscal policy report *Fiscal Monitor*<sup>132</sup> on the subject of tax havens and international tax planning the International Monetary Fund was unusually critical. In this report the IMF recommended extensive tax reforms for budget consolidation in order to provide an impulse for growth. What is noteworthy is how the IMF also refers to problems in connection with corporate tax. In the process it directly mentions companies such as Google and Starbucks and the fact that these companies use obsolete general conditions and basic principles to pay as little corporate tax as possible. It is rightly noted, too, that these famous names are only the tip of the iceberg and that international corporations generally profit from this and pay very little in corporate tax. In this report the IMF ultimately comes to similar conclusions to those of the OECD and the EU Commission as to why it is so easy for international corporations regularly to keep their tax burdens so low. The figures mentioned in estimating the problem are also interesting. For example, the IMF estimates that in the US

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<sup>131</sup> G20 Leaders' Declaration, September 2013, 12f.

<sup>132</sup> IMF (2013): *Fiscal Monitor: Taxing Times*

alone aggressive tax planning means that \$60bn a year cannot be collected in tax. This is equivalent to a quarter of all corporate tax paid in the US.<sup>133</sup>

## 9.5. Individual State Measures

As already mentioned, aggressive tax planning has assumed an extent that is no longer acceptable. The member states are already aware of this and in almost every industrialised country there are measures at individual state level that are intended to limit tax avoidance. Based on the measures in Austria, we will describe what these measures to combat abuse look like in practice.

Investment income in Austria, i.e. dividend payments from associated companies, is in principle tax-free. In the fiscal system this is also fundamentally correct in order to avoid double or multiple taxation in the field of corporation tax. The Parent-Subsidiary Directive also provides for this, although it also leaves a further alternative to the member states to avoid double taxation.<sup>134</sup> What is problematic for fiscal policy is the general exemption of investment income when it is connected with aggressive tax planning models. For this reason in § 10 para. 4 of the corporation tax act (CTA) there is a regulation on abuse that provides that the general tax exemption for investment income does not apply if there is a suspicion of abuse. This is intended to hinder so-called passive income being offshored to low-tax countries in order to minimise the burden on the corporation. This is the case if the focus of the company consists primarily, i.e. more than 50%, of passive income. Passive income is essentially income from interest, from the granting of moveable assets (royalties, patents, leasing etc.) or income from disposal of holdings, and if these companies are not subject to any comparable foreign capital gains tax. This applies if the average tax burden is less than 15%. Here both the tax rate as well as the tax base is correspondingly taken into account. If both of these points are fulfilled, tax exemption of the investment does not apply and the dividends received by the company are subject to corporation tax. Foreign income tax is taken into account. The dividend earnings, however, also increase the tax chargeable.

In addition to these provisions there is also the stipulation in §12 para. 1 Z9 of the corporation tax act that is intended to prevent abuse in relation to the leveraged acquisition of holdings. Interest payments in connection with the leveraged acquisition of holdings can then no longer be tax deductible as company expenses if they have been purchased by one of the corporation's companies.<sup>135</sup>

A further measure to prevent abuse was codified in the 2014 tax amendment act<sup>136</sup> in § 12 para. 1 Z10 of the CTA, so that expenditure for interest payments or royalties is not tax-deductible as company expenditure if it is paid to one of the corporation's companies that is not based in Austria and if it is subject to a tax rate of under 10% in this company.

In the past Germany has likewise introduced measures to combat aggressive tax planning and tax avoidance. In the course of the 2008 corporate tax reform the interest cap was introduced, under which the deductibility of interest payments was limited in order to prevent corporations shifting their profits abroad. The regulations on this are complex. Essentially it is a question that interest costs in as much as they exceed the tax-exemption limit of a million euro per year are now only effective as profit-reducing company expenditure up to 30% of

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<sup>133</sup> IMF (2013) , 33f

<sup>134</sup> The Parent-Subsidiary Directive also permits the tax-credit method as an alternative.

<sup>135</sup> § 12 para. 1 Z9 CTA

<sup>136</sup> Federal Law Journal I 2014/13 ab 1.3.2014

pre-tax profit – increased by the interest costs and depreciations. Apart from this, regulations have also been introduced to German foreign tax law in order to make the function-shifting of German companies to associated companies or production sites abroad less attractive from the taxation perspective. In the case of function shifting, the future profits that have been shifted abroad also become taxable in Germany at the time they are moved. This is intended to prevent shifting to low-tax countries.<sup>137</sup> But here too it is evident that despite complex regulations it has not been possible to combat the problems connected with aggressive tax planning effectively.

It is obvious that measures by individual states are only of limited use in solving the problem in connection with aggressive tax avoidance strategies by multinational corporations. As early as 2008 there were plans in Britain to tax the passive income of corporations based there. “The more successful tax collectors are in preventing firms from shifting profit out of Britain, the more they are likely to encourage firms to leave the country,” was Professor Deveraux’s comment on this announcement,<sup>138</sup> Meanwhile these concerns actually have to be taken seriously. In the past there was hardly any relocation of companies for purely tax reasons, because tax avoidance strategies made it easy to shift profits to low-tax countries or tax havens. Stricter regulations on combating artificial profit shifting in connection with the increasing digitalisation of the economy, however, involve the risk that if it is a case purely of measures by individual states, companies will actually move their headquarters. This problem can only be brought under control by transnational measures.

## 9.6. Summary of International Developments

Tax fraud and tax avoidance have in the meantime reached an extent that is no longer tolerable. This has now also been recognised by political decision-makers. Globalisation, which is additionally strengthened by the digitalisation of the economy, has led to the fact that the problem has assumed an international dimension that can no longer be effectively combated by the individual states affected on their own. The complexity is so extensive that measures by individual states are not sufficient to solve the problems described. Ultimately, only multilateral measures and only global approaches solve the above-mentioned problems in a lasting and sustainable way. The regulations on the taxation of multinational corporations are no longer up to date. The problems have long been known and it is also well known that these problems can only be solved by transnational measures. Measures by individual states can occasionally provide short-term remedies and be effective for the state concerned, but they will not have a long-term effect.

The summary by Rixen<sup>139</sup> explains very pointedly why ultimately only multilateral measures can lead to success in the fight against tax fraud and tax evasion: *“However, the insistence on their own tax sovereignty is counter-productive, because it leads to differences between national tax systems that the taxpayer can take advantage of and thereby incite tax competition. The paradox is that precisely because the states hold on to their formal tax sovereignty they lose control over their tax revenues. In reality tax sovereignty has long been hollowed out. Instead of holding on to the fiction of national sovereignty, under conditions of globalisation one really gains political autonomy over tax revenues if one shares legal*

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<sup>137</sup> V. Kumer/ H. H. Blome: Die deutsche Unternehmenssteuerreform 2008, in SWI 2007, 470ff

<sup>138</sup> The other tax rebellion::The Economist May 10<sup>th</sup> 2008, 40f.

<sup>139</sup> Thomas Rixen (2007): Das Doppelbesteuerungsregime als institutionelle Grundlage des internationalen Steuerwettbewerbs, 12f. in: Christian Kellermann / Jana Zitzler (ed.) (2007): Steuern im europäischen Wettbewerb. Unterbieten oder gemeinsam gestalten? (own translation)

*sovereignty with other states. Only collectively can governments recapture what they have lost individually.”*

The causes are likewise well known. Multinational corporations consist of a multitude of legal independent companies. Shareholding structures are usually complex. For corporate taxation according to fiscal principles in general, every individual legally independent corporate company is also an independent tax subject. This has the consequence that it is not the corporate group results that are subject to tax but that the individual results of the individual legally independent corporate companies are taxed. However, and this is where the problem fundamentally begins, in multinational corporations these are in the most diverse countries with a wide range of different regulations. Both profit reporting rules and the tax rates can diverge considerably. This simple fact is also the reason why transnational corporations regularly find it relatively easy to keep their corporate tax rates down. In the chapter on how tax havens work we have already described in detail the way this model functions in practice. Ultimately, with these mechanisms it is always a question of reporting profits where the tax conditions are particularly favourable. Whether it is through particularly favourable tax rates or through particular regulations that create special forms of relief or incentives for particular incomes. Thus it is possible to shift profits or to report them where the tax regulations are particularly favourable. There are, it is true, basic regulations that are intended to prevent arbitrary profit shifting, but owing to the great complexity, the existing rules are completely inadequate for this. The solution is actually obvious. Because even the most sophisticated models of profit shifting will be ineffective if, instead of taxation of the corporate group's individual companies, one regards the concern as an economic and legal entity and taxes it accordingly. This corresponds to the actual circumstances. There are considerations and concepts on this. In 2011 the European Commission put forward a proposal for a Directive on the introduction of a “Common Consolidated Corporate Tax Base.”<sup>140</sup> The intention of this proposed Directive was actually different, but this draft would solve many of the problems just described.

The proposals by the OECD and EU may indeed go in the right direction and it is welcome that the issue of tax fairness and the fight against tax fraud and tax avoidance have a central position on the policy agenda. However, the measures do not go far enough. Large, comprehensive measures have so far been completely absent. It is incomprehensible and regrettable that even inside the EU the Common Consolidated Corporate Tax Base (“corporation tax”) has still not been seriously connected with measures to prevent aggressive tax planning models. The proposed Directive for the introduction of a Common Consolidated Corporate Tax Base was already presented by the Commission in 2011.<sup>141</sup> The aim of the CCCTB actually was or is to provide multinational corporations with a standardised set of rules for profits reporting within the European Union, primarily in order to make it possible to reduce corporations' compliance costs and to facilitate cross-border loss evaluation within corporations. However, to date the EU member states have not found consensus on the actual introduction of the common consolidated corporate tax base. In order finally to get a grip on the problems of aggressive tax planning and tax dumping the introduction of corporate taxation is unavoidable however. In contrast to the Commission's proposed Directive, it must be ensured that multinational corporations obligatorily come under these rules. The proposed Directive only provides that member states create the preconditions that multinational corporations can use the consolidated tax base. However, it provides that it is up to the discretion of the respective corporate groups whether they tax their profits according to the proposed Directive or whether the profits are taxed as up to now

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<sup>140</sup> COM (2011) 121/4

<sup>141</sup> *Handelsblatt*. EU will Mindestsatz bei der Körperschaftsteuer, 05.09.2012

under the applicable national regulations of the countries in which the individual companies or permanent establishments are based. Nor does the proposed Directive provide for any adjustment of corporation tax rates in the individual member states. This again would lead to the fact that tax competition over corporation tax would be intensified. To this extent the common corporate tax base must in any case also be linked with the establishment of a minimum tax rate. But this demand is vehemently rejected by some member states. True, in the past there have regularly been a few proponents of a minimum tax rate. Thus, for example, in 2012 the previous Council President van Rompuy regarded the introduction of a minimum tax rate for corporation tax as sensible. But there is to date no majority for this opinion, let alone the consensus that is ultimately a precondition on tax questions in the EU.

Progress is also noticeable in the fight against tax fraud in connection with tax havens through the measures announced by the OECD and EU. Automatic information exchange for financial data will become reality, a development that just a few years ago was considered to be completely out of the question. Despite this very welcome development there is still a need for action here, also because the planned regulations on automatic information exchange still leave loopholes that need to be closed. Apart from this the fight against tax havens needs to be intensified.

It will also be necessary for the individual states to take on sufficient personnel in their tax administrations in order to actually be able to check compliance with the measures described. For this on the one hand it is necessary to have highly qualified experts who are able to respond to the large number of consultants available to the corporate side and there must also be a large number of them available. An EPSU report of March 2013, however, shows that currently precisely the opposite development can be observed. The austerity pressures in most EU states and the lack of political will in connection with the currently widely prevailing opinion regarding the need to strive for a “slimmer state” with as few public employees as possible has led to cuts. Within the then 27 EU countries and Norway the number of those employed in financial administration had fallen by almost 7% between 2007 and 2011. This corresponds to a cut in jobs of almost 50,000 people.<sup>142</sup> And this report adds that this process is by no means over, and lists a series of further planned job cuts in the individual states. In a report published in November 2014<sup>143</sup> the Austrian Court of Audit writes that in the tax office there were job reductions of 190 employees in the fields of fiscal assessment and company auditing between 2008 and 2012.<sup>144</sup> Here it is critically noted that these job cuts have taken place despite the fact that the legal material is ever more complex and difficult to implement.

For the auditing of large-scale undertakings, the department that is also responsible for auditing multinational corporations, the report adds that a company auditor incurs costs of some €74,000 per year. However, these means an extra average tax revenue of some €2,250,000. The cost-benefit relationship is thus around 31, i.e. one single auditor brings in 31 times more in tax revenue that is incurred in costs. This too clearly shows that an extension of company auditing makes economic sense.<sup>145</sup>

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<sup>142</sup> EPSU (ed.) (2013): Impact of austerity on jobs in tax services and the fight against tax fraud and avoidance in EU-27 + Norway, own calculations

<sup>143</sup> Austrian Court of Audit (2014): Court of Audit Report: Risk Management in Financial Administration, 221 f, <http://www.rechnungshof.gv.at>

<sup>144</sup> In full-time equivalents

<sup>145</sup> Court of Audit (2014), 231 f



## 10. Is Austria a Tax Haven?

As already mentioned, tax havens are distinguished by the fact that they levy no or very little income tax. In this sense, with a 43% tax rate, Austria is not a tax haven, but in Austria there are tax-haven-like elements, of which the following should be mentioned.

- \* Banking secrecy
- \* Private foundations
- \* Group taxation
- \* A general lack of foreign tax law

### 10.1. Banking Secrecy

Banking secrecy is not a question of the legitimate protection of personal bank data from the public and unauthorised third parties but the protection of bank data from law-enforcement agencies and financial authorities. In Austria this kind of banking secrecy developed in the post-war years. The aim was to bring illicit money that had been accumulated through black-marketeering back into bank accounts and thereby into official circulation.

In Switzerland, banking secrecy in relation to foreign countries was justified with the protection of the wealth of Jewish citizens in Germany. Today we are aware that the Swiss banks did not take the protection of Jewish citizens' wealth so seriously. Instead of researching the legal successors, they appropriated orphaned bank accounts. In both countries banking secrecy mutated into a safe haven for illicit money from tax evasion and crime.

In both countries banking secrecy can only be lifted by a court order (in Austria also through initiating formal criminal proceedings under tax law). This makes prosecution exceptionally difficult, because the evidence of a crime must already exist. In financial offences as a rule such evidence is only acquired by going through the accounts. In addition to this, OECD administrative assistance provisions do not permit "fishing expeditions"; so one cannot ask: "Who has an account in Austria?" but must specifically be able to name the person and the reasons for suspicion. Recently, through the implementation of the EU Administrative Assistance Directive there has been a significant change: for EU citizens who do not have unlimited tax liability in Austria, foreign finance authorities can demand the opening of the account just on "well-founded suspicion". In practice this will not achieve very much. Austria has a better level of banking secrecy in comparison to Switzerland. Whereas Switzerland has a central bank account register, this does not exist in Austria. The enquiry goes through the banking associations, who regularly appeal against it. As a result the person affected is informed, and again has enough time to take steps to hide any evidence. For everyone for whom this is still too risky, the Jungholz banking house in Kleinwalsertal (client volumes of €3bn) offers something special: the Goldfinger Numbered Account. One identifies oneself by electronic fingerprint, the account itself only has numbers and no names. In order to satisfy the Money Laundering Directive, there is a reference file in which the name is recorded and to which only two highly trusted employees of the bank have access. This makes it impossible to find the account-holder electronically. This bank's customers can only laugh about the purchased tax CDs. Until recently the bank still offered a service for German investors in which they published travel directions on the home page marking points where German customs investigators like to stand. In addition it gave conduct instructions according to the motto: "Anything in writing is poison!"

Even if not every bank goes to such extremes with the obvious background of attracting tax evaders, it has to be noted that the existence of banking secrecy makes tax evasion very

much easier. Whereas otherwise one can only do illicit business using cash, in Austria it is also relatively safe through current accounts.

## **10.2. Private Foundations**

In the year when private foundations were introduced (1993) the foundation was certainly a tax haven: the foundation endowment was only taxable at 2.5% inheritance tax, later no inheritance tax was due. Capital gains from major shareholdings were tax free in the foundation, as were capital gains from non-company real estate after ten years' ownership. Interest and dividends to the foundation were tax free. Only in the case of capital withdrawal was there a 22% tax. In the following years the tax reins were tightened: capital gains from major shareholdings are only tax free if the foundation invests in other holdings; interest is taxable at 25%; capital gains from real estate are now likewise subject to tax. The essential tax advantage in comparison to a public limited company remains the tax exemption of capital gains on shareholdings if the disclosed hidden reserves are transferred. This advantage can assume enormous proportions, however, as the sale of the Böhler Uddeholm shares showed: €600m was made tax free. With the ending of inheritance and gift tax, however, the essential advantage of a foundation has disappeared. Few foundations are still established for tax reasons alone. The tax-haven nature of the private foundation has largely evaporated.

## **10.3. Group Taxation**

The group tax introduced under finance minister Grasser was celebrated as a great financial policy achievement that was intended to attract company headquarters to Austria. In fact it was a provision that could not be justified by the fiscal system, through which foreign losses could be brought to Austria without foreign profits having to be taxed in Austria. As a result the foreign exchequer was relieved and the Austrian one was burdened. Currently the tax shortfall is estimated at €450bn.

A group comes into existence through a group agreement with a subsidiary in which the parent company must have at least a 50% shareholding. The corporation can decide which of its companies the group is formed with and which are not. Numerous such groups have developed, but there is no example of this also being a reason to move the headquarters with the management and staff units. What remains in Austria are the foreign losses, which can be booked as early as the moment the group is set up. If the losses are realised abroad they have to be charged back again. In numerous eastern European countries corporation tax is lower than in Austria. In these cases the corporation has no interest in charging back and the foreign losses remain permanently in Austria. A particular problem is that this offsetting option exists throughout the world. Thus a Chinese loss can also be booked against Austria. This loss is to be calculated both under Chinese as well as Austrian law. The fact that an Austrian auditor will fail in this task is clear; there is no mutual assistance agreement with China. Article 27 of the double-taxation agreement with China provides for information exchange for carrying out the agreement, but this does not cover the determination of the loss under Chinese law. The group taxation has torn open a hole that is beyond any official auditing.

## **10.4. Largely Absent External Tax Law**

In contrast to Germany, Austria has no external tax law. In Austria the OECD Transfer-Pricing Guidelines are applied. If an Austrian company pays into a finance company based in a tax haven, then the interest payment counts as tax-deductible operating expenses.

Restrictions can only be applied under the transfer-pricing guidelines if the interest payments are unusually high for the market.

Recent media reports have highlighted the extent of these business relations. Particular outrage has been caused by companies such as Apple, Microsoft, Starbucks etc., which record billions in profits but have an international corporate tax burden in single figures. A specific construction that makes this possible is the “Double Irish Dutch Sandwich”. As part of such a mechanism a company with a double domicile in Ireland and the Bahamas is founded. A subsidiary is also founded in Ireland. Here a particular feature of Irish law is exploited: in Ireland, mailbox companies without particular substance and without employees do not count as subjects of tax and cannot be taxed. The subsidiary company in Ireland transfers capital to another subsidiary in the Netherlands, which for its part buys licences, branding rights, franchise rights etc. Now a particular of Netherlands tax law is exploited. Profits from such licensing are subject to very low levels of tax. The companies in these corporations now pay into the Netherlands subsidiary and their payments reduce the national corporate tax base. These payments are subject only to low levels of tax in the Netherlands, and according to EU law no withholding tax may be levied on such payments. The transferred profits are not liable to tax at all in Ireland and likewise not in the Bahamas, because there is no corporation tax there. The world-wide expansion of the corporation is driven forward from the Bahamas by tax-neutral capital growth.

The bewildered observer will ask why the Netherlands mechanism is possible within the EU. There is the “Code of Conduct”, intended to prevent “harmful tax competition”, and non-taxation of royalties is probably something like that. The legality of the Netherlands’ creation has been expressly permitted by the EU Commission however. For good reasons the OECD Model Convention provides the levying of withholding tax on royalties, but an EU Directive prevents this. It would even be quite easy to contain the problem of tax havens by not recognising the royalties for licences, payments for branding rights, franchising rights, management fees etc. in tax havens or partial tax havens (such as the Netherlands) as company expenses.

Youth unemployment is increasing dramatically in large parts of Europe. In comparison to the losses of tax revenue caused by the policy of supporting tax havens, a €6bn package to combat youth unemployment, which has not yet be finalised in many specifics, appears ridiculous. The EU Commission will have ever greater difficulties in explaining this to an astonished public.

Austrian companies still make relatively little use of the Irish-Caribbean ploy. What is used to a greater extent are the financing companies in Malta, Cyprus and Hungary. Hungary levies only a 6% tax on the profits of financing companies. Austrian companies can be funded up to 100% external capital by a Hungarian financing company. The low-taxed profit is then transferred back into the Austrian company as tax-free inter-company dividends. Austria has reacted to this ploy to the extent that recognition as tax-free inter-company dividends is not granted. But there are other opportunities to bring tax-free capital back to Austria and the game continues.

So is Austria a tax haven? The examples mentioned are sufficient to establish that Austria is a partial tax haven. There is no objective justification for any of these examples. A future tax reform that is true to its name must have the aim of closing off these havens.

## 10.5. Possible Solutions

If economic and political pressure is exerted the number of agreements concluded grows.<sup>146</sup> This trend was noticed in the course of the financial crisis and the resulting budget problems. Tax havens' readiness to conclude agreements with high-tax countries is also greater when their economic power is more limited, while at the same time the readiness for cooperation falls when the negotiating power of the high-taxation countries is weaker. Theoretically, in the past the analysis was concentrated on the welfare effects.

Bilateral negotiations and their agreements are strengthening the remaining tax havens. It therefore makes more sense if it is not the individual countries that conclude agreements but that collective, multilateral agreements are achieved on a broader basis. Generally, only minor advances have been possible in the fight against tax havens and secrecy mechanisms. According to the OECD standard the automatic information exchange is to be implemented by 2016. The regulations and institutions that prevent transparency and thus the disclosure of ownership, income and asset relationships are still untouched. A central demand envisages the creation of an international financial register as the basis of automatic information exchange that lists actual business owners. Zucman regards the IMF, with its technological resources, as the institution that is in a position to develop such a register. The IMF already has sufficient information on capital flows and stocks of securities in almost every country. A further step should be the synchronisation and verification of national central deposits with other available data sources such as account balances, for example. Finally the national financial authorities must have access to the financial registry.

Measures to combat tax-avoidance strategies in the field of company taxation

- The introduction of unitary tax. With the proposed model of the Common Consolidated Corporate Tax Base there is already a suitable model. Adjustments are necessary however: on the one hand its application must be obligatory for multinational corporations and
- A minimum tax rate must be established.

As the urgently necessary introduction of the Common Consolidated Corporate Tax Base within the European Union cannot be expected in the short term, here too there are measures that could be implemented in the short to medium term that would likewise contribute to a mitigation of the problems. The following measures are also necessary with regard to company taxation in the EU in relation to third countries:

- The introduction of country-by-country reporting for multinational corporations
- Expansion on transparency
- The investigation by the Commission of the status quo on the existing tax incentives
- The targeted use of EU state-aid law in the field of company taxation
- The expansion of financial authorities in the field of company auditors
- The implementation of a general abuse clause

Measures to eliminate international tax fraud:

- The implementation of the automatic information exchange announced by the EU and OECD

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<sup>146</sup> Elsayyad 2013

- The closing of loopholes that are still possible with the planned information exchange
- A definition of tax havens by the European Commission
- The introduction of a general abuse clause
- The introduction of a common double-taxation agreement between the EU countries and third countries
- The stipulation that payments in tax havens are not recognised for tax purposes
- The introduction of an EU-wide wealth tax (or a coordination of wealth taxes within the EU)

In conclusion Gabriel Zucman criticises the lack of courage and determination of the individual national governments. His proposed solutions for effective measures to combat tax evasion and tax havens are all the more important. His proposals for international common regulatory and control mechanisms represent effective steps towards a solution.

## **11. Demands of the Chamber of Labour**

- Implementation of the Administrative Assistance Agreement and of automatic information exchange between the individual countries.
- Essential strengthening of the financial authorities in particular in connection with company auditing with regard to personnel and training options. A more intensive application can reduce tax arrears.
- The international networking of tax audits on multinational corporations.
- Reporting of asset and capital transfers to countries classified as tax havens. Starting points directly at banks and financial services companies.
- Private foundation mechanisms and trusts are frequently used to avoid and circumvent tax and should therefore be organised in a transparent way, not only in Austria but internationally. Registration with the disclosure of ownership structure is therefore necessary.
- Abolition of Banking secrecy to the tax authorities.
- The introduction of a unitary corporate tax base in the EU countries. This means the harmonisation of the corporate tax base, as has in the meantime also been advocated in an EU Commission proposal. Equalisation of the fiscal base then facilitates comparability of the national tax rates. A minimum tax rate at European level is thus a necessary step.
- Coordination of tax policy at EU level is required for all points.

## 12. Summary

The problem of tax avoidance and tax evasion is not a surprising, unknown phenomenon. However, the growing extent of offshore wealth, which despite the financial crisis has grown at a rate of 28% in the last five years, is alarming. Two thirds of international trade already takes place within multinational corporations and more than half of world trade flows through tax havens.

Wealthy individuals and companies can organise their tax planning within the legal framework of the countries in which they are active. For the majority of the world population, however, the concept of tax planning is meaningless. But a wealthy minority of private individuals and international companies have considerable advantages. There are multifarious practices in connection with tax avoidance and circumvention, the aggressive tax planning in the field of company taxation on the one hand and on the other hand tax evasion by private individuals. Whether legal or illegal, the drawing of boundaries between tax avoidance and tax evasion is not simple. This includes actions by taxpayers that run counter to the original intention of the law, but nevertheless not every tax planning measure is necessarily illegal. Lack of clarity and discrepancies are exploited in order to achieve tax advantages. This area is also preferred by tax consultancies and business auditing companies as well as being cultivated by tanks. Without their support and consultancy through tailor-made tax-saving models and mechanisms tax avoidance and evasion would be essentially more difficult.

Tax havens generally offer protection against detailed tax audits or security against regulated financial markets. The special flee function exists both for individuals as well as for companies, which, however, at the same time pass on the costs to the general public in their countries of origin primarily in order to accumulate their wealth. A further problematic aspect and so to speak an essential feature is the exclusion of the local population with the simultaneous preferential treatment of wealthy foreign interests. As a result, massive democratic policy deficits consolidate themselves with little chance of being changed.

The question of the proper and fair taxation of these global players is more topical than ever. All the more so, as precisely in periods of crisis it should be recognised that contributions from these financially strong and powerful social groups can no longer be dispensed with. Both the EU as well as the OECD have thus concerned themselves with the issue of international tax avoidance and have in the past reacted to the existent problem with action plans. The implementation of urgently necessary measures, however, is ultimately up to the individual nation states and is anything but ambitious. Many measures to take effective action against tax havens are still lacking. Individual nation-state initiatives or bilateral agreements are too weak in this context. Only a coordinated approach by the nation states to the problem of tax avoidance, tax evasion and tax fraud will be adequate. Because the individual states are overburdened by the extensive international interconnections. This is also evident in the numerous prominent examples in the media in recent months.

The revenue that the countries lose through the multinational corporations' tax-planning models every year is considerable. The fact that multinational corporations can minimise their tax burden through tax-saving measures has been known for decades.

Multinational corporations consist of a multitude of legally independent companies, and shareholding structures are usually complex. For corporate taxation according to fiscal principles in general, every individual legally independent corporate company is also an

independent tax subject. Consequently it is not the corporate group results that are subject to tax but the individual results of the individual legally independent corporate companies. In multinational corporations these are in the most diverse countries with a wide range of different regulations, both with regard to profit-calculation rules and the tax rates. Ultimately, with these mechanisms it is always a question of reporting profits where the tax conditions are particularly favourable. Existing regulations to prevent such arbitrary tax shifting are being undermined owing to their complexity.

The proposals by the international organisations are important, but their measures do not go far enough. Alongside measures to combat aggressive tax planning, the implementation of automatic international information exchange between the national finance authorities is being taken forward. Information on cross-border bank relations and financial transactions are important steps to prevent tax evasion. However, even after the implementation of these measures, there are still opportunities for circumvention through trusts and foundations, for example, owing to the lack of sufficient transparency provisions. In this connection a coordinated fiscal policy is essential in order to take effective measures. So is a coordinated tax policy that contains equally effective control mechanisms and effective sanctions.

The data on existing assets and international financial flows are extremely inadequate. There is therefore an increased need for strengthened research activity in these fields in order to find effective solutions.

## Appendix

### I. The Importance of Taxes and the Effects of Tax Evasion and Tax Avoidance on the “Developing Countries”

Effective tax systems are not only an important (and stable) source of revenue but also an important control mechanism and a fundamental building block of democratic governance.

#### The Situation in the Countries of the South

Tax revenues are extremely important in particular for the so-called developing countries. But although the need for financing is particularly high in these countries, their revenue base is still relatively low. This makes the poorest countries above all dependent on international donors. Whereas the wealthy OECD countries bring in an average of 35.4% of their GDP from tax, low-income countries receive only 13%, countries with low-to-medium incomes 17.7% and countries with high-to-medium incomes 20.7%.<sup>147</sup>

Naturally, these average figures hide differences between the individual states and their fiscal policies. However, for many of them what the Inter-American Development Bank noted for the tax structure in Latin American and Caribbean countries holds true: “*collection is very low, taxes are barely progressive, tax evasion is rampant, and tax administrations are very weak.*”<sup>148</sup>

The reasons for this can be found both in the national and international environment.

- As a result of trade liberalisation the income from easily collectable import and export duties have drastically decreased in recent decades. This trend is continuing through the further opening of markets (for example through the Economic Partnership Agreements agreed between the EU and the ACP countries).<sup>149</sup>
- VAT serves above all for the loss of this source of revenue. Under pressure from the IMF its introduction has been at the centre of the tax reforms in the developing countries for the last 30 years. It exists in over 80% of states in sub-Saharan Africa.<sup>150</sup> Consumption taxes, however, are regressive, thus disproportionately affecting people on low incomes. This can only be countered to a limited extent through the graduation of the tax rates or tax exemptions or reductions (for example for certain basic foodstuffs, kerosene etc.).<sup>151</sup>
- Taxation of land and wealth is also difficult to effect in developing countries. Not only does this affect the interests of politically and economically influential groups too much. Unclear ownership conditions represent a further obstacle to property tax. This might be among the most promising sources of revenue for municipalities. Most of them have very small budgets and little capacity (and also little motivation) to collect taxes themselves.
- Many developing countries have a large informal sector, in some of them larger than the formal sector, and naturally this is difficult to tax. Creativity in dealing with this

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<sup>147</sup> International Monetary Fund (2011): Revenue Mobilization in Developing Countries. March 8, 2011. pp. 53 ff.

<sup>148</sup> IDB: More than Revenue. Taxation as a Development Tool (Executive Summary). p. 1

<sup>149</sup> S.Bilal/M. Dalleau/D. Lui (2012): Trade Liberalisation and Fiscal Adjustments: The Case of EPAs in Africa. ECDPM Discussion Paper No 137.

<sup>150</sup> Michael Keen (2012): Taxation and Development – Again, IMF Working Paper WP/12/220. p. 11.

<sup>151</sup> Examples of this can be found in Grown, C. & Valodia, I. (2010): Taxation And Gender Equity. A Comparative Analysis of Direct and Indirect Taxes in Developing and Developed Countries.



problem is also needed. The incomes in the informal sector are often so low that they would not be taxed in any case: the costs of tax collection would exceed tax revenue. Nevertheless there are good reasons as to why this sector should be covered by tax: the tax base would be broader, fiscal morality in general would rise (because those in the formal sector would no longer see themselves as the sole taxpayers) and greater demands could be made of state responsibility, because *“Informal sector participants are willing to pay taxes especially when the payment is exchanged with their legitimacy, predictability and protection from arbitrary harassment from state agents”*.<sup>152</sup>

In francophone Africa countries are attempting to “tax” the informal sector by the sale of trading licences. In Accra, capital of Ghana, the tax authorities are cooperating with the bus-drivers’ union. The bus drivers pay their income tax to the union every day, and in return the government promises that they will no longer be stopped by the police for minor (or invented) offences. The deal collapsed however because the union stopped passing on the contributions in full. In Anglophone Africa (for example Kenya and Zambia) on the other hand, an attempt was made at flat-rate income tax.<sup>153</sup> In this context a brief reference could be made to “informal taxation”. By this the researchers Benjamin A. Olken and Monica Singhal understand *“a system of local public goods finance coordinated by public officials but enforced socially rather than through the formal legal system.”*<sup>154</sup> Based on a household survey of ten countries from Africa, Asia, Europe and Latin America they found that the “informal taxes” paid in the form of labour or money are widespread and represent an important source of revenue for public municipalities.

- In low-income countries, wage and income tax constitutes only 10% of the total tax income (25 % in the OECD states) and essentially cover only the income tax of those employed in state or international companies. Elites are often protected: *“Entrenched power structures and corruption are powerful obstacles to taxing elites and many high income/wealth individuals—perhaps more so than in the early days of income taxation in current high-income countries, given greater opportunities (from resource wealth, for instance) for rent-seeking and the concealment of income by placing it offshore.”*<sup>155</sup> The offshore problem will be looked at in greater detail below.

In this environment, many developing countries, in particular countries rich in raw materials, are dependent on the tax payments from multinational corporations. The pressure to attract international investments is forcing even the poorest countries to join in the international tax competition. As a result international corporations can often negotiate decades of tax-exemption.

In addition, in the past the international donors such as the IMF or the World Bank have forced generous tax treatment of foreign investors. The agreements concluded with foreign companies were and are hardly published. A good example of this is the gold sector in Tanzania. Even today the tax payments of the mining companies are only 10% of the gold exports. The reasons lie in the generous agreements that the Tanzanian government concluded with these countries in the 1990s and which allowed these companies to use inflated losses to reduce their tax.<sup>156</sup>

<sup>152</sup> Tax Justice Network-Africa (2012): Taxation and the Informal Sector: Africa Tax Spotlight (Quarterly newsletter of the Tax Justice Network-Africa). 2012, second quarter, volume 3. p. 8.

<sup>153</sup> Mick Moore (2013): *Taxing Africa*.

<sup>154</sup> B.A. Olken/M. Singhal (2009): Informal Taxation. NBER Working Paper No. 15221. p. 1.

<sup>155</sup> Michael Keen (2012), op. cit. p.10

<sup>156</sup> M. Curtis/T. Lissu (2008): How Tanzania is Failing to Benefit from Gold Mining.

If national tax authorities demand higher payments it can lead to years of litigation. A good example of this is the Uganda Revenue Authority, which has been in legal dispute with Heritage Oil and Tullow Oil over a tax payment of over \$400bn.<sup>157</sup> Heritage had sold oilfields in western Uganda extremely profitably to Tullow Oil; the authorities wanted to tax the sales revenue at 30%. Heritage, based in the Jersey tax haven, refused this and argued that the Ugandan share had already been handed over to its subsidiary in Mauritius before the sale and was taxed there (see The Example of Mauritius). The Ugandan government's Product Sharing Agreements with Tullow and Heritage were partly published by NGOs in 2010 and show that the companies were thereby able to reap large profits.<sup>158</sup> The legal dispute with Heritage was finally resolved in favour of the Ugandan authorities in June 2013.

In the international environment the continually fuelled devastating tax competition is one of the biggest problems of the development countries. According to Tax Justice Network Africa, east African countries are losing \$2.8bn per year through tax incentives granted to foreign investors. Uganda, for example, lost 2% of its GDP in 2009/10.<sup>159</sup> On this problem the IMF tersely commented: "*Tax competition can simply result in tax rates ending up too low.*"<sup>160</sup>

In a study on the "spillover effect" the IMF calculated that if many countries cut their tax rates then countries who do not do so are also affected. The expected losses fall if the country also cuts taxes. A few countries perhaps profit from this downward spiral of competition; at the global level, however, tax revenues *as a whole* are less. In comparison to trade, in the field of tax small countries (such as tax havens) can have a considerable effect.

According to the IMF, it is the developing countries that are particularly negatively affected by this: thus the loss of revenue for non-OECD countries is more than double the loss for the OECD countries (losses of 13% of company tax revenue in comparison to 5% losses in the industrialised countries).<sup>161</sup>

For global companies it is always relatively easy to transfer profits completely legally to tax havens that offer even lower tax rates or do not tax non-domiciled companies at all.

## **The International Tax System**

Legal tax evasion is facilitated by a system that is regarded as largely outdated, whose core is represented by double-taxation agreements (DTAs) and the Administrative and Legal Assistance Agreement. This system goes back to the 1920s, when the world economy was not so closely interwoven as it is today.

In principle the DTAs regulate the rights to level taxes between the two treaty states. They also lay down what exactly come under the agreement. This is intended to prevent double taxation (that is, taxation in both treaty states). "Treaty shopping", i.e. the exploitation of tax loopholes, ever more frequently leads to double non-taxation of natural persons or companies. Most bilateral DTAs are based on an OECD model convention (like the newly

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<sup>157</sup> SEATINI (2012): Understanding Tax Justice in the Context of Transparent and Accountable Oil Management in Uganda. p. 29 ff

<sup>158</sup> Platform: Uganda's oil contracts leaked – a bad deal made worse.

<sup>159</sup> Tax Justice Network-Africa & ActionAid International (2012): Tax Competition in East Africa – A Race to the Bottom?

<sup>160</sup> International Monetary Fund (2013): Fiscal Monitor: Taxing Times. October 2013, p. 33.

<sup>161</sup> IMF (2014): Spillovers in International Corporate Taxation. p.20.

added TIEAs<sup>162</sup>), which favours the states of residence (which tend to be OECD countries) over the source countries (which tend to be developing countries). Interest, dividends, royalties or capital gains are liable to tax where the (legal or natural) person liable to tax is domiciled. The UN's model convention is less favourable to the states of residence.<sup>163</sup> DTAs also regulate information exchange in tax affairs between the treaty partners, with the current standard being exchange on request (and not automatic data exchange).<sup>164</sup>

Recently the DTAs have come under increasingly critical scrutiny. With the support of the IMF, Mongolia investigated all its agreements. The finance ministry came to the conclusion that all these treaties led to significant shortfalls in revenue. In 2012 the DTAs with the Netherlands, Luxembourg, Kuwait and the United Arab Emirates were cancelled. In 2013 the Dutch NGO Somo published a study that estimated the revenue shortfall of 28 developing countries at €554m.<sup>165</sup> The Austrian DTAs have also been put under the microscope: a study by Julia Braun and Daniel Fuentes, financed by the VIDC, shows that DTAs stimulate Austrian investment projects in developing countries but can also lead to loss of revenue through reduced tax receipts. The advantages and disadvantages of these agreements thus need to be carefully considered. The authors therefore advise that impact assessment studies should be carried out before signing such agreements.<sup>166</sup>

## Tax Evasion

Despite all counter-measures illicit financial flows from developing countries are increasing. According to the Global Financial Integrity (GFI) think tank these countries lost \$947bn in 2011 – an increase of 13.7% on the previous year. This is approximately ten times the amount these 150 states received in funds from official development aid (ODA), \$93.8bn, in the same period. In the ten years before the total loss was \$5.9bn. According to GFI some 80% of these flows result from commercial transactions (price and credit manipulation, false transfer pricing) and 20% from corruption, bribery and theft.<sup>167</sup>

There are enough opportunities to transfer money out of a country in order to protect it from tax. Not only do a range of tax and regulation havens or “shadow financial centres” (see

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<sup>162</sup> The Treaties on Information Exchange in Tax Affairs (TIEAs) are exclusively dedicated to information exchange.

<sup>163</sup> In comparison to the OECD the UNO plays a far less important role in the development and establishment of international tax regulations and has far less funding and personnel. The 24-person “UN Committee of Experts on International Cooperation in Tax Matters” is based in the Financing for Development Secretariat and primarily works on the UN's own model double taxation conventions, although based on the OECD rules. See <http://www.un.org/esa/ffd/tax/>. The limited importance of the UNO has repeatedly been criticised by developing countries and NGOs.

<sup>164</sup> In January 2014 the G20 declared automatic information exchange (AIE) as an international standard (see FN 36).

<sup>165</sup> The study estimated only losses resulting from reduced tax incomes on interests and dividends. See McGauran, Katrin (2013): *Should the Netherlands Sign Tax Treaties with Developing Countries?* SOMO, Amsterdam. Further studies were published on the Swiss DTAs and on the situation in Latin America, see Bürgi Bonanomi, Elisabeth & Meyer Nandi, Sathi (2013) *Schweizer Doppelbesteuerungsabkommen: Aktuelle Politik und Entwicklungsrelevanz*. Bern: University of Bern, World Trade Institute, <https://ext.d-nsbp-p.admin.ch> and Latindadd & Fundación SES (2013) *Double Taxation Agreements in Latin America: Analysis of the Links among Taxes, Trade and Responsible Finance*, <http://eurodad.org/files/pdf/524d3b7c8e8ed.pdf>.

<sup>166</sup> Braun, Julia/Fuentes, Daniel (2014): *A Legal and Economic Analysis of Austrian Tax Treaties signed with Developing Countries*. Vienna. In its study quoted in FN 15 the IMF comes to a similar conclusion: “developing countries . . . would be well-advised to sign treaties only with considerable caution.” (p. 24)

<sup>167</sup> GFI (2013): *Illicit Financial Flows from Developing Countries: 2002-2011*. Washington.

below) take care of that but also an international network of tax consultancy companies, lawyers and company service providers. The grey area between legality and illegality here is relatively large and the interpretation of tax regulations is often pushed to the limits in the interests of the clients. The fact that there is a problem here that also affects the major industrial nations is evident from the questioning of the world's four biggest tax consultancy companies (PWC, Deloitte, Ernst & Young, KPMG) by British MPs. A representative of Deloitte UK admitted that the company recommended models to its clients as legal that had only a 50% chance of success in a court of law.<sup>168</sup> In the meantime the British Inland Revenue has already published a warning on tax saving models that may be offered to clients "on a large scale" but are guaranteed *not* to be recognised.<sup>169</sup> The OECD's already-mentioned BEPS action plan (see below) also envisages that in future companies should disclose their aggressive tax-planning models and national tax authorities should exchange information on international tax models.

Not least the irresponsible creditor policies of the 1970s and 1980s contributed to the rise of tax and regulation havens. Studies by James Boyce and Leonce Ndikumana show that between 1970 and 2004 62% of the funding that went to countries in Sub-Saharan Africa went straight out again. There was thus a strong connection between the irresponsible accumulation of debt, capital flight and the resulting indebtedness.<sup>170</sup>

### **Tax Havens, Jurisdictions, Financial Secrecy Locations – Many Names, One Problem**

The image of individual tax havens that are usually in the Caribbean is false. Today it is more a question of a worldwide network of shadow financial secrecy locations.<sup>171</sup> As mentioned above, the Tax Justice Network illustrates this network with its Financial Secrecy Index (FSI) published every two years.<sup>172</sup>

Hong Kong and Singapore, two rival and rapidly growing "financial secrecy centres" on the part of the developing countries were in third and fifth place. The "usual suspects", the British dependencies of the Cayman Islands, Jersey, Bermuda and Guernsey, were in fourth, ninth, fourteenth and fifteenth place.

Some of these countries serve as revolving doors for illegal or illegitimate finance flows, which – disguised as foreign investment – flow back into their original country ("round tripping"): Hong Kong serves as a revolving door to China; Mauritius and Singapore are sluices to India.

### **The Example of Mauritius – Tax Paradise or Sluice for Development Funds?**

With its low tax rates (maximum 3% effective taxation of foreign income, no capital gains tax) and a network of double-taxation and investment-protection agreements with African states, Mauritius is an ideal tax-saving door for investments in the Sub-Saharan area. According to the British NGO ActionAid in 2013 Deloitte explained to Chinese investors how tax-saving

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<sup>168</sup> House of Commons, Committee of Public Accounts (2013): Tax Avoidance: the role of large accountancy firms. Ev 8.

<sup>169</sup> See: <http://www.hmrc.gov.uk/avoidance/spotlights.htm>

<sup>170</sup> L. Ndikumana/J. K. Boyce (2008): New Estimates of Capital Flight from Sub-Saharan African Countries: Linkages with External Borrowing and Policy Options. PERI Working Paper Series No 166. Amherst. p. 17.

<sup>171</sup> Financial secrecy centres quite generally prepare the necessary infrastructure, with the staff and companies, to make it possible undermine tax laws and transparency regulations in another territory.

<sup>172</sup> See <http://www.financialsecrecyindex.com> (English) and <http://www.vidc.org/themen/wirtschaft/wirtschaftspolitik/schattenfinanzindex-2013/> (German)

was possible through Mauritius (*Investing in Africa through Mauritius*). Based on the example of Mozambique it was explained that just by founding a holding company in Mauritius a company has to pay only 8% withholding tax on dividends to the Mozambican tax authorities (instead of 20%) and no corporation tax (instead of 32%).<sup>173</sup> Barclays, too, one of the international banks with the densest networks of branches in Africa offensively advertises Mauritius to companies who wish to do business in this area.<sup>174</sup> According to the Financial Secrecy Index, Mauritius is not really transparent (80 of a maximum 100 secrecy points); Mauritius does not even have a publicly accessible company register.<sup>175</sup>

Certainly, not all investments made through Mauritius are for tax reasons. However, Kofi Annan, former UN Secretary-General and member of the Africa Progress Panel, warned: *“The extensive use made by foreign investors of offshore-registered companies operating from jurisdictions with minimal reporting requirements actively facilitates tax evasion. It is all but impossible for Africa’s understaffed and poorly resourced revenue authorities to track real profits through the maze of shell companies, holding companies and offshore entities used by investors.”*<sup>176</sup>

Not only private companies but also public donors increasingly route their investments through Mauritius. According to *The Guardian* a third of all developing funding from the CDC, the private-sector arm of the DfID government development agency went through the island.<sup>177</sup>

The British are not alone here. Other donors such as the World Bank Group (through its private-sector arm IFC) and other government development banks likewise support companies and funds that are based in tax and regulatory havens.<sup>178</sup> The Austrian development bank OeEB, for example, placed two tranches of credit with the Emerging Africa Infrastructure Fund (EAIF), which is registered as a limited company in Mauritius.<sup>179</sup>

Here too, tax reasons need not have been decisive for the decision on this location. But against the background of numerous declarations on the part of the G20, the EU and the OECD of their desire to fight tax evasion and tax avoidance, the cooperation with companies and funds based in tax havens should nevertheless be questioned.

The international agenda has clearly changed, above all since the outbreak of the global financial crisis and the associated empty state coffers. The fight against tax avoidance and evasion is assuming international priority.

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<sup>173</sup> ActionAid (2013): *Deloitte in Africa – Advising big businesses on how to avoid tax in some of the world’s poorest countries*. London.

<sup>174</sup> ActionAid (2013): *Time to clean up: How Barclays promotes the use of tax havens in Africa*. London.

<sup>175</sup> Financial Secrecy Index 2013: Report on Mauritius: URL: <http://www.financialsecrecyindex.com/PDF/Mauritius.pdf>

<sup>176</sup> Kofi Annan (2013): *Stop the Plunder of Africa*, *New York Times*, 9 May 2013. URL: [http://www.nytimes.com/2013/05/10/opinion/global/stop-the-plunder-of-africa.html?\\_r=0](http://www.nytimes.com/2013/05/10/opinion/global/stop-the-plunder-of-africa.html?_r=0)

<sup>177</sup> *The Guardian* (2013): *CDC used tax havens for almost 50% of aid investments, data reveals*. URL: <http://www.theguardian.com/global-development/2013/aug/14/cdc-aid-tax-havens>

<sup>178</sup> Eurodad et al. (2009): *Is the International Finance Corporation Supporting Tax-Evading Companies?*

Both ENDS (2013): *Cover for what? Atradius Dutch State Business’ support for transactions via tax havens*. URL: [http://www.bothends.org/uploaded\\_files/document/Cover\\_for\\_what.pdf](http://www.bothends.org/uploaded_files/document/Cover_for_what.pdf)

<sup>179</sup> See <http://www.oe-eb.at/de/projekte/Seiten/emerging-africa-infrastructure-fund.aspx>

## **The Major Reform Players: G20 and the OECD**

In the meantime the holes in the system have become so large and as a result of the crisis the public pressure to declare war on aggressive legal tax avoidance and illegal tax evasion has become so great that the G20 has taken action.

In April 2009 at the London summit meeting it not only declared, “The era of banking secrecy is over.” It also promised to protect public finances and finance systems, and agreed to take action against “noncooperative jurisdictions, including tax havens” (G20 Leaders 2009, Art. 15).<sup>180</sup>

Four years later, at the G20 summit in St Petersburg, the assurance was indeed made again: “In a context of severe fiscal consolidation and social hardship in many countries, ensuring that all taxpayers pay their fair share of taxes is more than ever a priority. Tax avoidance, harmful practices and aggressive tax planning have to be tackled.”<sup>181</sup> But now further-reaching measures are in sight: at this summit the BEPS project (see below) was supported and the automatic information exchange of tax data (at which Austria, above all owing to its banking secrecy, had previously baulked) was made a global banking standard. The OECD, already previously active in the field of tax in the tactically skilful establishment of so-called global forums going far beyond its own member states, thereby finally became the body in which the lines are laid down for the future reformed international tax system. The UNO like the IMF and the World Bank have to content themselves with the role of subcontractors.

### **Automatic Information Exchange (AIE)<sup>182</sup>**

Many specialists and NGOs have previously advocated AIE, also because of its deterrent potential for would-be tax offenders. Finally, in 2011 the die Multilateral Convention on Mutual Administrative Assistance in Tax Matters was amended by the OECD and the European Council. This also provides for the possibility of automatic information exchange. Now any country can join the convention, which above all benefits developing countries. Because as a result the opportunities for data exchange are extended for the countries who do not have a wide network of bilateral tax agreements.

Austria ratified the convention in August 2014, but limited the range of information exchange to VAT, income tax and corporation tax, excluding administrative execution assistance and prohibiting retrospective disclosure of banking information.

In April 2013 the G20 declared automatic information exchange (AIE) to be an international standard and charged the OECD with implementing it. The group of states will apply this standard from 2017 or 2018, according to the decision of the G20 finance ministers in September 2014.<sup>183</sup> In January 2014 the OECD submitted a new standard (Common

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<sup>180</sup> G20 Leaders (2009): Global Plan for Recovery and Reform. Statement Issued by the G20 Leaders. London, April 2, 2009. <http://www.g20.utoronto.ca/2009/2009communiqué0402.html>

<sup>181</sup> G20 Leaders (2013): G20 Leaders’ Declaration. St Petersburg, Russia, September 6, 2013. URL: <http://www.g20.utoronto.ca/2013/2013-0906-declaration.html>

<sup>182</sup> At EU level AIE is not completely unknown. Data on income from interest have for years already automatically been exchanged under the EU Savings Directive – however not by Austria and Luxembourg, which instead deduct a withholding tax. From 2015, on the basis of the EU Administrative Assistance Directive, all member states will automatically exchange data on earned income, pensions, income from directorships, particular life-insurance products and real estate. Data on royalties, dividends and other capital income are to be exchanged from September 2017. After initial hesitation and the request for an “extension of the deadline” until 2018, Austria finally gave in on December 2014 and will also introduce the AIE in 2017.

<sup>183</sup> See the G20 Communiqué: <https://www.g20.org>

Reporting Standard, CRS) and a model convention (Model Competent Authority Agreement, CAA). Unfortunately the latter is only a model for thousands of bilateral administrative assistance agreements that are still to be concluded, which will considerably delay the process. Important technical details for implementation were announced in July 2014.<sup>184</sup>

As countries participating in the AIE are required to ensure data-protection/data-security and reciprocity in the exchange of data, above all the poorer countries may not be able to participate for the foreseeable future, because they are not in a position simultaneously to send their own data abroad. The infrastructure for collecting and sending their own data would simply be too expensive. As many developing countries rather have to fight with (flight) capital outflows to countries such as Switzerland, this condition also provides little real added value. NGOs criticise these very restrictive participation conditions: in a transition phase countries of the South that are not notorious tax havens may indeed immediately profit from automatic data exchange, but should only be obliged to collect and transfer their own data after a transition period. Apart from this, they should be able to receive financial support to develop the necessary infrastructure.<sup>185</sup> After all, the G20 had previously promised: “We are committed to make automatic exchange of information attainable by all countries, including LICs [low-income countries], and will seek to provide capacity building support to them.”<sup>186</sup> However, anyone who is familiar with promises of assistance by the international donor community and the great problems at national (taxation) level knows that it can take a long time before the poorest countries will profit from this standard.

### **BEPS – An Action Plan Against (Legal) Tax Loopholes for Corporations**

In February 2013 the OECD presented a report to the G20 on the causes and effects of base erosion and profit shifting (BEPS) by international corporations. Based on this report the G20 tasked the OECD with drawing up an action plan, which was published in July 2013.

The plan covers 15 measures against BEPS, which were to be implemented between September 2014 and December 2015. Among other things these are intended to prevent companies from artificially reducing their income through interest or other mechanisms or being able to shift their intangible goods (such as patents) for taxation purposes. The aim is to live up to the challenges of an increasingly digitalised economy and exercise greater transparency. This is particularly true for the field of transfer pricing inside corporations, which is very difficult to ascertain objectively under the “arm’s length principle” and permits corresponding room for interpretation (up to and including tax fraud). A country-by-country breakdown of corporate data (i.a. profits, turnover and tax paid) helps tax authorities to arrive at a better estimate of corporate activities and the associated (non) tax payments. Last but not least, a multilateral instrument that is still to be developed is intended to prevent measures agreed in the course of the BEPS agreement having to be implemented in the thousands of already existing bilateral tax agreements.<sup>187</sup>

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<sup>184</sup> See <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm>.

<sup>185</sup> See Christian Aid et al. (2013): Automatic for the People: Automatic information exchange, tax justice and developing countries.

<sup>186</sup> G20 Leaders (2013), op. cit.

<sup>187</sup> More information on this from Martina Neuwirth (2013): Internationale Unternehmens(nicht)besteuerung: Wird ein neuer OECD-Aktionsplan Abhilfe schaffen? AK Wirtschaftspolitik – Standpunkte. 04 | 2013. p. 2 f. URL: [http://media.arbeiterkammer.at/PDF/AK\\_Wirtschaftspolitik\\_04\\_2013.pdf](http://media.arbeiterkammer.at/PDF/AK_Wirtschaftspolitik_04_2013.pdf)



The BEPS action plan certainly does not aim at a fundamental change but rather at a comprehensive repair of the existing international tax regime. However, it will not solve the problem of tax competition with constantly falling corporate tax rates. The action plan expressly notes that the allocation of taxation rights between source and residence states will not be affected.<sup>188</sup> The arm's length principle, accepted as an international norm but not uncontroversial, will also essentially be untouched in the calculation of internal corporation transactions.<sup>189</sup>

Some areas of the BEPS action plan which is directed at legal tax avoidance (disclosure of the actual economic beneficiaries, country-by-country reporting, transfer-price regulation) are likewise of interest in the fight against illegal practices – tax evasion, money laundering and corruption. Because international loopholes are also used for tax evasion, smuggling, the drug trade and human trafficking, and laundering illicit money.

In September 2014, the OECD presented a first interim report on its preliminary results. The BEPS Monitoring Group, a working group of academics and civil-society experts that critically monitors the BEPS process had analysed the first seven interim BEPS results and came to “the conclusion that significant progress had been made by the OECD initiative but that much remained to be done. For one thing the OECD is not a suitable institution for reworking global tax regulations . . . Apart from this the perspectives of the poorest countries of the global South, who are particularly dependent on corporate tax revenues, were not included in the negotiations.”<sup>190</sup> Alongside many half-hearted approaches to reform, the OECD proposal for future obligatory country-by-country reporting for all transnational corporation remains the success of the first BEPS year. But here too there is a drawback: in the view of the OECD the data should only be made known to the tax authorities, not to researchers or an interested public.

At EU level too there was some movement that may be of benefit to the so-called developing countries.

- From 2015 banks and international corporations involved in the raw materials and forestry sector that are domiciled in the EU are obliged to provide country-by-country reporting of their activities. This is intended to prevent profits or costs being artificially shifted between low- and high-tax countries solely to avoid tax. This an important decision in particular for countries of the South that have rich raw-material reserves. Previously, country-by-country reporting had been introduced in the US under the Dodd-Frank Act, but only for US companies in the raw-materials sector. In the course of the BEPS project the OECD proposed obligatory country-by-country documentation for all transnational corporations should be made available to the tax authorities in the respective countries of domicile or host countries. The NGOs are also calling for the extension of this reporting obligation to all sectors of the economy and above and beyond it the publication of the itemised country-by-country data.

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<sup>188</sup> OECD (2013): Action Plan on Base Erosion and Profit Shifting. OECD Publishing. p. 11.

<sup>189</sup> The complexity of the calculation of market prices for trade within corporations in products and services that do not even exist on the free market is itself a challenge for tax authorities in the OECD countries. Some major developing countries such as China and Brazil have therefore begun modifying the OECD model and adapting it to their requirements.

<sup>190</sup> Tax Justice blog (2014): BEPS Scorecard: Eine Kritische Bewertung des BEPS-Projektes der OECD. URL: <http://steuergerechtigkeit.blogspot.co.at>. Tax Justice Germany has written an extensive evaluation that can be found here: Der G20/OECD-Aktionsplan gegen Steuervermeidung von Unternehmen (BEPS), Info Steuergerechtigkeit # 12.



- In future the real economic beneficiaries of companies, trusts or foundations are to be disclosed, because obscure vehicles are frequently and extensively used to conceal the true ownership structure and thereby used for money laundering and tax evasion. For this reason, on 22 May 2013 the EU summit decided that “*the identification of beneficial ownership, including as regards companies, trusts and foundations, is essential.*”<sup>191</sup>

The fourth EU anti-money-laundering Directive is to include measures for this. Here in particular it concerns the establishment of company, trust and foundation registers intended to identify the beneficial owners. NGOs are demanding a publicly accessible register, as among other things this could ensure the better verifiability of the data. This demand is supported by the European Banking Association (for not entirely altruistic reasons, as otherwise the banks would have to carry out the verification of the data themselves). The European Parliament also spoke in favour of this in March 2014, “*to encourage that . . . central registers containing beneficial ownership information are established and information . . . in their countries is made publicly accessible.*”<sup>192</sup> Many governments remain sceptical however.

### **Necessary Measures**

In summary the following measures could help above all the poorer developing countries to raise their tax revenues and to prevent tax evasion and money laundering:

Increased tax cooperation between states instead of tax competition.

- This includes improved information exchange between the tax authorities, above all through the prompt implementation of automatic information exchange (with transitional arrangements in particular for poorer countries that cannot yet fulfil the standards), but also through improved administrative assistance by spontaneous information exchange or exchange on request.
- Increased mutual assistance by the tax authorities is also necessary, for example as part of “Tax Inspectors Without Borders”<sup>193</sup>

Greater transparency in the (tax) system:

- country-by-country reporting of all international companies and the obligatory publication of these reports
- obligatory disclosure of the actual economic beneficiaries of companies, trusts or escrow arrangements and foundations.
- public registers for companies, holdings, trusts and foundations.

Taxation according to actual economic activity: among other things this would have effects on:

- the taxation rights of source and host countries laid down in double-taxation agreements

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<sup>191</sup> European Council (2013): meeting of 22 May 2013. Conclusions. EUCO 75/1/13, 10 h).

<sup>192</sup> European Parliament (2014): European Parliament legislative resolution of 11 March 2014 on the proposal for a directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. (COM(2013)0045).

<sup>193</sup> This concerns support in complex tax audits. See <http://www.oecd.org/tax/taxinspectors.htm>.

- the use of transfer-pricing regulations and the drafting of new and simplified rules for allocation of profits (“profit-split methods”).

Implementation of international reform measures through multilateral instruments. The amendment or conclusion of new bilateral agreements is too difficult and time-consuming. In addition, bilateral negotiations disadvantage weaker negotiating partners.

Better involvement of developing countries in international decision-making processes, above all the development countries that are not part of the G20. The UN is the only global body at which all countries have an equal vote. A political as well as financial upgrading of the UN Tax Committee is therefore urgently necessary.

Donor countries such as Austria should support developing countries in strengthening their national tax systems as well as urging that the international fiscal architecture is reformed so that it also permits the poorest countries to gain tax revenues. Fully in keeping with the coherence principle in the Austrian Development Cooperation Act (DCA), the responsibility for this does not rest solely with state development agencies.<sup>194</sup> Broad cooperation between many ministries and authorities in the fields of finance, the economy and justice is necessary to combat tax avoidance and tax evasion.

## II. EU Measures to Combat Tax Avoidance and Tax Evasion

### The Starting Point

In combination with sluggish economic development, the financial crisis and the debt crisis that it triggered have contributed to the fact that tax evasion, tax fraud and tax avoidance are recognised as a serious problem. The work of NGOs such as the Tax Justice Network<sup>195</sup> or the revelations by “Offshore Leaks”<sup>196</sup> have provided essential contributions that have increasingly brought the discussion out into the public domain. Increasing globalisation is leading to a situation where measures by individual states to combat tax fraud and tax avoidance, which in the past were often only carried out half-heartedly and often did not go beyond lip service, are no longer suited to combating this problem effectively. The pessimistic growth forecasts and the consolidation measures necessary in most EU states have likewise contributed to the rethinking among political decision-makers:

*“Let there be no illusion: tax evaders steal from the pockets of ordinary citizens and deprive Member States of much-needed revenue. If we want fair and efficient tax systems, we must stamp out this activity. The political will to intensify the battle is there. Now it is time to translate that into action. As a Union of 27, we have a powerful advantage – strength in numbers. If we play as a team, with a common strategy, we can defeat the fraudsters and evaders, and reclaim vast sums of money that are legitimately due,”* Algirdas Semeta,<sup>197</sup> the Commissioner responsible for tax affairs stated when presenting a Commission report on measures to fight tax fraud and tax evasion in June 2012.<sup>198</sup>

<sup>194</sup> § 1 para. 5 of the DCA states “The government takes account of the aims and principles of development policy that may affect the developing countries in the policy areas it pursues.”

<sup>195</sup> <http://www.taxjustice.net/>

<sup>196</sup> <http://www.icij.org/>

<sup>197</sup> IP/12/697 vom 27.6.2012

<sup>198</sup> COM(2012) 351 final, 27.6.2012

In December 2012 the European Commission presented an action plan on combating tax fraud and tax avoidance<sup>199</sup> and at the same time presented two recommendations on this issue to the member states.<sup>200 201</sup> Here Semeta's words were unusually sharp:

*“Around one trillion euros is lost to tax evasion and avoidance every year in the EU. Not only is this a scandalous loss of much needed revenue, it is also a threat to fair taxation. While member states must toughen national measures against tax evasion, unilateral measures alone won't work. In a single market, within a globalised economy, national mismatches and loopholes become the play-things of those that seek to escape taxation. A strong and cohesive EU stance against tax evaders, and those that facilitate them, is therefore essential.”<sup>202</sup>*

The figures Semeta is drawing on here come from the study *Closing the European Tax Gap*, drawn up by Tax Research in 2012.<sup>203</sup> Even a few years ago it would have been unthinkable for the European Commission to refer to calculations by the Tax Justice Network on the subject of tax avoidance and tax evasion. Alongside the action plan, on 6 December 2012 the Commission also published two recommendations. The Recommendation Regarding Aggressive Tax Planning<sup>204</sup> and the Recommendation Regarding Measures Intended to Encourage Third Countries to Apply Minimum Standards of Good Governance in Tax Matters.<sup>205</sup> These developments give cause for hope that the fight against tax fraud, tax evasion, aggressive tax planning and tax havens is also being taken seriously at the European level.

The issue of tax fraud and tax evasion was a central issue at the European Council on 22 May 2013, and in his speech Martin Schulz, President of the European Council, said: *“If all taxes due were actually to be collected, the debts of all EU states could be redeemed within a decade.”<sup>206</sup>*

The issue of tax fraud, tax evasion and aggressive tax planning was also on the agenda at the G20 summit in St Petersburg in September 2013, and there was at least a strong avowal of the desire to fight tax evasion in that. The regulations that cause international tax avoidance and as a result permit an erosion of the tax base and profit shifting. In October 2013, as part of its six-monthly publication of the Fiscal Monitor, the IMF referred surprisingly clearly to the problems in relation to tax evasion and tax avoidance and called for swift counter measures.<sup>207</sup> Similar to the EU Commission and the OECD, the IMF also emphasised that as a result of the systematic exploitation of tax loopholes and aggressive tax planning, tax evasion and tax avoidance was costing countries urgently needed tax revenue. Here too, and this seems like a minor revolution if one looks at the previous IMF recommendations, tax competition is regarded critically and a coordinated approach to combat this problem is recommended. Even if it should be clear that at EU, OECD and G20 level beyond specific declarations of intent no far-reaching measures to combat tax fraud and

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<sup>199</sup> COM(2012) 722 final, 6.12.2012

<sup>200</sup> C(2012) 8805 final, 6.12.2012

<sup>201</sup> C(2012) 8806 final, 6.12.2012

<sup>202</sup> IP/12/1235 vom 6.12.2012

<sup>203</sup> Tax Research (2012): Closing The European Tax Gap

<sup>204</sup> C(2012) 8806 final, 6.12.2012; Recommendation of the Commission of 6.12.2012

<sup>205</sup> C(2012) 8805 final, 6.12.2012; Recommendation of the Commission of 6.12.2012

<sup>206</sup> Speech to the European Council 22.5.2013

<sup>207</sup> IMF(2013): Fiscal Monitor: Taxing Times

tax evasion have yet been taken, the fact that these problems are being discussed at the highest political level should at least be recognised as a partial success.

As early as June 2012 on the occasion of the presentation of a Commission report on measures to fight tax evasion and tax fraud, the Commission estimated the extent of the black economy in the EU as approximately €2tn per year. This corresponds to almost a fifth of the GDP of all EU member states.<sup>208</sup>

What is hardly known, however, is that a Council Resolution was passed on measures to combat international tax evasion and avoidance as early as 1975: “. . . *practices of tax evasion and tax avoidance reaching beyond national borders of Member States lead to budget losses, violations of the principle of fiscal Justice and distortions of capital movements and of conditions of competition . . . the international nature of the problem means that national measures, whose effect does not extend beyond State boundaries, are insufficient*”<sup>209</sup>

The problems listed in the resolution sound surprisingly topical, although it was published almost 40 years ago. The term aggressive tax planning may not have been common in 1975, but when the resolution mentions “*in particular [in cases] where there appears to be artificial transfer of profits between undertakings in different countries, or where transactions are carried out between undertakings in two Member States through a third country in order to obtain tax advantages, or where the tax has been or may be evaded for any reason whatever,*” then it clearly shows that many of the supposedly current problems were already well known almost 40 years ago. “*Recently more and more enterprises organised abroad by American firms have arranged their corporate structures aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing, the shifting of management fees, and similar practices. . . . in order to reduce sharply or eliminate completely their tax liabilities both at home or abroad.*” Here, too, it is surprising to learn that these words come from President John F. Kennedy, who was complaining about the tax-avoidance strategies of US corporations as early as 1961.<sup>210</sup> And these words, too, sound familiar and could also concern a current snapshot of problems related to aggressive tax planning.

Although many of the problems have been well-known some time, in 2005 the European Commission obviously did not yet see tax competition in the field corporate taxation as a great threat. And in October 2004, when sanctions cutting subsidies to various eastern European countries were being considered in response to tax dumping, Günther Verheugen, the Commissioner for industry, told the European Parliament: “*I see no danger that companies in the old member states might shift locations to other countries for tax reasons.*”<sup>211</sup> And the revenue shortfall and distortion of competition that would result from this were not addressed at all.

In the last 40 years the European Union has certainly not had its main focus on combating tax fraud. This is also not very surprising if one knows the general tax conditions in the European Union. Direct taxes are not covered at all by the EU Treaty. For indirect taxes the situation is different. Here the treaty provides both for a ban on tax discrimination as well as a

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<sup>208</sup> IP/12/, 27.6.2012

<sup>209</sup> Council Resolution of 10 February 1975

<sup>210</sup> Krienbaum, aktuelle steuerpolitische Entwicklungen, in Die Wirtschaftsprüfung 9/2014, 493 f.

<sup>211</sup> Liebert, Nicola (2005): Steuervermeidung als Konzernstrategie in: Informationsbrief Weltwirtschaft und Entwicklung 1/2005

requirement for harmonisation. The prohibition on discrimination under TFEU Art. 110 states that member states are not to levy higher domestic duties of whatever kind, directly or indirectly, on goods from other member states, which are to be treated as equal to domestic goods. The member states may not levy any domestic taxes on goods from other member states that are designed directly to protect other productions. The harmonisation requirement is laid down in TFEU Art. 113: “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.” As already mentioned, the situation for direct taxation is completely different. Harmonisation of direct taxes is not provided for in the EU treaties, and these taxes also in principle come under the competence of the member states. These are essentially free to organise their tax systems as long as they act within the context of the basic freedoms laid down in the EU treaties (Art. 18 EU citizenship, Art. 28 ff freedom of movement of goods, Art. 45 ff freedom of residence, free movement of services and capital). The regulations on state aid ( Art 107 ff) and on the ECJ judgements on direct taxes are also important (although here the basic freedoms are decisive).

Laws on direct taxation are regularly passed and based on TFEU Art. 115: “Without prejudice to Article 114, the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.”

The few laws on direct taxes are primarily aimed at eliminating tax obstacles to cross-border commerce. The fight against tax fraud and tax evasion plays no essential role and also the aggressive tax planning by international corporations has long not been regarded as a serious problem although the 1975 Resolution of the Council<sup>212</sup> sounds surprisingly topical and although the supposedly current problems were already well known in 1975.

As already mentioned, a real harmonisation of direct taxation is not provided for in the EU Treaty, but it has long become clear that a certain minimum of tax harmonisation or at least tax coordination in the single market is probably unavoidable. The first considerations on harmonisation measures, however, primarily concerned eliminating fiscal hindrances on companies operating across borders in order to facilitate the smooth functioning of the single market. Ensuring member states’ tax revenues, or concepts like aggressive tax planning or tax fraud and tax evasion and the fight against them here still played no significant role. This is clearly shown by the previously passed laws on direct taxation, which essentially aim at eliminating fiscal hindrances for companies in the single market.

### **The Parent-Subsidiary Directive**

The Parent-Subsidiary Directive,<sup>213</sup> adopted by the Council in 1990, regulates how profits distributed between corporations’ companies are dealt with under tax. The aim is to prevent double or multiple taxation of cross-border dividend payments. Essentially the Directive sees two possible choices here. Either the dividends paid to the parent company by the subsidiary

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<sup>212</sup> Official Journal 14.2.75, No. C 35/1;

<sup>213</sup> D 90/435/EC 23.7.1990

are not taxed at all at the parent company, or in the second case the distributed profit is indeed fundamentally subject to corporation tax on the parent company but there is also an offsetting against the corporation tax paid by the subsidiary. Apart from this the Parent-Subsidiary Directive rules that states are not permitted to levy withholding tax on dividends distributed from the subsidiary to the parent company. Both Austria and Germany, for example, decided on the general exemption of dividends at the parent company.

### **The Merger Directive**

The Merger Directive,<sup>214</sup> also adopted by the Council in 1990, is intended to eliminate fiscal obstacles on corporations involved in cross-border restructuring in which companies domiciled in two or more member states are involved. The Directive essentially provides for general capital gains that result from cross-border restructurings are granted a deferment of immediate tax liability as long as the takeover company also actually continues to hold the transferred asset. In 2005 there was an amendment of the Merger Directive<sup>215</sup> that extended both the area of application as well as the range of restructuring processes it applied to with regard the forms of enterprise.

### **The Interest and Royalties Directive**

The 2003 Interest and Royalties Directive<sup>216</sup> established that no withholding tax was due on cross-border payments of interest and royalties within corporations. This means that no withholding tax can be imposed on these interest and royalty payments within the paying company's state if the beneficial owner of these payments is a company or business premises in another member state. However, the Directive is only applied if it concerns companies or business premises that are subject to corporation tax within the EU and are domiciled in an EU member state. In November 2011 the Commission presented a revised proposal for a Directive. This extended the application area with regard to the legal forms, reduced the minimum shareholding for the classification as an associated company from 25% to 10% and established that the exemption from withholding tax essentially only had to apply if the payment of interest and royalties was also actually subject to corporation tax in the receiving company's member state.

### **The Savings Directive**

The Savings Directive<sup>217</sup> was also agreed in 2003 as a part of the tax package in June that year. The Directive came into force on 1 January 2005. It provides for automatic information exchange between all EU states on interest payments to investors resident in other member states. There was a transitional agreement for Austria, Belgium and Luxembourg. These did not take part in the automatic information exchange and instead collected a withholding tax. Initially this was 15% and was gradually increased to 35% in 2011. Essentially it was provided that these three states would likewise participate in the automatic information exchange as soon as Switzerland, Liechtenstein, Monaco, San Marino and the US declared their readiness for information exchange on request corresponding to the OECD standard. Despite the ambitious approach, success in the struggle against tax avoidance and tax evasion have been limited and even briefly after the Directive came into force it was clear that further amendments would be necessary, because the Directive left a lot of room for circumvention. On 24 March 2014, after years of negotiation the EU Council of Ministers

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<sup>214</sup> D 90/434/EC 23.7.1990

<sup>215</sup> D 2005/19/EC 17.2.2005

<sup>216</sup> D 2003/49/EC 3.6.2003

<sup>217</sup> D 2003/48/EC of the Council, 3 June 2003 on taxation of savings income in the form of interest payments.

finally agreed a revised form of the Savings Directive.<sup>218</sup> This version was based essentially on the first review of the implementation of the Savings Directive.<sup>219</sup> It is thereby intended to close the tax loopholes that had been identified and to combat tax avoidance and tax evasion more effectively. The provisions of the revised Directive must be incorporated into national law of all member states by 2016. However, critical observers have already noted that, despite numerous improvements, the amended Directive will still leave room for circumvention.<sup>220</sup>

An overview of the few laws on income and profits tax ultimately also clearly shows why tax avoidance and tax evasion is also a serious problem inside the European Union, because precisely the general conditions created by them are essentially responsible for a large part of the tax problems within the European Union. The establishment of the single market created a united economic area without borders. This is sensible, and the meaningfulness of the single market is not to be called into question here either. However, what leads to considerable problems is the fact that within this single market the coordination – to say nothing of harmonisation – of the member states' tax regulations has to date remained largely absent. Precisely the functioning single market and the associated prohibition of discrimination in connection with the lack of harmonisation on direct taxation leads to the ability of companies operating across borders to exhaust the models of aggressive tax planning, in many cases as a result hardly having to pay any tax on profits. The few laws on direct taxes have led to the fact that the ECJ has to be described as the actual motor of tax harmonisation in the EU. In its judgements on direct taxes the ECJ regularly has to determine whether the member states' tax regulations are in accord with European legal requirements, i.e. essentially to examine whether the basic freedoms are being adhered to. In this sense a harmonisation relating to the fact that discriminatory tax regulations in the member states were to be relinquished took place as a result of ECJ judgements. In many cases this led to tax shortages in the member states. Finally, here it comes to a levelling downwards. Thus it is hardly surprising that in recent years the European Union has been the economic area with the world-wide greatest competition in the field of corporation tax. Between 1995 and 2010 average nominal corporate tax rates in the EU member states fell from 34.8% to 23%. The EU guidelines for corporate taxation, i.e. the Parent-Subsidiary Directive, the Merger Directive and the Interest and Royalties Directive, ensure that tax obstacles for companies operating across borders are being removed. For these companies it thereby becomes easy to shift their profits to countries in which the tax burden on profits is the lowest. Simple corporate restructuring, such as the foundation of financing companies or group companies that are responsible for the administration of intangible assets such as licences, patents and branding rights, and are based in low-tax countries such as Ireland, where corporate tax is just 12.5%, make it possible to shift company profits on the balance sheet to where corporation tax is lowest. And as a mirror image, the profits of companies in the group domiciled in the so-called "high-tax countries" are minimised through interest payments or royalties to the companies based in the "low-tax countries". In practice the selected models of how international corporations shift their profits to low-tax countries or even to tax havens are essentially more complex, but the basic principles just described are regularly applied and facilitate profit shifting without an actual change of location. The Parent-Subsidiary Directive and the Interest and Royalty Payments Directive mentioned at the

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<sup>218</sup> D 2014/48/EU of the Council of 24 March amending Directive 2003/48/EC on taxation of savings income in the form of interest payments.

<sup>219</sup> D 2003/48/EC of the Council, 3 June 2003 on taxation of savings income in the form of interest payments.

<sup>220</sup> Giegold (2014)

beginning make these models even easier because they largely prohibit the levying of withholding taxes, which might act as a corrective here.

### **Code of Conduct and State-Aid Law to Combat Tax Avoidance**

Tax competition was generally long seen as essentially positive in the European Union. The Commission differentiated, and this differentiation is in principle still currently upheld, between beneficial and harmful tax competition. And correspondingly for the Commission it was only a case of containing harmful tax competition. As early as 1997 the Commission published a communication entitled "Towards Tax Coordination in the European Union",<sup>221</sup> in which a four-track strategy for combating harmful tax competition was proposed. One of these was the Code of Conduct for Business Taxation.<sup>222</sup> Adopted by the Council on 1 December 1997, this was intended to remove distortions in competition over company taxation inside the EU in order to prevent massive shortfalls in corporation tax. Although the code of conduct is in principle not legally binding on the member states, they are still under a political obligation and by adopting it they have committed themselves to abandoning existing tax measures that are considered harmful and not to introduce any further harmful measures in future. Under the code of conduct measures are categorised as harmful if they result in a significantly lower effective tax burden than the normal tax level of the state, which can lead to zero taxation. Specifically, the harmfulness of tax measures is judged on the following criteria:

- Do the measures lead to a significantly lower effective tax rate when measured against the existing tax level?
- Are the tax advantages exclusively granted to non-residents?
- Are the tax advantages completely isolated from the domestic economy so there are no effects on the domestic tax base?
- Are the tax advantages granted even when there is no genuine economic activity?
- Do the reporting rules on activities within multinational company groups diverge from the internationally recognised principles, in particular from the OECD rules?
- Do the measures lack transparency?

In November 1999, a working group established in 1998 published a report listing 66 harmful measures. The majority of these can be assigned to the following two categories:

1. Tax incentives for holding companies and for internal services in the corporation (company headquarters administration, research, marketing, sales, internal consultancy)
2. Tax incentives for companies in the finance sector (financing activities, asset management, licence management, insurance business etc.).

In the meantime these measures have largely been repealed by the member states affected. And also this working group still currently monitors the situation and regularly reports to ensure that no new harmful measures are introduced.

### **EU State-Aid Law**

Although the code of conduct for business taxation was not binding on member states, the Commission largely managed to get the harmful measures withdrawn. This was also possible with state-aid law, because the Commission had a powerful instrument to hand. Tax

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<sup>221</sup> COM(97) 495 final, vom 1.10.1997: Towards Tax Coordination in the European Union

<sup>222</sup> Decisions of the Council of 1 December 1997 on a Code of Conduct for Business Taxation; OJ EC C 2/2, 6.1.1998



incentives might also be forbidden state aid. The definition of when a tax incentive is forbidden state aid under competition law may not agree with the definition of harmful measures under code of conduct, but they overlap in many areas. The decisive provisions on state aid are articles 107 and 108 TFEU. TFEU Article 107 para. 1 states: “Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.” There is no question that tax incentives should also be judged from the a state-aid perspective. The conditions on which tax incentives would come under the prohibition of state aid were also listed in more detail in the 1998 Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation.<sup>223</sup> Fundamentally, selective tax incentives can be categorised as state aid.

What is decisive is the fact that the Commission itself is also active in competition law and that here the member states have no opportunity for a blocking mechanism. The consensus principle, which otherwise applies to tax questions within the EU and which is essentially responsible for the previous developments in the field of taxation, does not apply to decisions on state aid. This means that with the state-aid regulations the Commission actually has the most effective means of combating aggressive tax planning and tax dumping in its hands. This tool should therefore also be used accordingly as long as there are no far-reaching reforms in the field of taxation of international corporations at European level. And there are signs that the Commission is becoming more active than previously and regards the measures by the member states more critically. Thus in June 2014, in three cases the Commission had already begun to examine whether the decisions of the national tax authorities in Ireland, the Netherlands and Luxembourg concerning the corporation tax to be paid by Apple, Fiat Finance and Starbucks were in accord with the EU legal requirements on state aid. A formal investigation process was initiated for each case. “*In the current context of tight public budgets, it is particularly important that large multinationals pay their fair share of taxes. Under the EU’s state aid rules, national authorities cannot take measures allowing certain companies to pay less tax than they should if the tax rules of the Member State were applied in a fair and non-discriminatory way,*” Joaquin Almunia, the Commissioner responsible for state aid law, emphasised on the announcement of this investigation process. And the then Commissioner for taxation, Algirdas Semeta emphasised: “*Fair tax competition is essential for the integrity of the Single Market, for the fiscal sustainability of our Member States, and for a level playing field between our businesses. Our social and economic model relies on it, so we must do all we can to defend it.*”<sup>224</sup>

Essentially this investigation process concerns whether the tax decisions of the three finance authorities mentioned concerning the confirmation of the agreements on transfer prices on the part of corporations should be questioned from the point of view of state aid law. Using transfer pricing, the prices for transactions of goods or services inside the corporation, there is the possibility to shift profits between companies belonging to the corporation that are based in different countries. If these transfer prices accord with market circumstances, then according to the state aid regulations there is no state aid. However, if there are divergences, because the transfer prices cannot be economically justified, then it may be a question of state aid, which under competition law is impermissible. It is also problematic from the point of view of state aid law if the tax authorities do not have a clear margin of discretion as to

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<sup>223</sup> OJ C384/3, 10.12.1998

<sup>224</sup> IP/14/663, 11.6.2014

how these transfer prices can be established. In October the Commission announced that it would also be investigating the transfer-pricing agreements that are part of the taxation of Amazon in Luxembourg. Here too the words of the then Commissioner responsible for competition policy Joaquin Almunia were unusually sharp: *“National authorities must not allow selected companies to understate their taxable profits by using favourable calculation methods. It is only fair that subsidiaries of multinational companies pay their share of taxes and do not receive preferential treatment which could amount to hidden subsidies. This investigation concerning tax arrangements for Amazon in Luxembourg adds to our other in-depth investigations launched in June. I welcome that cooperation with Luxembourg has improved significantly.”*<sup>225</sup> Here too the Commission emphasises that the transfer prices must be based on market prices and that if this is not the case it may constitute impermissible state aid. In the press release the Commission adds that the royalties that reduce Amazon’s profit in Luxembourg, evidently already accepted by the Luxembourg financial authorities in 2003, may not be in conformity with the market, as they lead to an unjustifiable economic advantage for Amazon.<sup>226</sup> These are at least very clear words from the Commission that indicate that there will be serious investigations here. And this also leads to the hope that these investigative processes will be more frequent in future. The current publications from the Commission at least give cause to hope that here success against tax dumping can be achieved.

### The EU Action Plan

The following table of the EU action plan includes the initiatives that are relevant for corporate tax avoidance:

#### EU Action Plan measures (EK 2012)

Measures nos. 4,5,6,13,20,31 do not concern corporate tax avoidance and are therefore not listed.

Better use of existing instruments and high-priority initiatives by the Commission.		
1	New framework for cooperation between administrative authorities	Not all legal acts adopted regarding state aid and cooperation have been adopted by the member states. Increased information exchange is needed for effective cooperation.
2	Elimination of loopholes in the taxation of interest payments.	The Council is urgently called on to adopt the amendments to the Savings Directive and thereby to close loopholes. The Commission is to be given a mandate for negotiation for the amendment of interest payment agreements with third countries.
3	Agreement on combating fraud and cooperation in tax affairs.	The Council is called on to sign the proposal of the Commission for an agreement between the EU, its member states and Liechtenstein on fighting fraud and cooperation on tax affairs and to give the Commission the task of negotiating similar agreements with four other neighbouring third countries.
New Commission initiatives		

<sup>225</sup> IP/14/1105, 7.10.2014

<sup>226</sup> IP/14/1105, 7.10.2014

7	Recommendation for measures to “motivate” third countries to apply minimum standards.	The recommendation concerns relations with tax havens. For details see chapter 7.2.
8	Recommendation concerning aggressive tax planning.	The recommendation concerns aggressive tax planning. For details see chapter 7.2
9	Establishment of a platform for responsible behaviour in tax affairs.	A platform should be established with experts from the member states and representatives of interest groups in order to support the Commission in its reports and ongoing work.
10	Improvements in relation to harmful company taxation.	The existing body that is currently tasked with developing a “Code of Conduct for Business Taxation” is hardly making any progress. The member states are called on to implement measures to improve the realisation of the original aims of the code. The Commission will take action where the existing guidelines permit double non-taxation. Work concerning special taxation regulations for staff working abroad and wealthy individuals are to be intensified.
11 12	European TIN portal for tax identification numbers, standard form for information exchange.	The first step to a Europe-wide standardisation of tax identification numbers and the introduction of standard forms (including IT use) for all member states to improve automatic information exchange.
<b>Short-term initiatives (2013)</b>		
14	Revision of the Parent-Subsidiary Directive	To prevent double non-taxation of hybrid investment mechanisms.
15	Examination of the anti-abuse provisions in EU law	Examination of anti-abuse provisions in the Interest and Royalties Directive, the Merger Directive and Parent-Subsidiary Directive with regard to possibilities for aggressive tax planning.
16	Promotion of standards for automatic information exchange	The Commission commits itself to continue with pressure for automatic information exchange. The member states should be able to use standardised IT tools, which should also be distributed internationally by the OECD.
17	European code for taxpayers	A European code to improve and clarify the relationship between taxpayers and tax authorities should be introduced for the authorities in the member states.
18	Strengthening of cooperation with other law-enforcement agencies	Close cooperation with the authorities responsible for combating money laundering, for justice and social security. The Commission is considering naming tax offences as offences prior to money laundering in order to simplify cooperation between the various authorities in the fight against serious offences against tax law.
19	Increased use of simultaneous audits	To simplify tax auditing and to smooth the way for future joint audits, the member states should ensure that that their legal

	and the presence of foreign officials during tax audits	regulations do not impede the presence of foreign officials in the premises of the tax authority / taxpayer.
21 22 23	Computer format for automatic information exchange, EU-wide tax identification numbers, rationalisation of IT instruments	Formats for the automatic exchange of information on various incomes (no capital incomes!) are being developed, the implementation of an EU-wide tax identification number (TIN) is to be progressed. The introduction of the TIN portal is only the first step. Apart from this the Commission is introducing an EU-wide rationalisation of the IT instruments in order to ensure more effective and cheaper systems.
24	Guidelines for the tracing of money flows	Improved access for the tax authorities to information on money flows (e.g. on credit cards and EU / offshore accounts)
25	Improvement of risk-management techniques	Promotion of the structured exchange between the tax and customs administrations on strategies for fighting fraud.
26	Extension of Eurofisc to direct taxation	Eurofisc, the existing early-warning system for VAT fraud, is to be extended to the field of direct taxation.
27 28 29	Improved communication between taxpayers and tax authorities	The member states are to establish a central contact point for tax information, the existing web portal "Tax on Europe" is to be further developed in order to include cross-border tax information.
30	Alignment of administrative law and criminal law sanctions	It is to be examined whether the alignment of the definition of offences against tax regulations and actual sanctions is practical.
Long-term measures (no priority according to the Council)		
32	Methods for joint tax auditing	Specially trained auditing teams are to be able to undertake joint tax audits in various member states.
33	Mutual direct access to national databases	Direct access to national databases is to be made easier in the field of direct taxation. This access already exists in the field of VAT, this experience first has to be assessed.
34	One single legal instrument for cooperation between administrative authorities in relation to all taxes	There are currently different types of legal instrument for different types of tax – e.g. direct taxes, indirect taxes, VAT etc. In the long term there should only be one single legal instrument.

### OECD Measures

Specifically, the following 15 points have been identified for which appropriate measures are to be developed.

Measure	Description	Result	Deadline
1 - Solution of tax problems associated	Determination of the main difficulties for the application of	Report on the problems and	Sept. 2014

with the digital economy	existing international tax regulations caused by the digital economy.	solution measures.	
2 – Neutralisation of the effects of hybrid mismatch arrangements	Drawing up of model provisions for agreements and recommendations for the design of national regulations to prevent particular effects (e.g. double non-taxation etc.).	Changes in the model agreement.  Recommendations for the design of national regulations.	Sept. 2014
3 – Strengthening of the regulations on foreign transaction tax (CFC (controlled foreign corporation) rules)	Drafting of recommendations to design regulations for foreign transactions taxation.	Recommendations for the design of national regulations.	Sept. 2015
4 – Limitation of profit-shrinking through the deduction of interest payments or other financial costs	Development of recommendations concerning established procedures for the design of regulations to avoid profit-shrinking through the deduction of interest costs.	Recommendations on the design of national regulations.  Amendment of the transfer pricing Directive.	Sept. 2015  Dec. 2015
5 – Effective combating of harmful tax practices taking into account transparency and substance	Reorientation of work on harmful tax practices with the focus on the improvement of transparency.	Completion of the examination of the systems in the member states.  Strategy to extend participation of non-OECD.  Revision of the previous criteria.	Sept. 2014  Sept. 2015  Dec. 2015
6 – Prevention of abuse of agreements	Drafting of provisions for the model agreement and of recommendations for the design of national regulations for preventing the granting of agreement advantages in inappropriate cases.	Amendment of the model agreement.  Recommendations for the design of national regulations.	Sept. 2014  Sept. 2014

7 – Prevention of the artificial circumvention of status as a business premises.	Drafting of amendments to the definition of a business premises in order to avoid artificial circumvention of the status as a business premises in connection with BEPS.	Amendment of the model agreement.	Sept. 2015
8 – Ensuring agreement between transfer-pricing results and the value added by intangible assets	Development of regulations to avoid BEPS by the shifting of intangible assets between corporation companies.	Amendment of the transfer-pricing Directive and possibly to the model agreement.  Amendment of the transfer-pricing Directive and possibly to the model agreement.	Sept. 2014  Sept. 2015
9 – Ensuring agreement between transfer-pricing results and the value added by intangible assets – risks and capital	Development of regulations to avoid BEPS through the shifting of risks to corporation companies or the excessive loading of corporation companies with capital.	Amendment of the transfer-pricing Directive and possibly of the model agreement.	Sept. 2015
10 – Ensuring agreement between transfer-pricing results and the value added by intangible assets – other high-risk transactions	Development of regulations to prevent BEPS through the conclusion of transactions between third parties that do not or only extremely rarely occur.	Amendment of the transfer-pricing Directive and possibly of the model agreement.	Sept. 2015
11 – Development of methods to record and analyse BEPS data and counter-measures.	Development of recommendations on indicators for the extent and the economic effects of BEPS and ensuring the availability of instruments for continuous monitoring and assessment of the effectiveness and economic effects of the counter-measures against BEPS.	Recommendations with regard to the data to be gathered and methods for its analysis.	Sept. 2015
12 – Obligation of taxpayers to disclose their aggressive tax planning models	Development of recommendations for the design of compulsory disclosure rules for aggressive or abusive transactions, models or structures taking account of the administrative costs for tax	Recommendations for the design of national regulations.	Sept. 2015

	authorities and companies and drawing on the experience of the growing number of states that have such regulations.		
13 – Examination of the transfer-pricing documentation	Development of rules for transfer-pricing documentation with the aim of an improvement of transparency for tax authorities taking into account the compliance costs for companies.	Amendment of the transfer-pricing Directive and recommendations for the design of national regulations.	Sept. 2014
14 – Improvement of the efficiency of conflict-resolution mechanisms	Development of solutions for eliminating obstacles that hinder states from the resolution of agreement-related disputes as part of the mutual agreement procedures, including the absence of arbitration clauses in most agreements and the fact that in particular cases access to agreement and arbitration procedures can be refused.	Amendment of the model agreement.	Sept. 2015
15 – Development of a multilateral instrument.	Analysis of tax law and public law questions in connection with the development of a multilateral instrument that enables states who wish to do so to implement the measures developed as part of the work on BEPS and to amend bilateral tax agreements.	Report on the relevant public law and tax questions.  Development of a multilateral instrument.	Sept. 2014  Dec. 2015

### III. Money Laundering

The fight against money laundering is part of various measures as well as representing an essential part of the problem. The following will generally outline the way in which money laundering works.

If money is obtained illegally (drug-dealing etc.) or tax is evaded, it is categorised as illicit money. In order to bring this money back into the legal economy its origins have to be concealed. This is the task of money laundering. This happens in three stages:

- placement
- layering, and
- integration

The placement of quantities of cash in financial or economic circulation usually takes place through small quantities (smurfing) designed to conceal the payment of a large amount of money into an account. For this the money is divided into many smaller amounts that are then transferred in several tranches. In this way, in the many other transactions an unusually high amount of money for an account should therefore no longer attract attention. This process is particularly applied if amounts over €15,000 are to be paid in. In the EU, identification of the depositor is obligatory for cash in-payments over €15,000, and the data must be saved.<sup>227</sup> In order to circumvent this obligation the amount is paid in in several tranches none of which exceed this limit.

In a second stage (layering) the origin of this wealth is concealed. For this, the money is shifted back and forth in numerous transactions so that the criminal origin can no longer be traced or proved. This serves to cover the tracks.

In a third stage (integration), once the origin of the money can no longer be established, the “laundered” money is used as if it is a result of a legal business activity. Thus for example shares in companies or real estate are purchased. On an IMF estimate between 2% and 5% of world GDP originates from illegal sources.<sup>228</sup>

#### **Example of Money Laundering with the Aid of Tax Havens**

A foundation is established in Liechtenstein. The beneficiary is the tax evader. The name of the tax evader who has furnished the money does not appear in any of the foundation's documents, but only those of trustees (lawyers or notaries) who carry out all the transactions on behalf of the tax evader. Thus the founder remains unknown to the foreign tax authorities. The foundation runs a mailbox company; the placement is concluded.

Now the layering begins. The mailbox company operates fictitious businesses with a mailbox company in a tax haven and channels money into it for example through false invoices. The tax evader receives his transferred, evasive wealth in an offshore centre (tax haven) through an interim financing company as a loan.

As soon as the loan arrives in the tax-evader's country of residence the integration phase is complete.

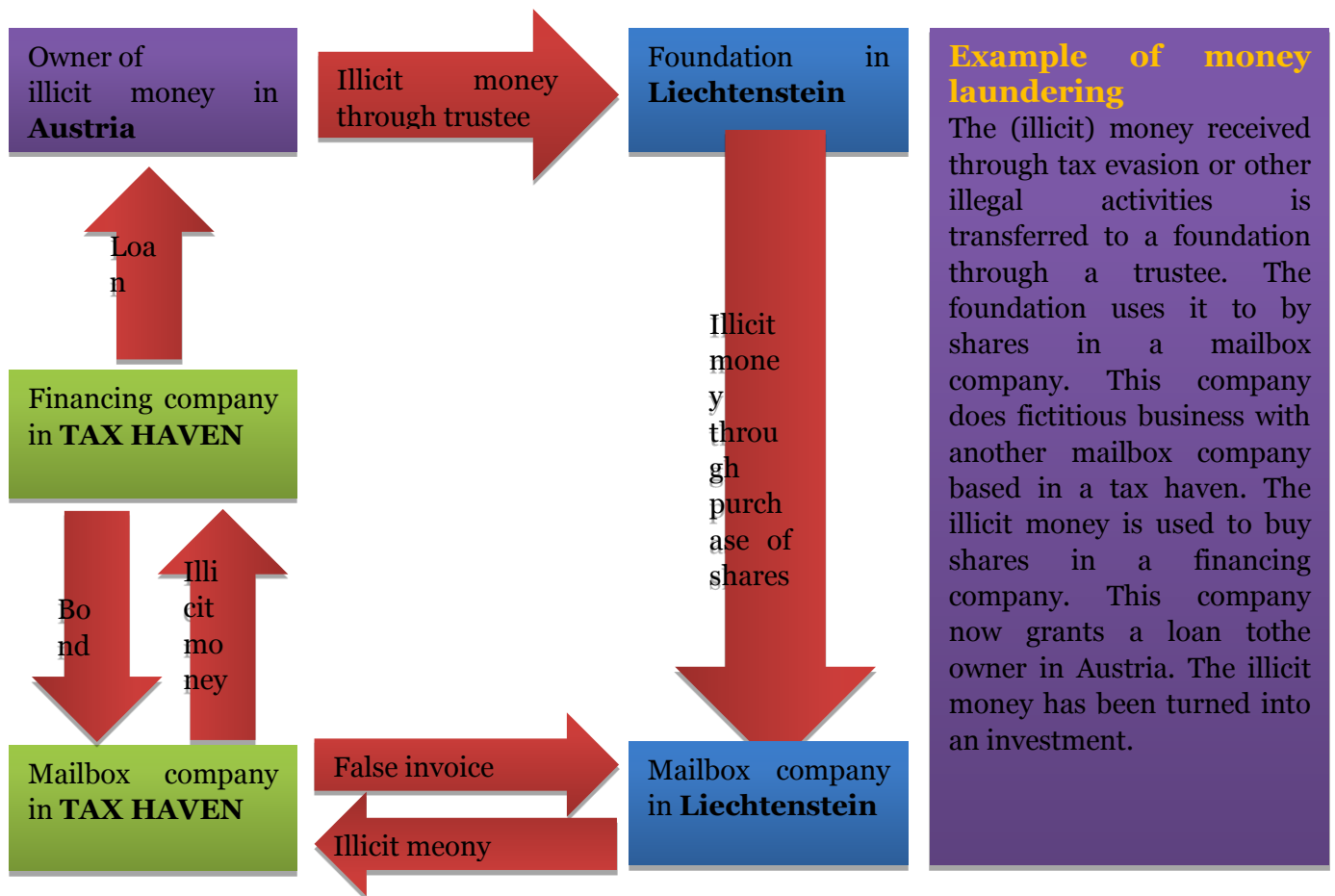
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<sup>227</sup> cf. 3. Money-Laundering Directive 2005/60/EC

<sup>228</sup> Homepage of the Austrian Ministry of Finance



Fig. 11  
Money Laundering



In Austria the measures to fight money laundering and the funding of terrorism are essentially based on international standards of the [Financial Action Task Force \(FATF\)](#) and the general conditions of the [European Union \(EU\)](#).

As there is no specific money laundering law in Austria the regulations are to be found in various laws. Banking, insurance and securities control laws contain their own provisions on money laundering. The penal code (StGB) penalises money laundering (§ 165 StGB). As the controlling body for banks, the Financial Market Authority has the legal obligation to check on money laundering and to take action if an offence is committed. Above and beyond this, the [Financial Action Task Force \(FATF\)](#) examines the Austrian measures.

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