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TAX AVOIDANCE REVISITED IN THE EU BEPS CONTEXT

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Tax Avoidance Revisited in the EU BEPS Context

Why this book?
This book discusses the legal meaning of tax avoidance and aggressive tax planning in 23 EU and non-EU jurisdictions and analyses the repercussions of the BEPS initiatives on those concepts.
It further discusses (i) whether there is a supranational meaning of tax avoidance and aggressive tax planning, both at the OECD/G20 and EU levels; (ii) the role played by transfer pricing rules in tax avoidance; and (iii) consistency and hierarchy among the BEPS initiatives.

National reports examine the response to tax avoidance and aggressive tax planning in individual jurisdictions, taking into account the OECD/G20 BEPS recommendations and the European Union's reactions. They also give notice of general anti-avoidance rules, special anti-avoidance rules and transfer pricing rules in force in each jurisdiction, analyse their meaning and scope, and trace the interactions among them. The national reports are accompanied by a general report, along with four thematic reports covering the main topics discussed during the 2016 EATLP Congress, held in Munich.

This book is part of the EATLP International Tax Series.

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Preface

This volume is the outcome of the 2016 Congress of the EATLP held in Munich from 2 to 4 June. The main subject of the Congress was tax avoidance: “Tax Avoidance Revisited - The Meaning of Avoidance and Aggressive Tax Planning in the BEPS Context”, which was discussed on 3 June.

For the purposes of the Congress, the aforementioned subject was divided into four panels: (i) Section 1, “The Meaning of Avoidance and Aggressive Tax Planning in the BEPS Context” (Ana Paula Dourado; Luc De Broe; Adolfo Martín Jiménez; and Yariv Brauner); (ii) Section 2, “Reactions to Avoidance and Aggressive Tax Planning” (Ana Paula Dourado; Judith Freedman; Joachim Englisch; and Lilian Faulhaber); (iii) Section 3, “Avoidance and Aggressive Tax Planning in the EU: Its Meaning and Adequate Reaction to BEPS” (Ana Paula Dourado; Pasquale Pistone; Edoardo Traversa; and Richard Lyal); and (iv) Section 4, “Multilateralism, Coordinated Bi-/Unilateralism or Chaos” (Ana Paula Dourado; María Teresa Soler Roch; Daniel Gutmann; and Reuven Avi-Yonah).

The preparation of the Congress involved a questionnaire sent to the national reporters, national reports and thematic reports on the four sessions.

This volume of the EATLP International Tax Series is organized as follows: my general report (Part I), thematic reports (Part II), the aforementioned questionnaire and 23 national reports, involving European and non-European jurisdictions (Part III).

My general report focuses on the answers given by the national reporters to the questionnaire, and tries to illustrate how the reported jurisdictions have been handling tax avoidance in recent years and whether the BEPS Project has brought any novelties to the reported national tax systems.

The four thematic reports cover some of the main topics discussed during the Congress in each of the four sessions: (i) “Tax Avoidance and Aggressive Tax Planning as an International Standard – BEPS and the ‘New’ Standards of (Legal And Illegal) Tax Avoidance” (Adolfo Martín Jiménez); (ii) “Transfer Pricing and Tax Avoidance” (Yariv Brauner); (iii) “The Meaning of Tax Avoidance and Aggressive Tax Planning in European Union Tax Law: Some thoughts in connection with the reaction to such practices by the European Union” (Pasquale Pistone); and (iv) “Consistency and Hierarchy among the BEPS Actions” (María Teresa Soler Roch).

I wish to express my deepest gratitude to all national reporters, thematic reporters and panellists in the Congress who contributed with many ideas to this book; to Peter Essers, who, as the EATLP Academic Chairman, strongly upheld the topic and the involving academic preparation by the reporters and panellists; to Kristy Jonas (the EATLP Academic Assistant) for her assistance in collecting the texts for this book and in the academic preparation of the Munich Congress; and to Raphael Monteiro de Oliveira, Dinis Tracana and especially Aakriti Srivastav for their assistance in editing the book.

Last, but not least, grateful acknowledgment goes to Wolfgang Schön and the Max-Planck Institute für Steuerrecht und Öffentliche Finanz in Munich; and to Klaus-Dieter Drüen and the Ludwig-Maximilians-Universität in Munich, for hosting the 2016 EATLP Congress; and to IBFD and the aforementioned Max-Planck Institute for their contribution to the editing costs of this book.

Ana Paula Dourado
Lisbon, March 2017

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Transfer Pricing and Tax Avoidance

Yariv Brauner

3.1. Introduction

Transfer pricing is undoubtedly a key, fundamental weapon in the arsenal of any modern tax planner. During the last two decades, most of the countries extensively (and even those less extensively) involved in international trade have adopted transfer pricing laws to combat this otherwise most simple of tax minimization techniques. Essentially all of them followed the almost universal arm's length standard, and a large majority of them also expressed commitment (though to various extents) to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (TPG). Transfer pricing abuse has also featured centrally among the most prominent issues dealt with by the base erosion and profit shifting (BEPS) Project, and has now long been declared as the most concerning challenge for MNE tax compliance.

For the purposes of this book, one therefore must consider transfer pricing, its regulation, practice and enforcement in the more general context of tax avoidance and laws attempting to limit it. This chapter considers, first, the conceptual relationship between transfer pricing and tax avoidance through tax planning. Second, it examines the appropriateness of viewing transfer pricing laws as general anti-avoidance rules (GAARs), and, finally, it explores the role of transfer pricing rules as specific anti-avoidance rules (SAARs) and their interaction, as such, with other common SAARs.

3.2. Transfer pricing and tax avoidance

Transfer pricing laws are a necessary product of two seemingly independent developments: economic globalization and the legal fiction of separate corporate personality. The opportunity that globalization presented to multinational enterprises (MNEs) to exploit (primarily) intangibles[1] has not only been an economic opportunity. Since essentially all countries legally

1. One may argue that such opportunities serve as the primary justification for MNEs to operate in that form.

adhere to the fiction (or metaphor) of separate corporate personality for tax law purposes, they also essentially view intra-firm transfers as real, cross-border transfers. Such cross-border transfers, even if not "real" for the firm in economic terms, are deemed real for tax law purposes, since typically there are competing claims of multiple jurisdictions to tax them regardless of economic realities. The point, for our purposes, is that transfer pricing planning at its core is not a tax planning technique in the sense of tax minimization but simply a mechanism to comply with the legal reality of jurisdictions claiming taxing rights over activities of MNEs, regardless of the real economics of these activities.[2] It is first and foremost an allocation norm.

As such, transfer pricing rules and compliance have obviously been a significant burden on MNEs. Yet, they also presented obvious opportunities. The separate corporate personality fiction permitted intra-firm, cross-border transactions that are easy, cheap and, by definition, unreal and fully in control of taxpayers. There can be no simpler profit shifting technique. Transfer pricing rules and the arm's length standard have been the solution, imposing supposed market discipline on this "too easy" planning. At a very general level, it would still be difficult to view the transfer pricing rules (and arm's length) as serving an anti-abuse role, since they primarily set the "rules of the game". In the absence of such rules, it would be difficult to view regular transfer pricing planning as abusive,[3] as MNEs are required (by law) to maximize profits, etc.

Yet, the application of the arm's length standard is difficult and far from perfect. Despite the supposed universal application, adherence to the TPG and the attention of governments to the matter, transfer pricing is at the forefront of the war over so-called aggressive tax planning by MNEs, as demonstrated by the BEPS Project. "Arm's length" rules require related parties to charge the prices they would have charged unrelated parties in comparable transactions and circumstances. This approach fortifies rather than counters the separate corporate personality fiction, since it mandates taxpayers to act (for tax purposes) according to that fiction, despite the fact that they explicitly chose to arrange their economic affairs hierarchically rather than contract with unrelated parties. This was done presumably because they believed that they would gain an economic advantage; however, this advantage is decidedly and consciously ignored by current transfer pricing rules worldwide.

2. Indeed, this basic approach was reflected in several reports. *See*, for example, Austria.

3. Assuming, for these purposes, behaviour that is not too aggressive, such as the creation of losses in a jurisdiction where a firm is clearly profitable.

Moreover, tax authorities and the OECD militantly and religiously protect and strengthen the dominance of arm's length-based transfer pricing, despite the ample criticism. It is easy to observe that the complexity of the rules, their strong political flavour and the general competitive framework of the international tax regime makes the identification of abuse in transfer pricing planning very difficult. Yet, aggressive transfer pricing planning clearly fails the "smell test" and, therefore, requires the same kind of scrutiny that other abusive tax planning techniques face, especially since transfer pricing planning is typically combined with other tax planning techniques that are subject to the scrutiny of anti-abuse norms as a matter of course.

To deal with this challenge, one must first establish a baseline, or zone of acceptability, the deviation from which would be considered abusive. Yet, despite the appeal of arm's length or "market behaviour" as a baseline, it is far from very useful in reality. First, due to the impossibility of generating accurate, pinpoint transfer prices, the practice requires flexibility and often uses an arm's length range rather than price. This very sensible practice introduces an inherent advantage to MNEs, especially intangible-heavy MNEs. Note that this bias is universal to arm's length transfer pricing, even when a range is not established, since the taxpayer is at the helm and has the opportunity to establish the facts, comparables, etc. of the case. Second, countries differ significantly in their interpretation and application of arm's length, and taxpayers have notoriously exploited the opportunities presented by these differences (more than they have suffered from them). Third, the lack of cooperation among countries has further blurred any potential baseline. Countries do not even consistently require consistent reporting by taxpayers. Transfer pricing compliance is essentially unilateral. This observation was made by the BEPS Project and work is being done that would make coordination more feasible, especially in the context of Action 13 of the BEPS Action Plan, yet one must wait and see how successful this work would be. Consequently, an application of the transfer pricing rules as anti-abuse norms would necessarily both over and under-regulate intra-firm transactions. A fictional baseline based on some unattainable arm's length price would have to serve as a benchmark for abuse. However, it must be noted that such an analysis would differ from the application of other anti-abuse rules, since deviation from the baseline would then automatically mean "abuse". There would not be an independent analysis of abuse, per se. The above-mentioned lack of a true international baseline makes it a moving target that would be a very poor and undesirable measure of abuse in the normal legal sense.

In what sense, then, may transfer pricing planning be abusive? Well, functionally, one may engage in abusive behaviour independent of the mere deviation from arm's length pricing. This seems to be the approach of most of the country reports in this book, yet, in reality, it is very difficult to distinguish abusive tax planning from mere aggressive transfer pricing positions. This difficulty may be resolved with an intent-based approach to the notion of abusive tax planning; however, as demonstrated in this book, such an approach is far from dominant in today's world. Only one country report has expressed an approach close to the latter intent-based analysis: the Netherlands. Other countries have also reported on the relationship between transfer pricing enforcement and doctrines such as *fraus legis*, yet none of them resembles the rather direct reliance on behaviour and intent of the Netherlands. Nonetheless, it is notable that even Dutch law does not rely solely on intent, which makes the analysis more complex.

The general approach to the concept of abuse and tax avoidance is further clarified in the next section, where the report analyses transfer pricing laws as GAARs.

3.3. Transfer pricing laws as GAARs

The debate during the congress has demonstrated the lack of consensus over the precise definition of GAARs and their appropriate use. One approach is functional, which one may call political, viewing GAARs as rules that transfer the power to set exact legal boundaries from legislators to governments (or tax authorities). Under this approach, a GAAR may be necessary or useful when the legislator cannot set exact boundaries or is not in the best position to do so efficiently. This approach tolerates different forms of GAARs, depending on the legal and business cultures of the relevant jurisdictions. Some countries' GAARs are rather expansive, shifting the discretion to the tax authorities,[4] and some are designed more narrowly, such as the newly enacted UK GAAR.

It may also generate resistance to GAARS, as best demonstrated by the United States report. However, that report also demonstrates that political resistance to GAARs does not make the challenges typically managed by GAARs simply disappear. The United States alternatively uses a large number of supposed SAARs and what may be viewed as a hidden GAAR: the US transfer pricing norm in section 482[5] of the US Internal Revenue

4. Which may still use it sparingly, such as in Sweden, where the GAAR is considered a tool of last resort.
5. All references are to the US Internal Revenue Code and Treasury Regulations, unless otherwise provided.

Code. Section 482 operates as a GAAR-like rule in that it provides the Internal Revenue Service (IRS) with significant discretion to intervene in the characterization of income from related-party transactions. This power is translated into a complex arm's length-based regime through detailed regulations.[6] While the transfer pricing rules target some of the same abuses as various SAARs, these rules apply separately and concurrently, and are not specifically coordinated within the US tax system. Although the transfer pricing rules provide the IRS with significant power to intervene in the pricing of intercompany transactions, the US government has struggled to enforce the transfer pricing rules. Both the government itself and the courts have clearly interpreted section 482 as a limited transfer pricing provision. Therefore, it would still be difficult to discuss section 482 in the same category as traditional GAARs.

A second approach to GAARs, already mentioned above, focuses on the intent of taxpayers. A few country reports mention the use of such GAARs in parallel or complementary to the transfer pricing rules,[7] yet none of them report a distinct transfer pricing rule with such GAAR features. Eventually, most countries view their transfer pricing rules as SAARs, as discussed in the next section.

3.4. Transfer pricing and SAARs

Most of the reports express an inherent understanding of their transfer pricing as SAARs, and are not concerned with their particular distinctive features.[8] The Turkish report mentions an explicit categorization as such, and the German report explains that the transfer pricing rules constitute a "closed system" within Germany's anti-abuse legislation. This system substantively conforms with OECD standards, but its administrative and compliance aspects are uniquely domestic (German), with "a number of national particularities and inefficiencies".[9]

The Brazilian report reflects a similar approach, despite the substantive deviation of the Brazilian rules from the universal norms reflected in the TPG. The anti-avoidance intent of Brazilian transfer pricing legislation is clear, according to the reporters, from their application to both controlled

6. US Treas. Reg. 1.482-1 to -9.
7. E.g. the Dutch report.
8. *See*, for example, the reports of Denmark, the Czech Republic, the Netherlands and Norway.
9. The French and Russian reports demonstrate similar approaches and distinctions.

and uncontrolled transactions (although the application to the latter is more limited).

The US rules all appear in regulations; even the arm's length standard, chosen by the Treasury and the IRS as the most appropriate for income allocation among related parties, appears only in the regulations. However, the evolution of the transfer pricing regime in the United States resulted in the near abandonment of the original purpose of the rules in favour of the implementation and instrumentality of the mechanism chosen for its application. First the government and then the courts limited the regime to a literal application of the arm's length standard in complete disregard of the object and purpose of the regime. It was all about the comparability of market and non-market transactions in the most straightforward and literal manner. The application of the detailed arm's length rules in the regulations combats much of the tax avoidance attempted by related parties, but it does so indirectly and only through the prism of the literal arm's length and prescribed regulations. There is no direct targeting of abuse or tax avoidance.

Yet, as mentioned before, some countries still struggle with automatically viewing transfer pricing as an anti-avoidance regime. The Polish report, for example, indicates a transition from this approach, where current law does not examine transfer pricing cases from an anti-avoidance perspective. Still, the reporters expect that recent reforms would result in more consistent interpretation of transfer pricing rules, interpretation that should also increasingly resemble that of other applicable SAARs.

The report of Portugal indicates that the anti-abuse nature of transfer pricing rules is apparent in practice, despite the obviation of the original purpose of allocation. The reporter reaches this conclusion based on the mandatory penalties regime that is typical for SAARs.[10]

The Italian report indicates that Italian courts have also struggled with this point. The Italian Supreme Court originally classified transfer pricing among other anti-avoidance rules, supported by scholars and other experts. However, the Court was criticized that this approach had been at odds with the wording of the transfer pricing law indicating solely allocation functions. This led the Supreme Court to change its position, recognizing that transfer pricing primarily represents an allocation rule. The report mentions a recent case, which stated: "The manipulation of transfer prices applied in transactions between related parties... is prosecuted, at international level,

10. The report for Portugal, fn. 35.

not so much because it is aimed at achieving an undue tax saving... but because it distorts the proper allocation between States of tax bases generated by cross-border transactions". Therefore, "[w]hile an anti-avoidance purpose exists, it does not exhaust the goals of this rule".

3.5. Application and interaction with other anti-avoidance rules

At present, it can be easily observed that jurisdictions generally prefer to package their transfer pricing rules as SAARs, despite the universality of arm's length and the unclear anti-avoidance origins of transfer pricing. However, the supposed abuse targeted by transfer pricing (leaving aside the question of whether it is directly or only incidentally targeted by them), is typically addressed by many other traditional SAARs as well. All of the country reports included refer to several SAARs that operate alongside the transfer pricing rules, often with very similar goals. Essentially all of the countries have, for example, rules that regulate or limit interest deductions, all of which are based on a presumption of non-market debt structures that are also regulated by the transfer pricing rules. Similarly, many countries employ controlled foreign companies (CFC) rules that try to prevent the artificial shifting of profits (especially to low-tax jurisdictions), which, again, is also the goal of transfer pricing rules, most definitely where such rules are framed as SAARs. The picture portrayed by the reports is quite uniformly one of preference for multi-layered anti-avoidance regimes. The different components usually operate in parallel, with little to no coordination or hierarchy.[11] Apparently, none of these regimes are accepted as sufficiently effective. A few reports, however, indicate a more complex legal situation where, although some coordination norms exist, their application is challenging. This is the situation in the Netherlands, for example, and also in Denmark, where the report indicates that real issues have arisen in the difficult interaction between the transfer pricing, thin capitalization and CFC rules. France reports coordination rules among SAARs, but with no specific ones for transfer pricing.

The interaction of the transfer pricing rules (as SAARs) with GAARs is more complex. In some countries, the GAAR operates as another anti-avoidance rule with no superiority or inferiority to SAARs, including transfer pricing rules.[12] In other countries, the GAAR is viewed differently

11. *See*, for example, Norway, Greece, Russia and the United States
12. *See*, for example, Norway and the Netherlands.

from SAARs even if not in terms of explicit hierarchy. For example, the Russian report indicates the importance of *lex specialis* in the application of anti-avoidance rules, effectively giving the GAAR a supportive and perhaps residual role to SAARs, which includes transfer pricing.[13] The Russian report mentions case no. A40-111951/12, where the transfer pricing rules (which were in force before the adoption of 227-FZ of 18 July 2011) have been applied and the court was requested to analyse their relations with the GAAR. The court focused in its decision on the application of transfer pricing rules to the facts of the case. It further referred to the GAAR, posing it as an abstract principle in service of the transfer pricing rules, helping to clarify their purpose and their proper use.

The German report indicates a very interesting aspect of the existence of a GAAR. The reporter explains that the GAAR is used as a weapon or a threat to taxpayers in cases where they cannot clearly establish their position. The important context of valuations is specifically mentioned in the report. This is a good example of the importance of the conceptual question of transfer pricing's place among the SAARs, since if it does not belong to this category, it would be difficult to justify such threats by the tax authorities (that said in general without reference to German law specifically). This is particularly relevant in the context of the valuation of intangibles, which is a very controversial matter.[14] Prudent taxpayers clearly may deviate in their positions from those of the tax authorities, making the desirability of harsh consequences very questionable. Is it reasonable to trigger a GAAR each time that taxpayers and tax authorities reach materially different conclusions in valuation studies? What penalty regimes should apply in these cases? Would typical penalty structures that depend on the extent of the deviation be appropriate in these cases? It does not seem that legislators and tax authorities have considered these issues carefully enough, if at all.

3.6. Conclusion

In conclusion, the almost universal arm's length-based transfer pricing rules are viewed by most countries as serving anti-avoidance purposes, primarily or in conjunction with their role as allocation rules of tax bases among competing jurisdictions. As such, they are generally included among other

13. Quite a similar situation seems to exist in Portugal and Turkey. The RSA report indicates a similar situation, where there is no explicit hierarchy, yet the tax authorities apply the GAAR as a tool of last resort.
14. *See*, for example, Y. Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 Va. Tax Rev. 79 (Summer, 2008).

SAARs. The basic application of the rules as SAARs and their interaction with other SAARs are also fundamentally similar in most countries. Where a GAAR exists, differences arise but interaction between transfer pricing rules and GAARs seem to be rare or practically non-existent, whether de facto or de jure.

However, once the details have been considered, it becomes difficult to reach conclusions about similarity of application of these rules worldwide. Domestic idiosyncrasies seem to feature prominently. Finally, despite the essential universality of the presumptive view of transfer pricing as a SAAR, such presumption leans on weak intellectual foundations, which in some countries lead to challenges in the application of the rules or deviations from international practices, and in others to a lack of clarity regarding the application of the rules, especially in difficult cases, such as the transfer of intangibles.

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