TAX AVOIDANCE REVISITED IN THE EU BEPS CONTEXT

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IBFD
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
Preface

About the Authors

Part I
General Report

Chapter 1: Tax Avoidance Revisited in the EU BEPS Context

Ana Paula Dourado

1.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

1.1.1. The meaning of tax avoidance in national legal systems

1.1.1.1. The role of GAARs and judicial interpretation

1.1.1.2. The role of administrative regulations and rulings clarifying the meaning of tax avoidance

1.1.1.3. Case law on the meaning of tax avoidance

1.1.1.4. BEPS repercussion on the meaning of avoidance

1.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

1.2. The reaction to avoidance and aggressive tax planning in the BEPS context

1.2.1. Domestic GAARs


1.3. TP rules, GAARs, SAARs and linking rules

1.3.1. LOB rules

1.3.2. CFC rules

1.3.3. Linking rules as recommended in G20/OECD BEPS Action 2

1.3.4. Limits on the deduction of interest

1.3.5. Other SAARs
## Table of Contents

1.4. Application of GAARs, TP rules and SAARs  
   1.4.1. Interaction of GAARs, TP rules and SAARs 20  
   1.4.2. Procedural rules underlying application of national GAAR, TP rules and/or SAARs 22

### Part II

#### Thematic Reports

**Chapter 2: Tax Avoidance and Aggressive Tax Planning as an International Standard – BEPS and the “New” Standards of (Legal and Illegal) Tax Avoidance**  
*Adolfo Martín Jiménez*

- 2.1. Introduction 25
- 2.2. The rise and fall of aggressive tax planning as an anti-avoidance standard: BEPS Actions as the international standard on avoidance 26
- 2.3. The core of the new international standards of tax avoidance: Actions 8-10 BEPS (transfer pricing) and their effects upon traditional anti-avoidance instruments 34
- 2.4. The PE definition as an instrument for enforcing the BEPS anti-avoidance standards (or to avoid taxation at source): Action 7 BEPS 43
- 2.5. The residual nature of Action 6 BEPS in the definition of the new anti-avoidance standards 48
  - 2.5.1. The anti-avoidance standards proposed by Action 6 BEPS 48
  - 2.5.2. Action 6 BEPS as a standard subordinated to that defined in Actions 8-10 BEPS 49
  - 2.5.3. The concepts of permitted and prohibited double non-taxation in Action 6 BEPS and the definition of special tax regimes 55
- 2.6. Conclusions 59

**Chapter 3: Transfer Pricing and Tax Avoidance**  
*Yariv Brauner*

- 3.1. Introduction 63
- 3.2. Transfer pricing and tax avoidance 63
- 3.3. Transfer pricing laws as GAARs 66
- 3.4. Transfer pricing and SAARs 67
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.5. Application and interaction with other anti-avoidance rules</td>
<td>69</td>
</tr>
<tr>
<td>3.6. Conclusion</td>
<td>70</td>
</tr>
<tr>
<td><strong>Chapter 4:</strong> 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</td>
<td>73</td>
</tr>
<tr>
<td>Pasquale Pistone</td>
<td></td>
</tr>
<tr>
<td>4.1. Introduction</td>
<td>73</td>
</tr>
<tr>
<td>4.2. The absence of a common concept of tax avoidance in tax systems</td>
<td>75</td>
</tr>
<tr>
<td>4.3. The meaning of tax avoidance in European tax law</td>
<td>78</td>
</tr>
<tr>
<td>4.3.1. The interpretation of principles and primary law in tax matters</td>
<td>78</td>
</tr>
<tr>
<td>4.3.2. Secondary law in direct tax matters</td>
<td>83</td>
</tr>
<tr>
<td>4.4. The meaning of aggressive tax planning</td>
<td>90</td>
</tr>
<tr>
<td>4.5. Summary and conclusions</td>
<td>99</td>
</tr>
<tr>
<td><strong>Chapter 5:</strong> Consistency and Hierarchy among the BEPS Actions</td>
<td>101</td>
</tr>
<tr>
<td>María Teresa Soler Roch</td>
<td></td>
</tr>
<tr>
<td>5.1. Introduction</td>
<td>101</td>
</tr>
<tr>
<td>5.2. The concept</td>
<td>102</td>
</tr>
<tr>
<td>5.3. Main targets and new standards</td>
<td>108</td>
</tr>
<tr>
<td>5.3.1. Tax competition</td>
<td>108</td>
</tr>
<tr>
<td>5.3.2. Tax avoidance</td>
<td>115</td>
</tr>
<tr>
<td>5.3.3. Double non-taxation</td>
<td>124</td>
</tr>
<tr>
<td>5.3.4. Transfer pricing</td>
<td>132</td>
</tr>
<tr>
<td>5.4. Final remarks</td>
<td>138</td>
</tr>
<tr>
<td><strong>Part III</strong></td>
<td></td>
</tr>
<tr>
<td>National Reports</td>
<td></td>
</tr>
<tr>
<td><strong>Chapter 6:</strong> Questionnaire for National Reports</td>
<td>143</td>
</tr>
<tr>
<td>6.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative</td>
<td>143</td>
</tr>
</tbody>
</table>
Table of Contents

6.1.1. The meaning of tax avoidance in national legal systems 143
6.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems 144

6.2. The reaction to avoidance and aggressive tax planning in the BEPS context 145
6.2.1. Domestic general anti-avoidance rules (GAARs) 145
6.2.1.1. Is there a GAAR in your national legal system? 145
6.2.2. EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule 146

6.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules 147
6.4. Application of GAARs, TP rules and SAARs 147

Chapter 7: Austria

Sebastian Bergmann

7.1. The meaning of tax avoidance 149
7.2. General anti-avoidance rule 151
7.3. Specific anti-avoidance rules
7.3.1. Linking rules 157
7.3.2. Interest deduction limitation rules 158
7.3.3. CFC rules 158
7.3.4. Transfer pricing rules 159
7.3.5. Subject-to-tax rules in DTCs 160
7.3.6. Limitation-on-benefits rules in DTCs 161
7.3.7. Other specific anti-avoidance rules 163
7.4. Interaction of general and specific anti-avoidance rules 164
7.5. Procedural aspects 165

Chapter 8: Belgium

Bart Peeters

8.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 167
8.1.1. Legal definition 167
8.1.2. Administrative clarifications 174
8.1.3. Tax rulings 179
8.1.4. Existing case law on the meaning of tax avoidance 181
8.1.5. Different bodies with judicial competence 185
8.1.6. External influences 185
8.2. The reaction to avoidance and aggressive tax planning in the BEPS context 186
  8.2.1. European demand for domestic general anti-avoidance rules (GAARs) 186
  8.2.2. Subject-to-tax rules to deal with double non-taxation 188
8.3. Transfer pricing rules, GAARs, SAARs and linking rules 189
  8.3.1. Transfer pricing rules 189
  8.3.2. Particular clauses in double tax conventions 190
  8.3.3. CFC legislation 191
  8.3.4. Linking rules 193
  8.3.5. Limits on the deduction of interest 193
  8.3.6. Other particular SAARs 195
8.4. Combination of GAARs and SAARs 197

Chapter 9: Brazil 199
  Luis Eduardo Schoueri and Ricardo André
  Galendi Júnior

9.1. Preliminary remarks 199
9.2. The meaning of avoidance and aggressive tax planning and the BEPS initiative 199
  9.2.1. Complementary law 104/2001: The amendment to the National Tax Code 200
  9.2.2. MP 66/2002: The rejection of the regulations on tax avoidance 203
  9.2.3. The CARF’s approach towards tax planning 204
    9.2.3.1. The misuse of private law concepts and the introduction of the business purpose doctrine 205
    9.2.3.2. The Lupatech case and the incoherencies in the Court’s reasoning 208
  9.2.4. The incentivized instalment programmes: Where was the judiciary in the meantime? 209
9.3. The reaction to avoidance and aggressive tax planning in the BEPS context 212
  9.3.1. Here they come again: MP 685/2015 and the BEPS Project 212
9.4. Transfer pricing rules, GAARs, SAARs and linking rules 215
  9.4.1. Brazilian transfer pricing rules and fixed margins 216
  9.4.2. Limits on the deduction of interests in the Brazilian legislation 221
9.4.3. The Brazilian CFC rules: No-deferral universal taxation regime is not a SAAR 222
9.4.4. Brazilian SAARs in tax treaties 225

9.5. Application of GAARs, TP rules and SAARs 227
9.5.1. The CARF’s doctrine, SAARs and TP rules 227
9.5.2. The interaction between TP and limits on the deduction of interests 229

9.6. Conclusion 230

Chapter 10: Croatia

Nataša Žunić Kovačević

10.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 233
10.1.1. The meaning of tax avoidance in national legal systems 233
10.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems 235

10.2. The reaction to avoidance and aggressive tax planning in the BEPS context 236
10.2.1. Domestic general anti-avoidance rules (GAARs) 236
10.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule 240

10.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules 240
10.4. Application of GAARs, TP rules and SAARs 246

Chapter 11: Czech Republic

Danuše Nerudová and Veronika Solílova

11.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 247
11.1.1. The meaning of tax avoidance in national legal systems 247
11.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems 249

11.2. The reaction to avoidance and aggressive tax planning in the BEPS context 250
11.2.1. Domestic general anti-avoidance rules (GAARs) 250
<table>
<thead>
<tr>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.2.2.</td>
</tr>
<tr>
<td>11.3.</td>
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<tr>
<td>11.3.1.</td>
</tr>
<tr>
<td>11.3.2.</td>
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<tr>
<td>11.3.3.</td>
</tr>
<tr>
<td>11.4.</td>
</tr>
</tbody>
</table>

**Chapter 12: Denmark**

*Jakob Bundgaard and Peter Koever Schmidt*

<table>
<thead>
<tr>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>12.1.</td>
</tr>
<tr>
<td>12.1.1.</td>
</tr>
<tr>
<td>12.1.2.</td>
</tr>
<tr>
<td>12.2.</td>
</tr>
<tr>
<td>12.2.1.</td>
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<tr>
<td>12.2.2.1.</td>
</tr>
<tr>
<td>12.2.2.2.</td>
</tr>
<tr>
<td>12.2.2.3.</td>
</tr>
<tr>
<td>12.3.</td>
</tr>
<tr>
<td>12.3.1.</td>
</tr>
<tr>
<td>12.3.2.</td>
</tr>
<tr>
<td>12.3.3.</td>
</tr>
<tr>
<td>12.3.4.</td>
</tr>
<tr>
<td>12.3.5.</td>
</tr>
<tr>
<td>12.3.6.</td>
</tr>
<tr>
<td>12.4.</td>
</tr>
</tbody>
</table>
Chapter 13: Finland

*Raimo Immonen and Juha Lindgren*

13.1. The meaning of tax avoidance in the national legal system

13.1.1. Legal definition of tax avoidance 285
13.1.2. Administrative regulations 286
13.1.3. Tax rulings 286
13.1.4. Case law 287
13.1.5. Other eventual judicial bodies 289
13.1.6. Influence of the interpretation in other jurisdictions, OECD soft law or the case law of the ECJ 289
13.1.7. Influence of BEPS 291
13.1.8. Amendments to tax law 292

13.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems 292

13.2.1. Legal definition of tax planning, abusive tax planning or aggressive tax planning 292
13.2.2. Administrative regulations 293
13.2.3. Tax rulings 293
13.2.4. Case law 293
13.2.5. Overlap 294
13.2.6. Other judicial bodies 294
13.2.7. Influence of the interpretation in other jurisdictions, OECD soft law or the case law of the ECJ 294
13.2.8. Influence of BEPS 294
13.2.9. Legislative amendments 294

13.3. The reaction to avoidance and aggressive tax planning in the BEPS context 295

13.3.1. Domestic general anti-avoidance rules (GAARs) 295
13.3.1.1. GAAR in Finnish legal system 295
13.3.1.2. Similarity with respect to the GAAR proposed by the EC 295
13.3.1.3. Compatibility with the EU/EEA concept of abuse 295
13.3.1.4. Analysis of the Finnish national GAAR 296
13.3.1.5. Interpretation in the case law 296
13.3.1.6. Differences of opinion 296
13.3.1.7. Replacement of GAAR 297

13.3.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule 297
13.3.2.1. Introducing a subject-to-tax rule as proposed by the EC in its DTCs 297
13.3.2.2. Eventual introduction 298
13.3.2.3. Does your domestic GAAR correspond to the proposed GAAR? 298
13.3.2.4. Will your SAARs have to be redrafted/amended according to the rules in the ATAD Proposal? 298

13.4. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules 299
13.4.1. National TP rules 299
13.4.2. Litigation 300
13.4.3. Case law 300
13.4.4. LOB rules in double taxation conventions 301
13.4.5. CFC rules 302
13.4.6. Introducing linking rules as recommended in OECD/BEPS Action 2 303
13.4.7. Limitation on the deduction of interest 303
13.4.8. SAARs in Finnish tax law 305

13.5. Application of GAARs, TP rules and SAARs 306
13.5.1. Interaction of GAARs, TP rules, SAARs and linking rules in the Finnish legal system 306
13.5.2. Hierarchy, coordination or overlapping of measures 306
13.5.3. Procedural rules underlying application of the Finnish GAAR, TP rules and/or SAARs 307
13.5.4. Application of procedural rules 307

Chapter 14: France 309
Emmanuel Raingeard de la Blétière

14.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 309
14.1.1. The meaning of tax avoidance in the French legal system 312
14.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in the French legal system 315
14.1.3. Conclusion 318

14.2. The French reaction to avoidance and aggressive tax planning in the BEPS context 320
14.2.1. Presentation of French GAARs 320
14.2.1.1. Focus on the “abuse of tax law” 321
14.2.1.2. Compatibility of the French abuse-of-law provision with EU law 324
14.2.1.3. Sole purpose versus principal purpose 328
14.2.2. The French implementation of the EC Recommendation on aggressive tax planning’s subject-to-tax rule 330

14.3. Transfer pricing rules, GAARs, SAARs and linking rules 331
14.3.1. Transfer pricing rules and the fight against avoidance 331
14.3.2. LoB in French tax treaty practice 332
14.3.3. French CFC rules 334
14.3.3.1. Entity definition 335
14.3.3.2. Control 335
14.3.3.3. CFC exemptions and threshold requirements 335
14.3.3.4. CFC income definition 335
14.3.3.5. Attribution of income 336
14.3.3.6. Rules to prevent double taxation 336
14.3.3.7. Safe harbours 336
14.3.4. Linking rules 336
14.3.5. Interest limitation rules 337
14.3.6. Others 339
14.3.7. Application of GAARs, TP rules and SAARs 341

Chapter 15: Germany
Ekkehart Reimer

15.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 343
15.1.1. The meaning of tax avoidance in national legal systems 343
15.1.1.1. The development of the German GAAR until the last (2008) reform 343
15.1.1.2. Functions, constitutionality and dynamics of the GAAR 348
15.1.1.3. Judicial and scholarly interpretation of the GAAR today 349
15.1.1.3.1. Delimitation to SAARs 350
15.1.1.3.2. Choice of an inappropriate legal arrangement 350
15.1.1.3.3. Tax benefit 351
15.1.1.3.4. Deviation from a notional legal model 351
15.1.1.3.5. Absence of significant non-tax reasons for the arrangement chosen 353
15.1.1.3.6. Irrelevance of subjective elements 353
15.1.1.4. The German GAAR in the light of the five criteria listed in the questionnaire 354
15.1.2. Tax rulings as an instrument to restore legal certainty 355
15.1.2.1. Ordinary advance rulings (verbindliche Auskunft) 355
15.1.2.2. Binding affirmation after tax audits (verbindliche Zusage) 356
15.1.2.3. Agreements on facts (tatsächliche Verständigung) 356
15.2. Constitutionalization of anti-avoidance – A new phenomenon 357
15.2.1. Possibility of tax avoidance can make a tax act unconstitutional 357
15.2.2. Relation to statutory anti-avoidance 358
15.2.3. Conclusion 358
15.3. European influence on German anti-abuse measures 359
15.3.1. ECJ case law 359
15.3.1.1. Deviation from Cadbury Schweppes 360
15.3.1.2. Systematic context 361
15.3.2. EC Recommendation C(2012) 8806 of 6 December 2012 361
15.3.2.1. No textual changes of German law 362
15.3.2.2. Interpretative relevance 362
15.3.2.2.1. Definition of “arrangement” 362
15.3.2.2.2. Clarification of “artificial” 363
15.3.2.2.3. Clarification of “avoiding taxation” 364
15.3.2.2.4. Clarification of “essential” 365
15.3.2.2.5. Clarification of “tax benefit” 365
15.3.2.2.6. Conclusion 366
15.3.3. The 2016 EU Proposal for National GAARs 366
15.4. Anti-abuse provisions in German international tax law 367
15.4.1. Linking rules 367
15.4.1.1. No comprehensive linking rule 367
15.4.1.2. Dividend-interest mismatch 369
15.4.1.3. Losses of a subsidiary within the *Organschaft* 369
15.4.1.4. Subject-to-declaration rule for employment income 369
15.4.1.5. Hybrid mismatch on the level of treaty interpretation 370
15.4.1.6. No unlimited personal tax liability of the recipient in the other state 370
15.4.1.7. Mismatch in personal attribution of dividends 370
15.4.1.8. Mismatch in the application of the Interest-Royalty Directive 371
15.4.2. Deduction of interest payments 371
15.4.3. Transfer pricing rules 371
15.4.4. CFC legislation 372
15.4.5. Saving clause and limitation of benefits (LOB) 373
  15.4.5.1. Saving clause 373
  15.4.5.2. Limitation of benefits (LOB) 374
15.4.6. A treaty GAAR – Treaty reference to domestic GAAR 375
15.4.7. Subject-to-tax rules 375
  15.4.7.1. Traditional German treaty practice 375
  15.4.7.2. EU COM Recommendation C(2012) 8806 of 6 December 2012 376
  15.4.7.3. Flexible modifications of the method article 377
  15.4.7.4. Subject-to-tax clauses in the distributive articles 378
15.4.8. Activity provisos and switch-over clauses 379
15.5. Application of GAARs, TP rules and SAAR 380
Annex 381

**Chapter 16: Greece**

*Eleni Theocharopoulou*

16.1. The meaning of avoidance and aggressive tax planning and the BEPS Project 385
  16.1.1. The meaning of tax avoidance in the Greek legal system 385
  16.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning 386
# Table of Contents

16.2. The reaction to avoidance and aggressive tax planning in the BEPS context

16.2.1. Domestic GAARs 387

16.3. Transfer pricing rules, GAARs, SAARs and linking rules 392

16.4. Application of GAARs, TP rules and SAARs 397

## Chapter 17: Italy

*Giuseppe Zizzo*

17.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

17.1.1. The meaning of tax avoidance in national legal systems 399
17.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems 404

17.2. The reaction to avoidance and aggressive tax planning in the BEPS context

17.2.1. Domestic general anti-avoidance rules (GAARs) 405
17.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule 408

17.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

17.3.1. Transfer pricing

17.3.1.1. Transfer pricing and tax avoidance 413
17.3.1.2. Transfer pricing litigation 415

17.3.2. LOB clauses 417

17.3.3. Controlled foreign companies (CFCs) rules 418

17.3.4. Linking rules

17.3.4.1. Hybrid instruments 420
17.3.4.2. Dividends and participation exemption 421
17.3.4.3. Foreign tax credit 421
17.3.4.4. Linking rules connected with the implementation of EU Directives 422

17.3.5. Limits on the deduction of interest 423

17.3.6. Other SAARs

17.3.6.1. SAAR relating to tax losses carry-forward 424
17.3.6.2. SAAR relating to loss carry-forward in mergers and demergers 425
17.3.6.3. SAAR relating to dividend washing transactions 426
17.3.6.4. SAARs included in Italian DTCs 426

17.4. Application of GAARs, TP rules and SAARs 429
17.4.1. Interaction between GAAR, TP rules and SAARs 429
17.4.2. Procedural rules relating to GAAR and SAARs 430
17.4.3. Procedural rules relating to TP rules 432
17.4.3.1. Advance pricing agreements (APAs) 432
17.4.3.2. Mutual agreement procedure 432

Chapter 18: Luxembourg 435

Werner Haslehner

18.1. The meaning of avoidance, abuse and aggressive tax planning 435
18.2. The reaction to avoidance and aggressive tax planning in the BEPS context 440
18.2.1. The domestic general anti-avoidance rule: Sec. 6 of the StAnpG 440
18.2.1.1. Use of forms and institutions of private law 441
18.2.1.2. Circumvention or reduction of tax liability 442
18.2.1.3. An inappropriate arrangement 443
18.2.1.4. Tax benefit as the sole purpose 444
18.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules 448
18.3.1. Tax treaties and anti-avoidance rules 448
18.3.2. Transfer pricing rules 449
18.3.3. Limitation on benefits (LOB) clauses and rules excluding tax treaty benefits 451
18.3.4. CFC rules 452
18.3.5. Linking rules 453
18.3.6. Interest deduction limitation rules 453
18.4. Interaction of GAAR, TP rules and SAARs 453
Chapter 19: Netherlands

Maarten de Wilde and Ciska Wisman

19.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

19.1.1. The meaning of tax avoidance in the Dutch tax system

19.1.1.1. The general approach towards tax avoidance in the Netherlands

19.1.1.2. The presence of administrative regulations clarifying the meaning of tax avoidance

19.1.1.3. Tax rulings and horizontal monitoring – Providing legal certainty and transparency

19.1.1.4. Case law on the meaning of tax avoidance

19.1.1.5. Judicial competence exercised by the courts rather than bodies that are not strictly judicial

19.1.1.6. Influences of tax effects in other jurisdictions, OECD soft law and ECJ case law on tax avoidance

19.1.1.7. Impact of the BEPS package on Dutch international policies on tax avoidance

19.1.1.8. Concrete impact of the BEPS package on addressing tax avoidance in legislation and case law

19.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in the Dutch tax system

19.1.2.1. The general approach towards tax planning in the Netherlands

19.1.2.2. The presence of administrative regulations clarifying the meaning of tax planning

19.1.2.3. Tax rulings – Providing legal certainty; trias politica

19.1.2.4. Case law on the meaning of tax avoidance

19.1.2.5. Relationships between tax avoidance, tax planning and aggressive or abusive tax planning concepts
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>19.1.2.6. Absence in the Netherlands of tax arbitration courts or economic-administrative instances</td>
<td>475</td>
</tr>
<tr>
<td>19.1.2.7. Influences of tax effects in other jurisdictions, OECD soft law and ECJ case law on tax planning</td>
<td>476</td>
</tr>
<tr>
<td>19.1.2.8. Impact of the BEPS package on Dutch international policies on aggressive tax planning</td>
<td>476</td>
</tr>
<tr>
<td>19.1.2.9. Concrete impact of the BEPS package on addressing aggressive tax planning in legislation and case law</td>
<td>476</td>
</tr>
<tr>
<td>19.2. The reaction to avoidance and aggressive tax planning in the BEPS context</td>
<td>477</td>
</tr>
<tr>
<td>19.2.1. Domestic general anti-avoidance rules (GAARs)</td>
<td>477</td>
</tr>
<tr>
<td>19.2.1.1. National GAAR; <em>fraus legis</em></td>
<td>477</td>
</tr>
<tr>
<td>19.2.1.1.1. <em>Fraus legis</em> as <em>ultimum remedium</em> interpretative tool</td>
<td>477</td>
</tr>
<tr>
<td>19.2.1.1.2. Regular fact-finding and interpretation methods already go a long way in addressing abuse</td>
<td>478</td>
</tr>
<tr>
<td>19.2.1.1.3. Requirements for <em>fraus legis</em>: Motive requirement and norm requirement</td>
<td>480</td>
</tr>
<tr>
<td>19.2.1.1.4. No <em>fraus tractatus</em> except for treaty cases under the PPT</td>
<td>482</td>
</tr>
<tr>
<td>19.2.1.1.5. <em>Fraus legis</em> counterpart for taxpayers having upright intentions</td>
<td>483</td>
</tr>
<tr>
<td>19.2.1.2. Similarities between <em>fraus legis</em> and the EC GAAR as proposed in the EC Recommendation (2012)</td>
<td>483</td>
</tr>
<tr>
<td>19.2.1.2.1. EC Recommendation GAAR: Objectified intention, subjective test, objective test</td>
<td>483</td>
</tr>
<tr>
<td>19.2.1.2.2. Similarities between <em>fraus legis</em> and the EC Recommendation GAAR</td>
<td>484</td>
</tr>
</tbody>
</table>
19.2.1.2.3. Differences between *fraus legis* and the EC Recommendation GAAR 485

19.2.1.3. Compatibility of *fraus legis* with the EU/EEA concept of abuse 486

19.2.1.3.1. *Fraus legis* and the EU/EEA concept of abuse: Nearly identical concepts 486

19.2.1.3.2. Utilization of disparities allowed if economic activities are genuine 487

19.2.1.3.3. Artificiality as a constituent test in both EU law and *fraus legis* 488

19.2.1.4. The elements of *fraus legis* further assessed from an EU anti-abuse perspective 489

19.2.1.5. *Fraus legis* case law leaves international mismatches untouched – A matter for the legislature 492

19.2.1.5.1. The intent of the law revealed by reference to the internal consistency of the Dutch tax system 492

19.2.1.5.2. Supreme Court case law on hybrid mismatches 493

19.2.1.5.3. Supreme Court case law on TP mismatches 494

19.2.1.6. Countering profit drainage via *fraus legis* – Supreme Court anti-profit drainage case law 497

19.2.1.7. *Fraus legis* has not been replaced and will not be replaced by the EC Recommendation GAAR 498

19.2.1.8. The Netherlands implemented the GAAR in the PSD as per 1 January 2016 499

19.2.2. EC Recommendation on introduction of subject-to-tax rule 500

19.2.2.1. EC Recommendation: Proposal for subject-to-tax requirement in national rules and tax treaties 500
19.2.2.2. No subject-to-tax gateway requirements in the Netherlands for exempting foreign-source active income; a credit regime applies for passive income 500

19.2.2.3. No plans to introduce a subject-to-tax rule as proposed by the EC Recommendation 501

19.3. TP rules, GAARs, SAARs and linking rules 502

19.3.1. National TP rules 502

19.3.1.1. Taxable-profit calculation and the ALS as an integral part thereof 502

19.3.1.2. ALS included in the definition of “profits” 504

19.3.1.3. Codification of ALS and TP documentation requirements 505

19.3.1.4. No specific TP GAAR 506

19.3.2. TP disputes 507

19.3.3. Case law on TP 507

19.3.4. Tackling avoidance through anti-abuse clauses in Dutch tax treaties 509

19.3.4.1. Policy on inclusion of anti-abuse clauses in tax treaties 509

19.3.4.2. LOB provisions 510

19.3.4.3. PPTs 511

19.3.5. Provisions in the CITA resembling CFC rules 512

19.3.5.1. No general CFC regime in the Dutch tax system 512

19.3.5.2. Double tax relief and addressing undue tax deferral 513

19.3.6. Linking rules relating to hybrid financial instruments – PSD 515

19.3.7. Limitations on the deduction of interest 516

19.3.7.1. Objective interest deduction limitation provisions for the preservation of corporate tax base 516

19.3.7.2. Anti-profit drainage – Article 10a of the CITA 517

19.3.7.3. Interest deduction limitation to counter international TP mismatches – Article 10b of the CITA 520
19.3.7.4. Tax base protection by limiting deduction of interest related to participations – Article 13l of the CITA 520

19.3.7.5. Tax base protection by limiting deduction of interest on “acquisition debts” – Article 15ad of the CITA 522

19.3.8. Other SAARs in the Dutch tax system 523

19.3.8.1. Various additional SAARs in the Dutch tax system 523

19.3.8.2. The substantial holding regime – Article 17(3)(b) of the CITA; PSD 524

19.3.8.3. Loss offset limitation regimes – Articles 20a and 20(4) of the CITA 525

19.3.8.4. Anti-deferral rules relating to business restructurings – Articles 13h-13k and 14-14b of the CITA 526

19.3.8.5. SAAR neutralizing “Sarakreek mismatches” – Article 15ac(4)-(6) of the CITA 527

19.3.8.6. Dividend tax anti-avoidance rules for Dutch cooperatives – Article 1(7) of the DWTA; PSD 528

19.3.8.7. National beneficial ownership test, dividend stripping – Article 4(7) of the DWTA 528

19.4. Application of GAARs, TP rules and SAARs 529

19.4.1. The interaction of fraus legis, TP rules, SAARs and linking rules 529

19.4.2. Interrelationships of applicable rules in terms of hierarchy, coordination or overlapping of measures 530

19.4.3. Procedural rules underlying application of the national GAAR, TP rules and SAARs 533

Chapter 20: Norway

Benn Folkvord 537

20.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 537

20.1.1. The meaning of tax avoidance in national legal systems 537
20.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems 540

20.2. The reaction to avoidance and aggressive tax planning in the BEPS context 542
20.2.1. Domestic GAARs 542
20.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule 544

20.3. TP rules, GAARs, SAARs and linking rules 545
20.4. Application of GAARs, TP rules and SAARs 547

Chapter 21: Poland

Agnieszka Olesińska and Joanna Witkowska

21.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 549
21.1.1. The meaning of tax avoidance in national legal systems 549
21.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems 550

21.2. The reaction to avoidance and aggressive tax planning in the BEPS context 551
21.2.1. Domestic GAARs 551
21.2.2. EC Recommendation C(2012) 8806 of 6 December 2012 and subject-to-tax rule 556
21.2.2.1. Has your Member State introduced a subject-to-tax rule as proposed by the EC in its DTCs? 556
21.2.2.2. If the answer to 21.2.2.1. is no, is your Member State planning to introduce a subject-to-tax rule as proposed by the EC? 560
21.2.2.3. Does your domestic GAAR correspond to the proposed GAAR? 561
21.2.2.4. Will your SAARs have to be redrafted/amended according to the rules in the ATAD proposal? 561

21.3. TP rules, GAARs, SAARs and linking rules 562
21.3.1. Are your national TP rules often used to prevent or combat avoidance? 562
21.3.2. Do your TP rules often raise litigation? 564
21.3.3. If the answer to the above is yes, is there case law on the application of your TP rules?  564
21.3.4. Do your DTCs include LOB rules?  568
21.3.5. Does your tax legislation include CFC rules?  570
21.3.6. Did your country introduce linking rules as recommended in OECD/BEPS Action 2?  575
21.3.7. Does your tax legislation include limits on the deduction of interest?  575
21.3.8. Do you have any other SAARs?  577

21.4. Application of GAARs, TP rules and SAARs  580
21.4.1. How do GAARs, TP rules, SAARs and linking rules interact in your national legal system?  580
21.4.2. Is there a hierarchy, coordination or overlapping of measures?  581
21.4.3. Are there procedural rules underlying application of your national GAAR, TP rules and/or SAARs?  582

Chapter 22:  Portugal  583

Gustavo Lopes Courinha

22.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative  583
22.1.1. Tax avoidance  583
   22.1.1.1. In the Portuguese tax system  583
   22.1.1.2. In the Portuguese judicial and arbitral jurisprudence  584
   22.1.1.3. BEPS influence  585
22.1.2. Aggressive tax planning  586
   22.1.2.1. In the Portuguese tax system  586
   22.1.2.2. In the Portuguese judicial and arbitral jurisprudence  589
   22.1.2.3. BEPS influence  590
22.2. The reaction to avoidance and aggressive tax planning  590
22.2.1. GAAR  590
22.2.2. EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule  594
22.3. Transfer pricing, GAARs, SAARS and linking rules  595
   22.3.1. Transfer pricing rules  595
   22.3.2. LOB rules  596
   22.3.3. Linking rules  597
22.4. Application of GAARs, TP rules and SAARs  597
### Table of Contents

#### Chapter 23: Russia

*Evgeniy Pustovalov, Eugeniy Zakharov and Andrey Savitsky*

23.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 599
23.2. The reaction to avoidance and aggressive tax planning in the BEPS context 602
23.3. TP rules, GAARs, SAARs and linking rules 605
23.4. Application of GAARs, TP rules and SAARs 615

#### Chapter 24: South Africa

*Craig West and Jennifer Roeleveld*

24.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative 617
   24.1.1. The meaning of tax avoidance in South Africa 617
   24.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in South Africa 619
24.2. The reaction to avoidance and aggressive tax planning in the BEPS context from a non-EU Member State 621
   24.2.1. South Africa’s GAAR 621
   24.2.2. South Africa’s GAAR compared to the EC Recommendation 623
   24.2.3. South Africa’s GAAR compared to the Anti-Tax Avoidance Draft Directive 625
   24.2.4. South Africa’s SAARs and the EU Anti-Tax Avoidance Draft Directive 626
24.3. TP rules, GAARs, SAARs and linking rules 627
   24.3.1. Transfer pricing 627
   24.3.2. Controlled foreign companies 628
   24.3.3. Domestic SAARs 629
   24.3.4. Linking rules and domestic legislation with reference to BEPS 631
   24.3.5. Preventing treaty abuse through the use of LOB provisions 633
24.4. Application of GAARs, TP rules and SAARs 634
Chapter 25: Spain

Jorge Martín López and Elizabeth Gil García

25.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative
   25.1.1. The meaning of tax avoidance in national legal systems
   25.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

25.2. The reaction to avoidance and aggressive tax planning in the BEPS context
   25.2.1. Domestic GAARs
   25.2.2. EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule

25.3. Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules

25.4. Application of GAARs, TP rules and SAARs

Chapter 26: Sweden

Anders Hultqvist

26.1. Tax avoidance revisited: Exploring the boundaries of anti-avoidance rules in the EU BEPS context

26.2. The meaning of tax avoidance in the Swedish legal system and the BEPS initiative

26.3. The meaning of tax planning, abusive tax planning and aggressive tax planning in the Swedish legal system

26.4. The Swedish GAAR


   26.7.1. The ATAD’s GAAR and the Swedish GAAR
   26.7.2. Redrafting/amendment of SAARs according to the rules in the ATAD Proposal

26.8. Transfer pricing rules, GAARs, SAARs and linking rules
   26.8.1. Transfer pricing
   26.8.2. LOB rules
   26.8.3. CFC legislation
### Table of Contents

26.8.4. Limited interest deduction 692  
26.9. Application of GAARs, TP rules and SAARs 692  

**Chapter 27: Turkey**  
_Funda Başaran Yavaşlar, Mustafa Sevgin and Namık Kemal Uyanik_  

27.1. Concept of tax avoidance and aggressive tax planning and the BEPS initiative 695  
27.1.1. Concept of tax avoidance 695  
27.1.1.1. Meaning of tax avoidance in the Turkish literature 695  
27.1.1.2. Tax rulings and their impacts on tax avoidance 698  
27.1.1.3. Non-judicial institutions/methods for tax disputes and tax avoidance 699  
27.1.1.4. Repercussions of BEPS on the concept of tax avoidance 702  
27.1.2. Concept of tax planning, abusive tax planning, aggressive tax planning and tax evasion in Turkish legal systems and the BEPS initiative 704  
27.1.2.1. Concept of tax planning, abusive tax planning, aggressive tax planning and tax evasion 704  
27.1.2.2. Concept of bypassing tax 708  
27.1.2.3. Tax rulings and non-judicial institutions/methods for tax disputes 716  
27.1.2.4. Influences on the meaning of tax planning, abusive tax planning or aggressive tax planning by their meaning in other jurisdictions or OECD soft law 717  
27.1.2.5. Repercussions of BEPS 718  
27.2. The reaction to avoidance and aggressive tax planning in the BEPS context – Domestic GAARs 718  
27.3. TP rules, GAARs, SAARs and linking rules 727  
27.3.1. National transfer pricing rules as a tool against tax avoidance 727  
27.3.2. Application of TP rules by the judiciary 730  
27.3.3. LOB rules in Turkey’s DTCs 733  
27.3.4. CFC rules 734
| 27.3.5. Limits on the deduction of interest | 735 |
| 27.3.6. Other SAARs | 736 |
| 27.4. Application of GAARs, TP rules and SAARs | 736 |

### Chapter 28: United Kingdom

*Sandra Eden*

| 28.1. The meaning of tax avoidance and tax planning in the United Kingdom | 737 |
| 28.1.1. Introduction | 737 |
| 28.1.2. The approach of the courts to tax avoidance | 737 |
| 28.1.3. Legislative definition | 741 |
| 28.1.4. Tax rulings | 742 |
| 28.1.5. External influences | 743 |
| 28.2. EU Recommendation C(2012) 8806 | 746 |
| 28.2.1. The UK GAAR | 746 |
| 28.2.2. “Subject to tax” in UK double taxation treaties | 751 |
| 28.3. Transfer pricing rules, GAARs, TAARs and linking rules | 752 |
| 28.3.1. Introduction | 752 |
| 28.3.2. Transfer pricing | 753 |
| 28.3.2.1. Introduction | 753 |
| 28.3.2.2. Transfer pricing case law | 755 |
| 28.3.2.3. Advance pricing agreements (APAs) | 756 |
| 28.3.3. Limitation of benefit rules and other anti-shopping devices | 756 |
| 28.3.4. UK CFC rules | 758 |
| 28.3.4.1. Introduction | 758 |
| 28.3.4.2. Entities affected | 758 |
| 28.3.4.3. Gateways | 759 |
| 28.3.5. Special provisions relating to the deduction of interest | 761 |
| 28.3.5.1. Thin capitalization | 761 |
| 28.3.5.2. The worldwide debt cap | 762 |
| 28.3.5.3. Interest treated as distribution | 763 |
| 28.3.6. Other TAARs | 763 |
| 28.3.6.1. Diverted profits tax | 763 |
| 28.3.6.2. Taxation of immoveable property in the United Kingdom | 765 |
| 28.3.6.3. Anti-hybrid rules | 765 |
| 28.3.6.4. Royalty withholding tax | 766 |
| 28.3.6.5. Attribution of gains of non-resident companies to UK residents | 767 |
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>28.3.6.6</td>
<td>Transfer of assets abroad (TAA)</td>
<td>768</td>
</tr>
<tr>
<td>28.3.6.7</td>
<td>Offshore employment intermediaries</td>
<td>769</td>
</tr>
<tr>
<td>28.3.6.8</td>
<td>Exit charges on accrued capital gains</td>
<td>769</td>
</tr>
<tr>
<td>28.3.6.9</td>
<td>Other anti-avoidance provisions</td>
<td>769</td>
</tr>
<tr>
<td>28.4.</td>
<td>Relationship between GAARs, TAARs and transfer pricing rules</td>
<td>772</td>
</tr>
<tr>
<td>Appendix</td>
<td>The UK’s response to the BEPS Actions</td>
<td>773</td>
</tr>
</tbody>
</table>

## Chapter 29: United States

*Yariv Brauner*

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>29.1.</td>
<td>The meaning of avoidance and aggressive tax planning and the BEPS initiative</td>
<td>779</td>
</tr>
<tr>
<td></td>
<td>The meaning of tax avoidance in national legal systems</td>
<td>779</td>
</tr>
<tr>
<td>29.1.2.</td>
<td>The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems</td>
<td>782</td>
</tr>
<tr>
<td>29.2.</td>
<td>The reaction to avoidance and aggressive tax planning in the BEPS context</td>
<td>784</td>
</tr>
<tr>
<td>29.2.1.</td>
<td>Domestic general anti-avoidance rules (GAARs)</td>
<td>784</td>
</tr>
<tr>
<td>29.2.2.</td>
<td>EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule</td>
<td>790</td>
</tr>
<tr>
<td>29.3.</td>
<td>Transfer pricing rules, GAARs, specific anti-avoidance rules (SAARs) and linking rules</td>
<td>790</td>
</tr>
<tr>
<td>29.3.1.</td>
<td>Transfer pricing</td>
<td>790</td>
</tr>
<tr>
<td>29.3.2.</td>
<td>Limitation on benefits (LOB)</td>
<td>792</td>
</tr>
<tr>
<td>29.3.3.</td>
<td>CFC rules</td>
<td>794</td>
</tr>
<tr>
<td></td>
<td>Subpart F</td>
<td>794</td>
</tr>
<tr>
<td></td>
<td>PFIC</td>
<td>797</td>
</tr>
<tr>
<td></td>
<td>PFIC and CFC</td>
<td>798</td>
</tr>
<tr>
<td>29.3.4.</td>
<td>BEPS Action 2 linking rules</td>
<td>798</td>
</tr>
<tr>
<td>29.3.5.</td>
<td>Earning stripping (section 163(j))</td>
<td>798</td>
</tr>
<tr>
<td>29.3.6.</td>
<td>Other SAARs</td>
<td>798</td>
</tr>
<tr>
<td></td>
<td>Anti-conduit regulations</td>
<td>799</td>
</tr>
<tr>
<td></td>
<td>Section 894(c)</td>
<td>799</td>
</tr>
<tr>
<td></td>
<td>US investment by foreign subsidiaries</td>
<td>799</td>
</tr>
<tr>
<td>29.3.6.4</td>
<td>Section 267</td>
<td>800</td>
</tr>
<tr>
<td>29.3.6.5</td>
<td>Section 7874 and regulations</td>
<td>800</td>
</tr>
<tr>
<td>29.3.6.6</td>
<td>Transfers of intangibles – Section 367(d)</td>
<td>800</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>29.4.</td>
<td>Application of GAARs, TP rules and SAARs</td>
<td>800</td>
</tr>
</tbody>
</table>
Table of Contents

List of Abbreviations  803
List of Tables  807
Sample Content
Chapter 3
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) intangibles¹ 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. 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, 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 4825 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. 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, 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. 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”.

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

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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.\(^\text{11}\) 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.\(^\text{12}\) In other countries, the GAAR is viewed differently

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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. 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. 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

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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.

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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