

# **Preventing Base Erosion and Profit Shifting in Finland**

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<p>In the recent years, the focus on multinationals' tax avoidance schemes or Base Erosion &amp; Profit Shifting (BEPS) has been increasing constantly. The OECD and the European Commission are working on new tax rulings to counter those harmful practices.</p> <p>The report aims to analyse and assess the anti-BEPS package: what does it contain, how can it be effective on the European level and how is Finland implementing the new recommendations? The analysis was a desktop study: peer-reviewed articles, legislation documents, relevant literature and email interview were used for this research.</p> <p>This study presents the subtle difference between tax avoidance and tax evasion. It also shows what kind of tax structures companies are using to minimise their tax, with examples of two companies. It details the OECD's anti-BEPS package with a focus on two out of fifteen action plans.</p> <p>This assessment demonstrates that the anti-BEPS package is not perfect nor the real needed overhaul of the outdated tax system. However, it is a necessary first step in the right direction to counter harmful practices. Finland has started implementing the OECD's recommendations and the European Union's Anti-Tax Avoidance Directive (ATAD). This implementation faces diverse challenges. It has created confusion and uncertainty amongst Finnish companies and the tax administration. The difficulties come from the interpretation of those action plans, the lack of cooperation between countries and the different timelines in implementing them throughout the world.</p> <p>The benefits linked to the new rulings will take some time to appear. The work on the matter will continue for the Finnish Tax Administration. It must be done hand in hand with the other tax administrations. Those actions will be more effective if all the countries were to collaborate. In a couple of years, new assessments must be made to evaluate the situation and work on the new solutions.</p>	
<b>Keywords</b> Corporate taxation, tax avoidance, BEPS, double non-taxation, tax evasion, aggressive tax planning.	

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# 1 Introduction

3<sup>rd</sup> of April 2016, the International Consortium of Investigative Journalists (ICIJ) brought to light new pieces of evidence on multinationals' tax avoidance schemes also called Base Erosion and Profit Shifting (BEPS) by the Organisation for Economic Co-operation and Development (OECD). They are currently the center of a political turmoil worldwide. Governments and people from all over the world are asking for more transparency on these unethical practices. But international groups are not the only ones to benefit from those schemes. Individuals, celebrities, athletes etc. have their names emerged from the list of beneficiaries (ICIJ 2016). Several heads of government are listed in the "Panama Papers", for example the Icelandic Prime Minister Sigmundur Davíð Gunnlaugsson (Harding 2016). He has since left his position in the Icelandic government.

Since 2013, the OECD has been working on 15 action plans to counter BEPS (OECD 2016b).

## 1.1 Background

In November 2014, the ICIJ has revealed special deals made by the Luxembourg's Tax Authorities with multinationals for them to pay less taxes (ICIJ 2014). These revelations are called the Luxembourg Leaks or LuxLeaks. However, since the beginning of April 2016, the famously called "Panama Papers" are highlighting how corporations are using shell companies, loopholes in taxation laws and, tax havens to lower or nullify the impact of corporate taxes in their profits. For example, Facebook only paid £4 237 in corporate taxes in the United Kingdom on £105m of revenue (Stewart 2015).

These schemes are not new to the public knowledge. Their complexity and their scale are what the spotlight is focusing on. Without the files taken from Mossack Fonseca, it would have been impossible to track the real beneficiaries. Even inside the European Union, some member states could be considered as tax havens (Martin 2013.) Following the Facebook example, the company is using Ireland for its low corporate taxes (12,5%) to transit money to their tax haven in the Cayman Islands (Gibbs 2016.)

The OECD has now released their anti-BEPS package. Several countries in the European Union are starting to change their taxation laws. This package aims to stop those unethical practices and recover an estimated of €50-70bn per year in lost taxes (European Commission 2016b). This thesis will bring more insights on the effects of the counter-measures on both multinationals and the European Union. Both side of the spectrum will benefit of this assessment. Multinationals will then determine how they will change the

way they operate. State members will then assess how they will prevent and claim back lost taxes.

## 1.2 Research Question

The aim of the following research is to study Base Erosion and Profit Shifting, and analyse how multinationals are applying it. The document is concentrating on the effects of the OECD's countermeasure package on governments' taxation laws and on international groups' tax practices. In the following sub-chapters, the research question and investigative questions, primary data collection and secondary data will display the research structure.

The research question can be worded as how OECD's action plans will help Finland in preventing BEPS?

IQ1- What is aggressive tax planning?

IQ2- How multinationals are applying aggressive tax planning?

IQ3- What is the BEPS countermeasures package?

IQ4- How can those action plans be effective on the European Union level?

IQ5- And in Finland?

Table 1 below presents the theoretical framework, research methods and results chapters for each investigative question.

Table 1. Overlay matrix

Investigative Questions	Theoretical Framework	Research Methods	Results (Chapters)
IQ 1. What is aggressive tax planning?	(1) Scrutiny of appropriate literacy (Stiglitz, J. 1986. The General Theory of Tax Avoidance and Sandmo, A. 2005. The Theory of Tax Evasion: A Retrospective View)  (2) Analysis of articles and medias from reliable news sources (The Economist, the Guardian, BBC News and oth-	Desktop study	Chapter 2

	ers)		
IQ 2. How multinationals are applying aggressive tax planning?	(1) Analysis of articles and medias from reliable news sources (The Economist, the Guardian, BBC News and others)	Desktop study	Chapter 2
IQ 3. What is the BEPS counter-measures package?	(1) Analysis of articles and medias from reliable news sources (OECD, The Economist, the Guardian, BBC News and others)	Desktop study	Chapter 2
IQ 4. How can those action plans be effective on the European Union level?	(1) Interview with a tax specialist from the Finnish Tax Authorities  (2) Analysis of articles and medias from reliable news sources (The Economist, the Guardian, BBC News and others)	Qualitative analysis of open questions	Chapters 3, 4
IQ 5. And in Finland?	(1) Interview with a tax specialist from the Finnish Tax Authorities  (2) Analysis of articles and medias from reliable news sources (The Economist, the Guardian, BBC News and others)	Qualitative analysis of open questions	Chapter 5

### 1.3 Demarcation

The Anti-BEPS package is composed of 15 measures to tackle tax avoidance. Each of these action plans is targeting a specific loophole or grey zone in taxation laws. The author should limit the number of action plans that he can analyse. This thesis will be then focusing on 2 measures: “Neutralising the Effects of Hybrid Mismatch Arrangements” and “Limiting Base Erosion Involving Interest Deductions and Other Financial Payments”

(OECD 2015a). These two measures are particularly interesting because of their international dimension. They are the response for more unified corporate taxation laws throughout the world.

Tax avoidance and tax evasion are phenomena occurring worldwide. It would be very interesting to investigate the impacts on emerging economies. But this research will only be focusing on the European Union level and especially on Finland. It would be very difficult for the author to take on a wider spectrum with also less possibility to find reliable sources.

#### **1.4 International Aspect**

This topic is only concentrated on multinationals and international tax treaties. It gives the research an international aspect.

#### **1.5 Anticipated benefits**

The result of this research is an objective and accurate assessment of the always changing situation in corporate taxes that companies or governmental agencies will find useful.

#### **1.6 Key Concepts**

**Aggressive Tax Planning** (ATP) is taking advantage of loopholes in a tax system or disparities between two or more tax systems to lower taxes impact on profit. (Bundgaard & al 2015, 23.)

**Base Erosion and Profit Shifting** or BEPS designates tax planning structures that take advantage of loopholes and disparities in tax legislations and the artificial shifting of profits to a low or no-tax jurisdiction. (OECD 2016a.)

**Luxembourg Leaks** also known as LuxLeaks are secret favorable tax deals given by the Luxembourg's Tax Authorities to more than 350 companies from around the world, resulting in billions of euros in tax relief. (ICIJ 2014.)

**Tax avoidance** refers to using any possible legal techniques with the aim of providing the highest returns possible to their stakeholders. (Raiborn, Massoud & Payne 2015, 77.)



**Tax evasion** can be simply defined as the taxpayer's method to hide his assets from the Tax Authorities resulting on paying less taxes. (Sandmo 2005, 646.)

**Transfer pricing** is a set price of transactions between legal entities within a same group. Transactions can be goods, services, income payment or capital transfer. (OECD 2001.)

**OECD Action plans** are composed of 15 countermeasures to block tax avoidance schemes. (OECD 2015.)

## **1.7 Risks and risk management**

Due to the sensibility of the topic, the challenge is to be able to interview a person from one of the Big Four. The Big Four are the four most popular consulting companies (PriceWaterhouseCoopers, Accenture, KPMG and Ernst & Young). Secrecy and opacity were the cornerstones of these schemes. These consulting companies are not very keen on revealing these secrets. To counter that, the author must build a questionnaire that will be general enough to still get some information. This questionnaire will mostly consist of open questions where the interviewee could speak freely. If the author is not able to conduct any interviews, then the adequate literacy will be used.

Base Erosion and Profit Shifting is quite a new subject in the world of finance. The number of books on this subject is quite limited and none available at Haaga-Helia's library. Fortunately, many peer-reviewed articles and working papers are available in the UAS' database.

Another risk for this paper is objectivity. The author cannot take side and judge what is good or bad practices. The main goal of the research is to make an objective and accurate assessment on the effects of new taxation laws.

## **1.8 Case company**

As today, this thesis is not commissioned by any case company.

## 2 Aggressive tax planning as a tool to minimise taxable profit

### 2.1 Introduction

The first step is to examine what the “aggressive tax planning” term means. The OECD is using this term to refer to consulting companies and multinationals’ tax schemes. Is ATP related to tax avoidance? Are there any differences? Answers to these questions are linked to IQ1.

The next step is to define tax evasion. Tax avoidance and tax evasion must be compared to differentiate what is the common practice in multinationals. Tax avoidance has a legal framework and tax evasion is a criminal act. Then showing some examples of these schemes will help the reader to understand how multinationals are saving on taxes. This will lead to answer IQ2.

In the final step, the anti-BEPS package will be examined. The author will first write an overview of the 15 action plans and then focusing on the chosen two in more details. This paragraph is connected to IQ3 and will serve as transition for the empirical part of this research.

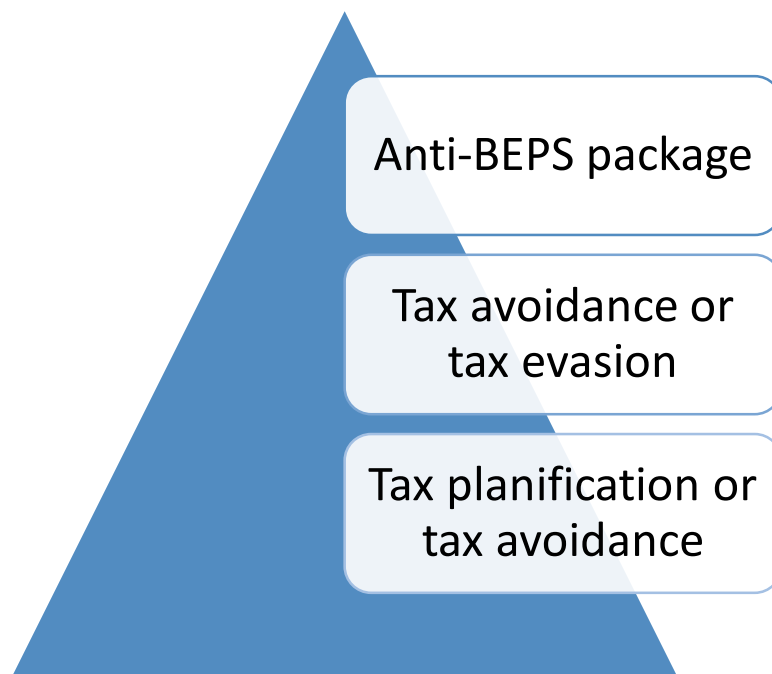


Figure 1. Theoretical framework

From SMEs to multinationals, a wide range of companies are using loopholes in taxation laws to optimize their profits. Each country applies different tax rules making it easier to find grey areas. Inside the European Union, each Member States have different tax legislations. Even inside the same country, there is some special rulings, such as the Åland Islands in Finland. Companies, with the help of consulting firms, are creating very complex schemes to take advantage of these gaps. Throughout the years, corporations are relying more and more on these tax structures. They rapidly became a fundamental part of any business plan (The Economist 2015.) They are often referred as tax planning or as tax optimization in business organizations.

Looking at tax planning from a legal point of view, are these practices considered as tax avoidance or as tax evasion?

## **2.2 Tax evasion or tax avoidance?**

There is a thin and blurry line between tax evasion and tax avoidance. It is very important for the reader to dissociate these two terms to fully understand how corporations operate.

### **2.2.1 Tax evasion**

The term of tax evasion can be defined as an individual or a business organization is actively hiding his assets to the Tax Authorities resulting in paying less taxes (Sandmo 2005, 646.)

To illustrate, we can take the case of the famous football player Lionel Messi. The star player's father built a complex network of shell companies in favorable tax offshore locations, here Belize and Uruguay, to hide his son's taxable assets from the Spanish government (Phillips Erb 2016.) In this case, we can clearly see that the sole purpose of creating these shell companies was to intentionally shield their taxable incomes therefore they have been found guilty of tax evasion and sentenced to 21 months in prison.

### **2.2.2 Tax avoidance**

Tax avoidance on the other hand is to use ambiguous or contradicting tax rules to one's benefit (Haigh 2010, 31.) Tax avoidance is still in a legal framework where tax evasion is a criminal act.

Taking the example of the American coffee company Starbucks in Europe. The corporation has a subsidiary in the Netherlands (Starbucks Manufacturing EMEA BV). This affiliate organizes the sale and the distribution of the brand's coffee and coffee related items (mugs, cookies, etc.) to all its retails throughout Europe.

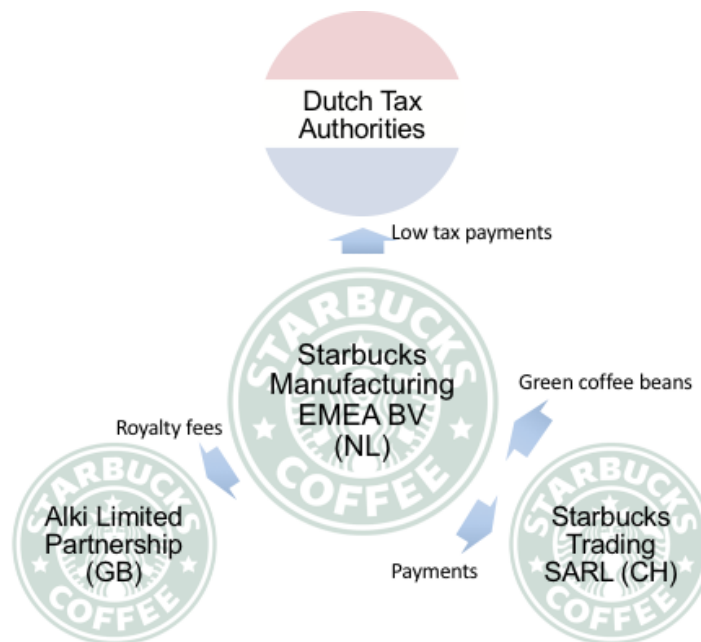


Figure 2. Starbucks Tax Planning Strategy (European Commission 2015a.)

As seen on figure 2, Starbucks Manufacturing is buying raw materials: green coffee beans (unroasted), from the sister company based in Switzerland (Starbucks Trading SARL) at a very high price. The subsidiary is also required to pay royalties for using the knowledge and expertise of roasting coffee beans to another sister company based in the United Kingdom (Alki Limited Partnership). Leading to a profit shifting from the Starbucks Manufacturing to Alki. All the revenue generated by the sales of trademarked coffee specialties, muffins, etc. is taken by the royalty fee payment (European Commission 2015a).

The sister company doesn't have to pay any corporate taxes in U.K. nor in the Netherlands, following the European Directive 2003/49/EC. Cross-border interest or royalty payments are not subject to taxation if they are within a group and made between entities located in the European Union (European Commission 2017b). Starbucks Manufacturing also beneficiates from a special arrangement with the Dutch Tax Authorities to pay a very low amount of taxes in the Netherlands. Additionally, Starbucks Trading SARL is only paying 12% of taxes on its operations based in Switzerland (Knight, 2012.) Loopholes, in this example, are working in favor of the company's interest.

Comparing the definition of tax avoidance and the practice of aggressive tax planning (ATP), there are lots of similarities between them. In the writer's mind, these terms are synonyms. Corporations are then using tax avoidance strategies to lower the impact of taxation on their incomes. Thus, this study will not be taking tax evasion into account.

## **2.3 Aggressive tax planning structures**

With the wide media coverage on the LuxLeaks and on the Panama Papers, the public has now access in large amount of information about these legal or illegal schemes. Some of these are complex and opaque, because they are spread globally and their trails are difficult to follow. The real beneficiary is always well hidden in a labyrinth of shell companies.

The European Commission made a study on these aggressive tax planning strategies and it was published in December 2015. The Commission has identified, classified and illustrated them. They have determined 7 most common structures that multinationals are using throughout the European Union and pointed out what was flawed on the actual tax system of the different Member State. 4 of these strategies are dealing with financing inside a MNE group (loans, interests, etc.) and the other 3 are dealing with intellectual property rights also within the same corporation (licenses, sub-licenses, royalties, etc.).

### **2.3.1 Case study: Caruna Oy**

In this structure defined as Interest-free-loan ATP structure by the European Commission, a MNE group lend money to a subsidiary using transfer pricing to reduce the impact of taxation on the subsidiary's own profit.

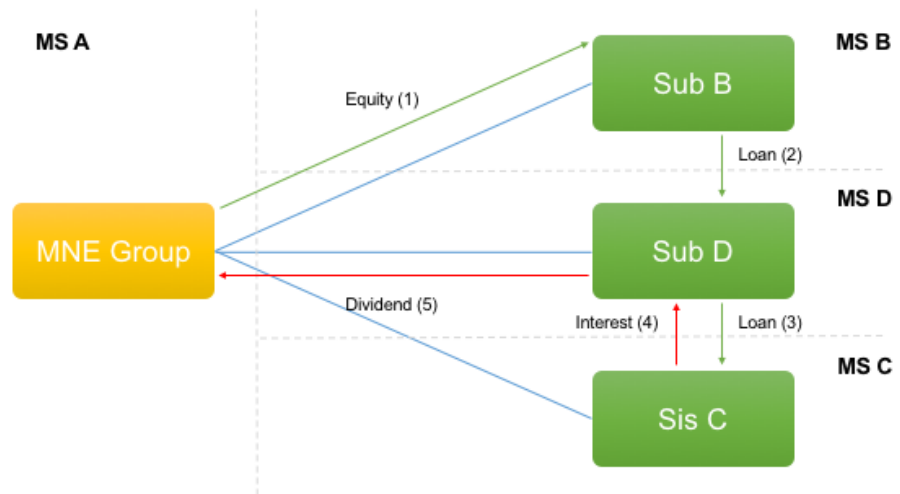


Figure 3. Interest-free-loan ATP structure

In figure 3, the MNE has 2 different daughter companies (Sub B and Sub D). Both are fully owned by the parent company. The group is established in Member State A while its subsidiaries are based in 2 other Member States (MS B and MS D).

Sub D borrows money from Sub B and the loan doesn't carry any interest. But Sub D can still claim tax deduction in MS D on the interest it should have paid if there was any.

Then Sub D on-lends the money previously received to a sister company of the group (Sis C) in another Member State (MS C). This time the loan bears interest and is on arm's-length basis.

Sis C pays interest to Sub D and applies for tax deduction in MS C. This interest is now part of Sub D taxable income in MS D but the tax deduction previously claimed will offset partly or completely the income.

Finally Sub D uses the interest received to pay dividend to the group.

To illustrate this type of tax strategy, a real-life case example would be the Finnish company Caruna Oy. In 2014, the energy company has shifted 50,5 million euros in profit to holding companies.

Caruna Oy is owned at 40% by First State Investments based in Australia, another 40% by Borealis Infrastructure from Canada and finally the last 20% by two Finnish employment pensions companies (Keva at 12,5% and Elo at 7,5%).

The parent company was created on 15 November 2013 by all the partners previously listed, it is called Suomi Power Networks Topco B.V. based in the Netherlands. The company acts as a holding and financing entity. In 2014, Fortum sold a part of its distribution branch that covers about 20% of the market share of the local electricity transmission to Suomi Power Networks Oy (subsidiary to Suomi Power Networks Topco B.V.). Caruna Oy was then founded.

In the same year, the parent company has given two loans to its subsidiary. The total amount of these loans are around 1 billion euros. The first one, given in March 2013 for 150 000 euros, has an interest rate of 5,33% plus 0,117% of Euribor-rate. For the second one, given in December 2013 for 972 million euros, the interest rate was 8,5% (Yle News 2016.) According to the Bank of Finland, loans interest rates were, in March 2013, at 2,09% for non-financial corporations and at 2,36% in December 2013 (Bank of Finland 2017.) Both loans are bearing huge interest rates, way above the ones available in the commercial market.

In 2014, Caruna has made a profit of 50,5 million euros. After paying financing costs to the parent company, the subsidiary recorded 7,6 million loss. The European Directive 2003/49/EC, like in the Starbucks' case, is in play. All the interests received by the parent company are not taxable. In the end, Caruna only paid 822 000 euros in corporate taxes representing barely 1,6% of their original profit. (Yle News 2016.).

### **2.3.2 Case study: Starbucks**

As previously discussed in the Starbucks' example, the scheme used by the company is a small variation of the one called Patent box ATP structure as defined by the European Commission.

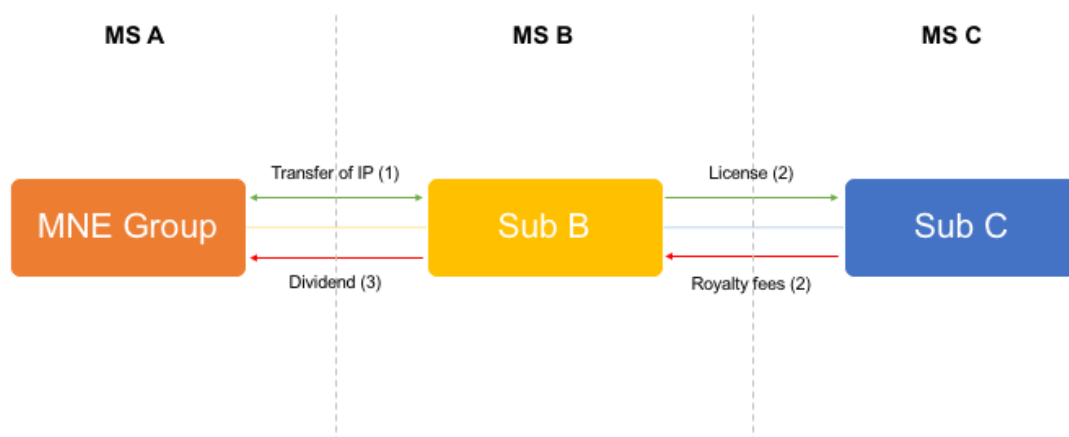


Figure 4. Patent box ATP structure

This strategy consists in one multinational group in Member State A with subsidiaries in different Member States. The corporation is selling its Intellectual Properties' rights to one of its affiliates (Sub B) established in a Member State B. Also, every new Research & Development activity will be done and IP rights will be kept by B. Company B is then providing licenses to the other subsidiaries in different Member States, here in the example Sub C based in Member State C.

Company C, by using trademarked goods and patented know-hows, is paying royalties to B. In MS B, Sub B has then a special tax arrangement with the Tax Authorities and pays very low taxes on royalty income received. The MNE group get dividends from Company B. These dividends are in fact profits generated by Sub B.

## 2.4 Anti-BEPS package

Since 2013, the OECD has worked on fifteen action plans to address these issues and close any possible grey areas in tax legislation. The project has involved more than a hundred countries for example the members of the G20 (20 major economies). These action plans are aiming different fields for example digital economy's challenges, transfer pricing and transparency.

If governments choose to apply these recommendations, tax avoidance schemes based on old tax rules would become obsolete.



For this study, the author will be focusing on two of the fifteen action plans: “Neutralizing the Effects of Hybrid Mismatch Arrangements” and “Limiting Base Erosion Involving Interest Deductions and Other Financial Payments” (OECD 2015).

#### **2.4.1 Neutralizing the Effects of Hybrid Mismatch Arrangements**

The first action plan is focusing in elaborating templates and recommendations for new domestic legislation to counteract the effects of hybrid tools and entities. These effects are for example the double non-taxation or double deduction, etc. Templates and recommendations would help unify national practices resulting in the neutralization of these harmful effects. For example, double non-taxation can be prevented by the dismissal of tax benefits gain in mismatches. They would also help to finish with numerous deductions for a single expense, deductions in one country without the matching taxation in the other country involved in the cross-border operation, and the creation of numerous foreign tax credits for a single amount of foreign tax paid.

The following actions might be needed:

- i. “changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly
- ii. domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payer
- iii. domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules)
- iv. domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction
- v. where necessary, guidance on coordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure.” (OECD 2015, 15-16.)

#### **2.4.2 Limiting Base Erosion Involving Interest Deductions and Other Financial Payments**

The second action plan is dealing with the development of recommendations for better practices. New rules must be created to block base erosion by using interest expenses.

Base erosion means that companies' taxable income (base) is slowly disappearing (erosion). The amount of corporate tax revenue perceived by governments is declining (OECD 2015b.)

Base erosion can be obtained for example by using a related party or a third-party debt to reach excessive interest deductions or other financial payments that are economically equivalent to interest payments, etc.

The OECD will evaluate the effects of different types of limitations. This analysis will aim to find the best suited limitation that will not lead to double taxation.

The organization will also develop a guide for transfer pricing. It will help in setting prices for any financial transactions between legal entities of the same group. Thus, any net interest deductions made by legal entities will be directly associated to the taxable income engendered by its economic activities.

This plan will also lead to a more harmonious tax ruling between countries involved in those cross-border activities.

### **3 Research design and methods**

This chapter will define what research methods were used by the author in data collection for this study. Possible risks encountered and legitimacy problems will be also assessed.

#### **3.1 Introduction**

The data will be obtained by interviews, either face-to-face or via emails with two respondents from both side of the spectrum. The author will create a questionnaire with open questions. The questions will be designed to provide more insights on the current and future situation for them. The researcher will be then able to analyse the answers, compare them to the theoretical framework and peer reviewed articles.

#### **3.2 Data Collection**

This thesis has been constructed mainly around peer-reviewed articles, law acts and assessments from governmental institutions. Desktop research was the best fitted for this study due to the sensitivity of the information. MNEs don't give that kind of information willingly. Investigation journalism was important for this research to unveil the secrecy around this subject.

The author has also used qualitative method. He has created two sets of questions. These sets were composed of 5 open questions. One was submitted to the Finnish Tax Authorities (Konserniverokeskus) and the second one was send to the consulting firm Ernst & Young. These questionnaires were aiming to gain more insights, details on the current and future situation for Finland in implementing the OECD's recommendations from knowledgeable sources.

#### **3.3 Risks faced in data collection**

Data collected from peer-reviewed articles, international institutions and acts of law present no risks.

The major risk encountered in conducting this research is the lack of transparency and the secrecy surrounding the subject. Like stipulated previously, companies do not share any information and only whistleblowers have leaked them to investigative journalists. Those reporters have then continued to scrutinize companies and published information to the

public. There is currently an excessive number of verified sources and it is sometimes difficult to sort out which is the most relevant for this research.

The minor risk is data collected by the questionnaires sent to the two institutions. Answers to those surveys can be biased or not trustworthy. Questions were created to eliminate such variance.

### **3.4 Legitimacy concerns**

This paper has been using qualitative research throughout, reliable sources were find. The research has been conducted with objectivity making this assessment legitimate.

## **4 Discussion on research findings**

This section will highlight what are the problems that led to this situation especially in the European Union perspective. It will bring light on the solutions given by the OECD and it will show how the European Union will adapt and apply them.

### **4.1 Problems**

The writer found two main reasons why MNEs could find all sorts of gaps in tax legislations especially in cross-borders operations. The first reason is outdated tax systems throughout the European Union and the second reason is the lack of cooperation between countries.

#### **4.1.1 Obsolete tax systems**

The actual base of tax legislation comes from the industrial age. The current system is unable to answer the new economies' needs in term of taxation. This situation leaves numerous exploitable gaps.

Since the 80's, the e-commerce is constantly growing. With the fast development in telecommunication (internet, mobile devices, etc.), customers can be reached from all over the world at any time. Corporations don't have to physically establish an outlet near their consumers anymore. Alongside the e-commerce, the new digital economy has started its expansion in the beginning of 2000. Those have helped multinationals to become more globalized.

Products are getting dematerialized at fast pace such as music, movies or games. It is thanks to the relentless increase in internet speed through cable, optical fiber or mobile network. Downloading and streaming are the way people are now consuming these cultural goods.

Streaming is considered as a service and not as a product because the consumer doesn't own anything. By paying a monthly fee, the client is granted access to a huge library of content but nothing is his. This example highlights the rapid shifting from physical items consumption to intangible ones in the recent years.

Gaming on mobile devices (phones or tablets) is a booming economy where platforms like the Apple's App Store takes 30% on all the benefits generated (Carson, 2016). How is any government able to take any taxes on micro-transactions that take place inside these

games/ applications? These new forms of economies are problematic for the old industrial age base of taxation.

Digital economy era is not the only problem for this aging tax system. Many countries have worked together in creating multiple bilateral tax treaties. These treaties were meant to remove double taxation to support viable economic growth. Taxes taken from the same source of earned income twice could hinder international trades. Too high tax level would make international operations not cost-effective enough for MNEs. Groups would simply stop growing internationally.

Ultimately, the proliferation of these bilateral treaties led to a very difficult situation. With so many different tax rulings linked together, it resulted in a double non-taxation or even in less than a single taxation on profits from cross-border activities.

#### **4.1.2 Lack of co-operation between Member States**

As previously stated in chapter 2.1, each Member State has its own tax rulings. Therefore numerous grey areas were formed and they can be exploited to reduce corporate tax bill.

There are two elements that made cooperation between Member States quasi inexistent. First, European countries are independent in their tax legislation. There are no common rulings. Also, sharing information with another Member State is at a country's discretion, meaning there is no obligation on sharing data about their own tax rulings to another European country even though it could be relevant to the other especially in cross-border activities.

Secondly, several nations are making special arrangements with big corporations to give them very low taxes. This is the case for the Netherlands, the Luxembourg and Ireland, they have fostered many aggressive tax planning structures that lead to profit shifting. And with the help of those schemes and the European Directive 2003/49/EC (discussed in chapter 2.2.2), those MNEs are only taxable in those countries.

Without the cooperation of all Member States, loopholes can still be found and abused to minimize corporation's tax bills.

## **4.2 Solutions**

The Organisation for Economic Co-operation and Development laid out fifteen action plans filled with recommendations and frameworks for the elaboration of new tax rulings including better transparency in Member States tax practices and in companies' reporting.

### **4.2.1 New tax rulings**

Already examined in the chapter 4.1.1, current tax systems are out-dated and an update is more than necessary.

Each State Member is in the working phase to adapt and to put in practice those recommendations and frameworks. The OECD has lay them out in the anti-BEPS package. The main objective is to fill up all the loopholes in the different tax legislations within the European Union. Making tax rules more homogeneous between European countries. Also, this harmony will help each country to be more prepared to face abusive practises.

In June 2016, the European Council has approved the Anti-Tax Avoidance Directive (2016/1164/EU). This directive is part of the Anti-Tax Avoidance Package. Inside this ruling, there are five legally binding actions that would tackle abusive practices: Controlled Foreign Company (CFC) rule, Switchover rule, Exit Taxation rule, Interest Limitation rule and General Anti-Abuse Rule (GAAR).

The CFC rule aims to discourage MNEs to shift their profits to low or no tax countries by taxing shifted profits.

The Switchover rule deals with double non-taxation for example dividends paid back to an EU-based company. Those dividends were not taxed nor in the country of origin nor in the European country receiving them. Under this rule, they will be taxed if not properly taxed in the country of origin.

In the Exit Taxation rule, the Commission is trying to tackle issues coming from groups relocating their assets such as intellectual property rights. As discussed in the Starbuck case (2.2.2 and 2.3.2). If a company has transferred their IPR in a low or no tax country. It could shift its profit by paying IP fees to the country where the IPR are located. Those fees are not taxable. The Member State would now be able to tax the value of company's asset before its relocation to a tax haven.

The purpose of the Interest Limitation rule is to prevent the creation of artificial debts by corporations in a low or no tax country and the capacity to shift their profits by paying loan interests to the tax haven. This kind of arrangement was previously analysed in the Caruna Oy case (2.3.1). This rule will limit the amount of deductible interest and then the company will have to pay taxes on the exceeding amount.

With the General Anti-Abuse Rule (GAAR), each European country will be empowered to fight any Aggressive Tax Planning (ATP) if no other rules apply for it. ATP has several forms and not all of them can be covered by those new rulings. If a Member State detects a structure that is not covered, the European country has then the power to counteract (European Commission 2017a).

Member States must implement those new taxation rules by January 2019.

#### **4.2.2 Better transparency**

Going hand in hand with new tax rulings is the necessity for more transparency. It is important for all European countries to be transparent in their tax practices. The call for more transparency is intended for big Corporations as well.

The European commission released in March 2015 a tax transparency package. It consists in numerous measures to improve tax transparency. An example of those measures is that Member States will have to automatically share information on their tax rulings with other Member States. This will improve cooperation between countries. Therefore it will be easier to spot abusive practices from MNEs, and countries can take necessary actions to tackle them. Another measure is to create a Code of Conduct on Business Taxation, it contains different criteria to judge if a tax regime is harmful or not.

Ultimately, this kind of transparency will make more difficult for a tax authority to offer a special tax arrangement to a company that could potentially be harmful to the other tax authorities (European Commission 2015b).

In April 2016, the European Commission has set new tax transparency requirements for companies. The amendment will be added to the European Directive 2013/34/EU. Multinationals will have to reveal in their annual reporting not only the consolidated data but the profit generated and, taxes accrued and paid in each Member State on a country-by-country basis. The data should be accessible for a minimum of five years. This will lead to a better accountability for big corporations because the public will be able to see how mul-



tionals pay their taxes. And the company's image is very important, if they behave poorly in terms of tax avoidance. Their image will be negative to their consumers (European Commission 2016a).

To conclude this chapter, the European Commission is working on complementing and reinforcing the OECD's guidelines. The anti-BEPS package is not legally binding where the EU anti-tax avoidance directive is. Countries are following the anti-BEPS recommendations because they are part of a global agreement to fight harmful practices.

## **5 What about Finland?**

For this section, the author is basing his research on interviews conducted via emails, news articles and an audit firm survey. Two sets of questions were sent. One set was sent to the Finnish Tax Administration (Konserniverokeskus) and the other one to the consulting company Ernst & Young. Unfortunately, after several months of discussion with the contact in the consulting firm, the questions are left unanswered due to the no disclosure agreement with their clients.

### **5.1 Finnish Tax Authority's perspective**

This part deals with the difficulties that face the Finnish tax administration to interpret, implement OECD's guidelines and the European Commission's directive.

#### **5.1.1 Challenges on implementation**

Implementing OECD's recommendations is not an easy task, here the Finnish Tax Administration faces challenges in that matter.

Both the OECD and the European Union are working on parallel projects to counter profit shifting: The Anti-BEPS package for OECD and the Anti-Tax Avoidance Package for the European Commission. By trying to fight the same issues, recommendations or rulings from those institutions could overlap and make implementation more difficult.

Another challenge from implementing the OECD's package is the fact it contains rulings that makes tax position in one jurisdiction dependent on the tax laws in another jurisdiction. This dependence will create more unnecessary paperwork for both the taxpayers and tax administrations (Koikkalainen 24 November 2016.)

The Finnish tax administration is probing into transfer pricing used by Finnish multinationals. In 2014, Finnish tax officials asked the state-own company Fortum to pay back 136 million euros for operations made by its financing subsidiary in Belgium back in 2007 (Yle News 2015b.) But, in July of the same year, the Supreme Administrative Court has ruled against the Finnish tax administration in another case. It was also concerning transfer pricing and especially interests paid on intragroup loans. The tax authority was viewing those interests (non-taxable) as external capital (taxable) which the court didn't agree with. This ruling has then set a precedent for Fortum's case (Yle News 2014a) and the

company has its fine revoked by the tax administration later in the same year (Yle News 2014b.) This example shows the difficulty for the Finnish tax administration to interpret the OECD's guidelines concerning transfer pricing.

### **5.1.2 More actions taken in future?**

The implementation of those counter-measures is in process in the European Union and especially in Finland. To see the benefits of those measures will still take some time. Those results will be also hindered if other jurisdictions don't apply those recommendations or implement them later.

The Aggressive Tax Planning structures that have been analysed by both the OECD and European Commission could change form overtime too. Those schemes could find new gaps even with the new measures in place. The work on anti-tax abuse is a continuous one.

## **5.2 Finnish Companies' perspective**

Finnish companies have not welcomed those efforts in fighting aggressive tax planning from the European Union and the Finnish tax authority. From corporations to small medium enterprises, they have shared concerns on the new tax rules and regulations. They fear an increase in bureaucracy to comply with them and uncertainty in cross-borders operations.

Big companies, like Fortum, are especially uneasy about country-by-country reporting and the tax transparency linked to this kind of reporting would draw pointless media attention. And misinterpretations of the numbers showed in news articles would inevitably come. The tax chief, from the Confederation of Finnish Industries (EK), added that the country-by-country reporting would give more positive results if done on a voluntary basis and should not be regulate by the government (Yle News 2015a.)

The middle-market's main concerns are the increase risks of the returning double taxation and international tax appeals (RSM 2016a). The double taxation refers to a company whom must pay taxes in the country of operations and in the country of residence for the same declared income. It comes from the chaos in implementing those new regulations. Countries are not implementing them at the same pace. With tax administrations asking for tax back, the number of tax appeals is increasing. Companies disagreeing with the tax

decision must go through the appeal process which could be long and costly. Leading to a bigger administrative burden for both the tax authorities and the tax payer.

The situation in Finland, as many other European countries whom are in the process of implementing those new tax rules, is quite confusing. This uncertainty is affecting every level of the economy; tax administrations and companies.

## 6 Conclusion

In this conclusion, the researcher will highlight some negative aspect of the anti-BEPS package. And he will also discuss about his personal learnings by study in this subject.

### 6.1 Concern on the anti-BEPS package

Since the Action Plans' release in 2015, several critics have started to emerge from the nature of the package itself to the application of those new recommendations.

Those Action Plans are viewed as just a small fix and not a real overhaul of the outdated tax system. The OECD is keeping this old tax system with its flawed pillar: the "independent entity" principle. This principle is based on the notion that every entity in a group (parent and subsidiaries) is making operations between each other at arm's length. Which is not often the case. Establishing subsidiaries to shift profit in tax havens by making transactions at non-market prices, like the cases analyzed in this research, is not at arm's length type of operations (The Economist 2015.) The real overhaul will only be possible if every country has the exactly same tax legislation without any slight differences.

Another reason, why the package looks like just a band aid, is that the G20 has commissioned the OECD to work on those tax reforms. Meaning that they can influence the process and especially what will be include in those new rulings. The United States of America did weight a lot in weakening several proposals concerning how to tax cross-border online sales. Because lots of American MNEs with IP as a core business will lose the most with those proposals (The Economist 2015.)

The influence of the G20 on this package can also be seen in the fact that poor or developing countries' opinions are not heard. They don't have the same bargaining power as the biggest economies against big corporations. They won't be able to obtain the necessary data from companies, operating in their countries, to be able to fight effectively profit shifting.

The package also creates uncertainty. Countries outside the OECD are not bound to follow those recommendations. They can choose to apply them or not. As discussed earlier, those actions can be overlapping an actual law in some jurisdiction. The same way it could overlap the Anti-Tax Avoidance Package from the European Commission. Which countries will apply which ruling? Confusion and increase pressure on tax payers and tax administrations are expected. For what benefit? No one can really know yet.

In the meantime, it seems that some countries are fighting each other to get their hands on a part of MNEs' profits. This can be seen even inside the European Union where Ireland is fighting back the EU's decision ordering the country to collect €13bn in back taxes from Apple (The Guardian 2016). Ireland is fighting back because Apple would not be interested in the special tax deal with the country anymore. Meaning that the company will move in a more tax favorable country and Ireland will lose the tax revenue from Apple.

To conclude, those Action Plans are still a needed first step towards a better tax system. It will take years to really get rid of harmful practices. Finland, as any other country, cannot deal with those on its own. Co-operation between all countries is the key element.

## **6.2 Personal Learnings**

In this project, the writing process was not the most time-consuming part. The research was the biggest part. Looking for reliable sources, reading them, selecting the most relevant ones for this study took a lot of time. There is a plethora of different sources available on the subject. It is quite a new subject and it is evolving non-stop. The author has sharpened his critical thinking in process by analysing all those sources.

His negotiation skills have been also put to a test, while trying to get interviews with the Finnish Tax Administration and Ernst & Young. After several months of talks between different contacts, he obtained the necessary answers from the tax authorities but not from the consulting firm. Disclosure agreements couldn't be bypass by the contact inside Ernst & Young.

The subject is very interesting and will need more work done. New assessments on the matter are coming out continuously. The main motivation for this study were to understand those complex structures, to get a broader view on international trades and, to make the difference between legality and ethics.

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## Appendix

### Appendix 1. Survey Finnish Tax Administration

- What are the challenges on implementing OECD's anti-BEPS in Finland?

Both OECD and EU have been simultaneously developing measures against base erosion and profit shifting. The basic difference between the OECD and EU projects is that OECD work often results in recommendations which are binding for jurisdictions mainly at political level. EU level projects instead are legally binding for the member states especially when the measures are carried out in the form of directives. The main challenges on implementing OECD's anti-BEPS in Finland arise from partially overlapping EU and OECD projects.

Another issue arises from the fact that OECD recommendations include rules where the tax position in one jurisdiction depends on the tax law of another jurisdiction. This kind of regulation would create new challenges and increase administrative burden for both taxpayers and tax administrations.

- Which are the most important action plans for the Finnish economy?

The Ministry of Finance has in January 2016 set up a working party which evaluates the economic influence of OECD's and EU's anti-BEPS measures. The working party will publish a final report. In addition, the Ministry of Finance has evaluated the economic influence of EU ATAD interest limitation rule in a document UJ 9/2016 vp given to the Parliament.

- How the tax administration is taking care of issues coming from interests paid in intragroup loans? From royalty fees in IPR inside the MNE?

Interests paid in intragroup loans are deducted in accordance with the effective national interest limitation rule and arms' length principle. For royalty fees primarily type of income and arms' length principle are considered.

- Do you have any real life case (company's name can be redacted) and how the tax authority dealt with it?

Tax issues considering a separate taxpayer are confidential. Thus, we are not able to present any real life cases not published by administrative courts. The Supreme Administrative Court published last spring two rulings on interests paid in intragroup loans, SAC 2016:72 and SAC 2016:71.

- Are these Action Plans enough to counter any profit shifting in the future?

The effectiveness of the Action Plan remains to be seen as it depends firstly on how exhaustively jurisdictions will implement recommendations in their local law and secondly how tax planning structures will develop in the future. Anti-BEPS work will continue both at OECD and EU level.

- What else can be done?

No jurisdiction can tackle BEPS on its own. Therefore, developing the international cooperation and collaboration with other tax administrations is very important.

## **Appendix 2. Survey Ernst & Young**

- What are your customers (SME or MNE) concerns about the implementation of OECD's Action Plans in the Finnish tax legislation?
- How these concerns differ for a SME and for a MNE?
- How are your customers adapting to these new tax rulings? How have they changed their old practices?
- Are these Action Plans enough to counter any profit shifting in the future?
- What else can be done? What is missing in the anti-BEPS package?