

# Harmful tax competition

**Aggressive tax planning. Unaccepted methods of tax planning. World practices of crime and punishment.**

Amidst the global financial crisis, the reduction of the tax base and the budget deficit growth, the prior task for governments and relevant international institutions is to find out new sources of income.

In this regard, tightening of state tax control and “arranging” of widely used tax practices comes to the fore among the priorities of regulatory and law enforcement agencies in most countries of the world. The object of this impact is the business of any size and scale.

The basic principles of combating “harmful”/“aggressive” tax planning are being determined by influential international organizations. Adapted by national governments to local conditions, these regulations are very similar to the rules of engagement. At the same time, the border between legal and illegal schemes is often very transparent and can be determined arbitrarily.

Our professionals with high expertise will help You to determine the limits of acceptable tax planning, find ways for doing business safely, minimise legal, financial and, most importantly, reputational risks.

## **I. Terms and Definitions**

The first attempts to identify **an unfair (“harmful”) tax competition** as it is and to develop basic principles of counteraction to such practices were made in the late 1990s.

In a 1998 report issued by the Organisation for Economic Co-operation and Development (OECD) [HARMFUL TAX COMPETITION: An Emerging Global Issue](#) the criteria of “harmfulness” of tax competition and methods of fighting it have been identified for the first time.

Initially, the OECD definition of **“harmful tax competition”** was applied to “the tax policies of states belonging to offshore jurisdictions and creating conditions for the outflow of financial resources from “onshore” countries through preferential tax regimes”. In a [OECD Report of the 1998 Cape Town Forum On Tax Administration](#) the situations of **“aggressive tax planning”** have been described in general terms. Totally, their meaning was amounted to developing by taxpayers of **“unacceptable” methods of tax planning** and making transactions aimed at **“illegal minimisation of tax burden”**.

Furthermore, the key role of **“tax intermediaries”** (law and audit firms, tax consultants, banks, investment, insurance companies, and other financial institutions) in the implementation of “aggressive” schemes has also been defined for the first time.

Later, the concept of “aggressive tax planning” was widely used in official OECD documents. However, **its clear definition has not been recorded**.

However, the practical value for the relevant regulatory authorities (but not for business) may be [a secure directory of over 400 aggressive tax planning schemes submitted by member countries \(ATP Directory\)](#).

*The Directory contains a database of more than 400 tax planning schemes and a section on hybrid mismatch arrangements with tables that compare the tax treatment of entities and instruments in various countries in order to facilitate the detection of hybrid mismatch arrangements.*

The ATP Directory is maintained by the ATP Expert Group, a sub-group of Working Party No. 11 on aggressive tax planning.

In turn, **the European Union** takes a clearer position in the definition of “aggressive tax planning”. In particular, [European Commission Recommendation of 06.12.2012 on aggressive tax planning](#) has emphasised that **tax planning is considered to be aggressive when imperfections and inconsistencies in the tax systems of different countries are used to reduce tax burden**. Often the use of such gaps provides the income that is a subject to taxation in none of the involved countries.

## **II. OECD at the forefront of the fight against aggressive tax planning**

Continuing the policy of global economic regulation in taxation started in the 1960s, at present the **OECD**, in fact, is a **leading think tank** to form a global model for combating low-tax jurisdictions and offshores (“harmful” tax competition).

Following the introduction in 2013 of [Action Plan on Base Erosion and Profit Shifting \(BEPS Project\)](#) OECD actions in this area have become more systematic. According to the BEPS Plan, the purpose of the **radical restructuring of international tax regulation system** is to force companies to “pay more taxes and, moreover, where profits are formed, as well as to deprive them of possibility to hide their income in “tax havens” (in fact “aggressive” tax planning).

Under the OECD, such schemes are beneficial majorly to the largest transnational corporations, “which pay up to 5% of income taxes, and for small companies the tax rate is 20-30%, which is extremely unfair.”

The implicit idea of the BEPS Plan is to prevent using artificial tax schemes that have no other business purposes but to reduce taxes. One of the most important mechanisms is creating an integrated system for the exchange of financial and tax information.

This was largely due to the biggest offshore scandals in 2014-2016, in particular [Luxemburg Leakage \(LuxLeaks\)](#), [Panama Papers](#), [Paradise Papers](#), and etc.

## **III. National practices in fighting “aggressive” tax planning**

While the OECD develops a global strategy to counteract aggressive tax planning, specific directions are determined at the national/supranational level.

In this regard, the experience of certain countries, such as the United Kingdom, the European Union, Russia, China, etc., could be of practical interest.

The **United Kingdom** is for today undoubtedly at the forefront of fighting aggressive tax planning. In implementing its own strategy to improve tax transparency and combat tax evasion used by global enterprises, the UK has also initiated appropriate measures at the international level, particularly within the OECD.

In 2008, with a direct UK participation was issued a *Study into the Role of Tax Intermediaries*.

At present the UK has [the largest number of agreements within CRS Multilateral Competent Authority Agreement](#) (as of February 2019 it can receive data about UK taxpayers from 95 countries and send to 68 ones respectively).

**Criminal Finances Act 2017** which came into force in September 2017 has significantly expanded the powers of regulatory authorities and allowed to file criminal charges for “failure to prevent tax evasion” against any legal entity with a presence in the UK, as well as related persons (partners, consultants, contractors, etc.). Alongside, the law has opened a way for further tightening tax policy.

Among the measures taken in 2017-2018 are the following:

- Introduction in July 2017 of rules **making equal “tax intermediaries” with their clients in responsibility for tax avoidance** (the size of penalty can reach up to 100% of the amount of avoidance). One of the purposes is to bring out of the shadow “tax consultants who often deliberately offer illegal tax schemes to their clients.”

*In 2012 Her Majesty`s Revenue and Customs (HMRC) revealed a [K2 scheme](#). Using of it has allowed more than 1000 wealthy persons, primarily the celebrities, to “save” **about £168 million on taxes**. In the scheme the salaries of individuals in the UK were channelled through shell corporations in an offshore jurisdiction (Jersey) with lower salaries. The difference was compensated by the issuance of loans that were not taxable.*

*In 2016 HMRC revealed a formally legal [tax avoidance scheme through investments in the film industry](#) worth **about £700 million**. Dozens of bankers and a number of athletes and celebrities have invested in Ingenious Media Holdings Plc. in order to receive a tax deduction due to the company`s total losses. Ingenious Media itself used artificial overstatement of losses. In August 2018, more than 500 investors filed a class action lawsuit accusing Ingenious Film of fraud.*

*Even before the adoption of the rules concerning the responsibility of tax intermediaries, at the end of 2016, the Royal Bank of Canada refused to provide services in tax planning.*

By the way, in the United Kingdom **tax avoidance schemes are often arranged** by large taxpayers **directly with tax authorities**.

*In 2016, a Formula One case has become public. [Formula One had been using a scheme to legally avoid huge corporate taxes](#) (£945.6 thousand with £305 million of profit) by repurchasing loans from similar companies. It was argued that this strategy was part of a system of agreements with HMRC.*

- **The requirement** for large UK companies and multinational enterprises which present in the UK **[to publish their large business tax strategies](#)** (starting from September 2017). The tax strategy should explain the tax vehicles of a certain business, including the use of preferential taxation.
- Creating an **[open register of beneficiaries](#)** and the requirement for UK companies and partnerships to disclose beneficiaries or **[people with significant control \(PSC\)](#)**, as well as **[single register of trusts](#)**.

In order to counteract the aggressive tax planning in the UK there is an extensive system of bodies to detect and investigate violations of tax legislation both within the country and abroad. It includes the **Fraud Investigations Service (FIS)** and its **Offshore Co-ordinated Unit, Affluent Unit** (more than £1 million wealth) and the **High Net Worth Unit** (more than £10 million wealth).

*In February 2019, [a former Derbyshire company boss who tried to hide money in an offshore bank account was sentenced and ordered to repay the stolen cash or face five years in prison](#). A businessman tried to evade **£277,616 in tax**.*

*Between 2004 and 2010, Mark Williams paid €1 million owed to his kitchen sales firm APCA UK Ltd to a Spanish bank account. APCA Ltd had issued invoices to an Italian company for commission due on sales of their kitchens in the UK.*

*The FIS criminal investigation found that the businessman declared no overseas income on his tax returns, nor did he reveal the existence of the bank account.*

Similar measures are also taken by the **European Union**, consistently implementing policies to combat aggressive tax planning in line with the OECD recommendations.

In March 2018, amendments were adopted to [The Directive on Administrative Cooperation in the field of Taxation \(DAC6\)](#).

The purpose of innovations is **to oblige all “tax intermediaries”** (legal, audit firms, tax consultants, insurance companies, etc.) **to disclose the content of tax planning schemes** of their clients in cross-border transactions. The information should be provided to the local tax authorities, once a quarter it is planned to exchange between tax authorities of the EU members.

It is assumed that from July 1, 2020 the rules will be valid throughout the European Union. However, currently [bankers, law firms and tax consultants point out that «retrospective reporting is potentially absurd»](#). As experts say, this decision of the European Commission “has completely changed the rules in the industry.”

**The object of interest** of the European tax authorities today **are both large and medium-sized businesses and individuals**.

*The cases of using by global giants Apple, Google, Amazon, Starbucks, McDonald’s, FiatChrysler, etc. some European low-tax jurisdictions for corporate purposes (Ireland, the Netherlands, Luxembourg, etc.) have been widely-known.*

*Following the investigations in August 2016 [the European Commission has ordered Apple to pay back the Irish state up to €13 billion in taxes](#) (earlier, due to the tax deal between Apple and Ireland, the tech firm paid **income tax at just 0.005%**).*

*The European Commission estimated that [since 2008 the Dutch tax ruling allowed Starbucks to avoid tax of between €20 million and €30 million](#).*

*The investigation of these cases has ultimately put an end to the widely used [tax avoidance schemes such as Double Irish/Double Irish with Dutch Sandwich](#).*

The profound legal changes in the **Russian tax system** in 2015-2018 have led to a **serious strengthening of state tax control**.

The starting point can be considered the amendments to the Tax Code of Russia in 2017-2018, which actually annulled the tax practice of the previous 12 years and defined the border between legal and aggressive tax planning.

Before the new rules came into force, the law took into account only the so-called **unjustified tax benefit** introduced in 2006 by the Supreme Arbitration Court of Russia. According to the newly adopted amendments, the key factors were the specific actions of a taxpayer, which can be recognised as abusive.

The basic criteria are **the absence of business purposes and the activities aimed only to obtain tax benefits**.

Among the fundamental innovations are:

- **Significant narrowing opportunities for tax avoidance**

In the explanatory letter of the Russian Federal Tax Service (FTS) and the Investigative Committee of July 2017 (a kind of step-by-step instruction on how to identify and prove tax evasion schemes), a number of previously used tax planning schemes have been considered as tax evasion attempts. They comprise the distortion of information to obtain a favourable tax status or benefits under double taxation agreements, deliberate acts of tax evasion, fragmentation of business, unreality of transaction, use of intermediaries to create fictional expenses and fictional loans, use of transfer pricing, substitution of civil contracts, etc.

- **Increasing tax control over beneficial owners**

The first example of successful actions of FTS was the case of car-manufacturer Avtotor-Management in 2014. In the ground of the scheme laid a transfer of taxable profit from the tenant (Avtotor-Management) to the lessor (Baltic automobile plants LLC, a resident of the special economic zone in Kaliningrad), which were part of a single group of companies. The latter one has channelled its profits as dividends to Doan B.V. (Netherlands), and the beneficiary of all companies was the Russian owner (available upon request to the Dutch tax authorities). The court added to Avtotor-Management **596.5 million roubles (\$9.06 million) of taxes, fines and penalties**. A total amount of additional tax payments for the three companies of the group reached **3.7 billion roubles (\$56.1 million)**.

In October 2016, a tax investigation showed that a Russian steel-producing giant PAO Severstal had paid about 7 billion roubles (\$106.3 million) of dividends to Cyprus companies and transferred them to affiliates (British Virgin Islands) as dividends or loan repayment. Later there have been found nominal activities of Cyprus companies in share ownership as well as dividend disposal. Additional tax charges have amounted to almost **1 billion roubles (\$15,1 million)**.

- **Bringing to subsidiary liability on the company`s debts of all responsible persons** (CEO, CFO, chairman of the board, CAO, etc.) within 3 years, even after the bankruptcy. A similar measure is sometimes applied to business-related persons.

Earlier in 2012, the founder of Maxi-Group steel company N. Maksimov was brought to subsidiary liability for almost **6.4 billion roubles (\$97,2 million) of debts** of Uralsnabcomplekt LLC previously declared to be a bankrupt. Uralsnabcomplekt LLC has been actually controlled by N. Maksimov.

- **Tax control in Russia has become extra-territorial and sectoral in its nature**

In 2015-2018, a special attention of tax authorities was drawn to pharmaceuticals, jewellery, fish processing, cleaning companies, as it was believed that "grey" schemes of tax evasion had been most often used in these industries.

*Following a series of tax audits in 2017, a number of major pharmaceutical manufacturers and distributors have been assessed more than **5 billion roubles (\$75.9 million)** of additional taxes.*

- **Providing tax authorities with access to audit secrets**

*Since July 2017 tax authorities have had a right to demand from auditors documents/information on their clients if such documents had not been submitted by a taxpayer during the audit. The very discovery of documents is allowed on the decision of the head (or his deputies) of the FTS.*

- [Russia`s accession to the Automatic Exchange of Common Reporting Standard \(CRS\) Information in October 2014](#) and the beginning of such exchange in September 2018 (as of February 2019 – receiving information on assets of Russian tax residents from 90 jurisdictions) significantly expand the capabilities of the Russian tax authorities.

Apparently, the fiscal measures of Russian authorities has significantly reduce the scope of opportunities for tax planning, both international and domestic. Most likely the announced trend of “additional adjustment” of the whole tax system, coupled with “de-offshoring” of the Russian economy is to be continued and strengthened.

The problem of huge foreign accounts held by Chinese residents beyond the government control has always forced the tax authorities of **China** make efforts to find an effective way for taxation of private assets overseas.

For this reason, China has actively been supporting all OECD initiatives in tax planning, including the BEPS Plan, and been working closely in this area.

In China there is also no clear distinction between direct tax evasion and legal methods of tax planning. In order to avoid a broad interpretation of these concepts in official use and business practice, they are often combined into one category “**tax evasion/tax avoidance**”, which means “**any abusive (aggressive) tax planning scheme**”.

Under the current legislation, this concept, set out in **Corporate Income Tax Law (2008)**, implies actions, the result of which is:

- abuse of tax benefits, tax treaties or non-compliance of such actions with the legal form of the company
- tax evasion through the use of a tax haven
- tax evasion through mechanisms that do not have a reasonable commercial purpose.

In addition, there are some general rules that specify the measures that are considered as not having a reasonable commercial purpose and, therefore, “aggressive” methods of tax planning:

- abuse of any preferential tax regime
- incorrect application of any type of tax treaty
- abuse of the form of corporate organisation
- tax evasion through tax havens
- entering into other agreements that do not have a reasonable commercial purpose.



[Starting from September 2018 the Multilateral Competent Authority Agreement has come into effect for China](#) (as of February 2019, China receives information on its residents from 91 countries and provides data to 63 jurisdictions respectively) largely simplifies for State Taxation Administration to “work with foreign assets of Chinese residents”.

*It is stated that the object of interest of the Chinese tax authorities will also be **the owners of small accounts in foreign banks**, although the priority will be aimed at obtaining information from foreign jurisdictions on large taxpayers.*

Furthermore, [new rules of taxation has entered into force in January 2019 in China](#), focusing on the reform of income tax for individuals, including foreigners. It is aimed primarily at reducing tax burden for middle – income citizens and raising the rate for the wealthy.

*Under the new rules, individuals who are Chinese residents or non-residents, but live more than 183 days a year in the country, are considered as tax residents of China.*

In general, the practice of combating tax violations in China is very specific and is based on the **social responsibility of a person**.

Thus, in 2014 China has started ranking citizens with a [Social Credit System](#), which takes into account the achievements and offenses of a citizen on the basis of a number of parameters (public honesty, commercial integrity and public integrity, judicial credibility) and assigns the appropriate rating.

This strategy, with maximum publicity, is often used in fighting high-ranking corrupted officials or wealthy citizens suspected of tax evasion.

*The system involves the largest Chinese hi-tech companies like Alibaba which offered to law enforcement agencies to identify potential offenders, including tax evaders, on the basis of analysis of their online purchases. The programme also intends to connect Facebook.*

A similar ranking of “**social responsibility**” is also applied to celebrities, its aim is “to attract public attention to the rich or high-ranking offenders, provide strong moral influence to make them realize their misconduct, cause repentance and compensation.”

*In October 2018 the Chinese tax authorities accused Fang Bingbing, a highly-paid film star, in alleged **tax evasion** of nearly **\$129 million**. They have also investigated and verified online allegations that TV and film actors had evaded taxes by signing two contracts (**general practice of “Yin-Yang contracts”**), only the smaller of the two would be shown to the authorities, thus incurring a much lower rate of tax than would be taken from a total payment.*

In turn, the Chinese leading hi-tech firms are also actively used to combat tax evaders.

*In May 2018, [Chinese technology giant Tencent Holdings Ltd. and Shenzhen National Taxation Bureau](#) announced their partnership. The co-operation will bring key instruments and tools together to help the Chinese government track large underground markets for tax fraud cases.*

*Government agents will be able to stay atop of tax payments and prevent the issue of counterfeit or copied goods and items. Furthermore, buyers known to use fraudulent receipts to defraud employers, claim false expenditure or evade taxes will be dealt with thanks to the new system, which is currently in development.*

Strengthening tax control around the world and in certain countries, in particular, the ever-growing financial risks repeatedly increase the need of business for careful planning of its activities. And, most importantly, they require a much more thorough approach to choosing legitimate and effective development strategies.

As we see, the price of business reputation mounts significantly. In an era of almost total transparency, investments in security, both personal and business, the preservation of commercial secrecy turn out to be a valuable asset.

In these terms, professionals with extensive knowledge and high expertise, who are able to protect You, Your business and Your reputation are considered to be a resource of utmost importance.

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