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# THE TRANSFER PRICING DISCIPLINE: THE IKEA CASE STUDY

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# ABSTRACT

Gli ultimi vent'anni sono stati segnati da grandi cambiamenti nell'economia mondiale che hanno portato alla creazione di un unico grande mercato globale in cui le multinazionali hanno assunto un ruolo fondamentale.

La presenza di filiali in più paesi ha permesso alle multinazionali da un lato di operare in più territori e dall'altro di poter ridurre la tassazione, infatti le multinazionali sono in grado di attuare politiche fiscali volte a ridurre l'impatto fiscale sulla società di bilancio.

Il fenomeno dell'elusione fiscale non ha rilevanza marginale, infatti solo nell'Unione Europea questo provoca un danno fiscale di circa 70 miliardi di euro all'anno. Secondo Oxfam, che lavora per limitare l'ingiustizia e la povertà, l'elusione fiscale delle multinazionali raggiunge i 240 miliardi di dollari all'anno, mentre le pratiche legate all'abuso fiscale fanno perdere ai paesi in via di sviluppo circa 170 miliardi di dollari l'anno. La maggior parte dei profitti delle multinazionali sono depositati in paesi definiti paradisi fiscali, caratterizzati da una tassazione quasi nulla. Tra queste spiccano le Bahamas dove, secondo l'International Consortium of Investigative Journalists, sono state registrate negli ultimi 26 anni 175.000 società

di comodo (società di comodo inattive utilizzate come strumento per le manovre finanziarie).

Tra le pratiche di pianificazione fiscale aggressiva troviamo il transfer pricing che, sebbene non sia una pratica puramente elusiva, se manipolato può consentire il trasferimento di ricchezza da uno Stato all'altro.

In questo lavoro verrà analizzata appunto la disciplina del transfer pricing, fornendo prima di tutto la sua evoluzione storica e poi analizzando le diverse metodologie adottate per la determinazione dei prezzi di vendita.

Nella seconda parte ho concentrato l'attenzione sul problema dei paradisi fiscali con maggiore focus sul caso olandese e i danni che quest'ultimo ha provocato all'Italia. Infine, ho cercato di dare una soluzione come possibili misure che l'unione europea dovrebbe adottare per la lotta all'evasione fiscale.

Nella terza e ultima parte di questo elaborato, ho dapprima introdotto l'argomento degli Advance Pricing Agreements con i relativi pro e contro che questi accordi comportano, per poi ricollegarli direttamente al caso Ikea, accordi completamente legali con alcuni stati europei che ha permesso a quest'ultima di risparmiare miliardi di euro in tasse.

# INTRODUCTION

The last twenty years have been marked by major changes in the world economy that have led to the creation of a single large global market in which multinational companies have taken on a fundamental role.

The presence of branches in multiple countries has allowed multinationals on the one hand to operate in multiple territories and on the other to be able to reduce taxation, in fact multinationals are able to implement fiscal policies aimed at reducing the fiscal impact on the balance sheet company.

The phenomenon of tax avoidance has no marginal relevance, in fact only in the European Union this cause tax damage of around 70 billion euros per year. According to Oxfam, which works to limit injustice and poverty, the tax avoidance of multinationals reaches 240 billion dollars per year, while practices related to tax abuse cause developing countries to lose about 170 billion dollars the year. Most of the profits of multinationals are deposited in countries that are defined as tax havens, which are characterized by almost zero taxation. Among these, the Bahamas stand out in which, according to the *International Consortium of Investigative Journalists*, 175,000 *shell companies* (inactive shell companies used as a tool for financial manoeuvres) have been registered in the last 26 years.

Among the aggressive tax planning practices, we find *transfer pricing* which, although it is not a purely elusive practice, if manipulated it can allow the transfer of wealth from one State to another.

In this work the transfer pricing discipline will be analysed, first of all providing its historical evolution and then analyse the various methods adopted for the determination of sales prices.

In the second part I focused my attention on the problem of tax havens with greater focus on the Dutch case and the damage it caused to Italy. Finally, I tried to find a solution as to possible measures that the European Union should take to combat tax evasion.

In the third and last part of this paper, I first introduced the argument of Advance Pricing Agreements with the relative pros and cons that these agreements entail, and then reconnect them directly to the Ikea case, completely legal agreements with some European states that allowed this latest to save billions of euros in taxes.

# PREMISE

The ever more frequent increase in liberalization and the importance of markets worldwide have led to what is called the phenomenon of the ***internationalization of business activities***. International exchanges and the possibility for large companies to structure themselves in agglomerations located in various countries leads to the birth of the so-called *multinational groups*. In order to better understand what the regulation of transfer prices is, it is necessary to elucidate what the *corporate groups' tax regime* is.

Tax planning is one of the main sources of profit for modern businesses and this phenomenon is evident when we talk about companies that carry out their business in countries with a tax regime different from that to which Italian companies are subject. Market strategies are not the only tools needed to produce at low costs, they are not the only levers on which today a multinational company tends to make profits, what is most important are the location choices of the companies' to them affiliates, the distribution of profits themselves and the allocation of income which allows to reduce the tax burden. These are aspects that have become fundamental and have an impact on the management of business activities. The various problems that the multinational company is facing are caused by frequent avoidance attempts, implemented through the development of strategies aimed at reducing the tax burden.

The influence of the tax element in the localization strategy of the income-producing units appears to be decisive and in practice very widespread, that is, to establish between the parent company and its affiliated financial units mostly with offices in low-tax countries. This simple trick allows you to avoid taxation in the state in which the parent company is based. The establishment of a holding in tax-based countries does not represent the only "taxable" wealth transfer method: this can also be done through the transfer pricing technique, which is the subject of this work.

# CHAPTER 1 – THE HISTORICAL EVOLUTION AND DETERMINATION OF SALES PRICES

## 1.1 The history evolution of transfer pricing

In recent times, the emergence of the phenomenon of transfer prices has been of considerable importance.

Already in 1910, on the initiative of those states that had a more advanced tax regime than ours 2 (UK, USA), the regulation on transfer prices was subject to analysis and regulation with numerous regulatory interventions; This is where the reports drawn up by the OECD (**organization for economic cooperation and development**) of the 1970s are located. In states that have an advanced tax regime, tax laws contain targeted provisions aimed above all at regulating the correct determination of the values to be attributed to what are the exchanges between a resident enterprise and another enterprise located in a foreign state in the case in which the two economic subjects are linked to each other, as mentioned, by participation or other relationships, whether direct or indirect.

In going to reconstruct what is the historical genesis of the regulation on transfer prices, it is necessary to analyse the role played by the cooperation organizations

between States which, as anticipated above, concentrate their work in going to eliminate the distorting effects produced by the assessments of the Financial Administrations of the different countries. Among those organizations, the most important is the OECD[1], it was born in the period after the Second World War to meet the need for cooperation and coordination of the European states and then subsequently expanded to the rest of the world up to now include 35 member countries[2] and collaborations with 70 countries among the so-called "*Developing and transition economies*". It must be remembered that OECD interventions have often taken on a legislative value within the various national systems. An example

[1] OECD brings together thirty-five Member States in a single forum, which meet to discuss, develop and define economic and social policies. Within the organization, States have the opportunity to compare their experiences, find answers to common problems and direct national and international policies, with the aim of supporting States in the difficult task of dealing with phenomena of global relevance. Beyond the agreements (legally binding and not) concluded on specific topics, the discussions have the function of directing the activities of individual States within the broad spectrum of government policies that can be implemented by assessing the impact they could have on the international community. The OECD brings together countries that are committed to guarantee respect for fundamental rights, democratic pluralism and the development of a market economy amentia rich, in that its members produce two thirds of the world's wealth, but not exclusive. In recent years, in fact, it has also welcomed developing countries, as well as some countries belonging to the former communist bloc of Eastern Europe.

[2] The OECD has replaced the Organization for European Economic Cooperation, established under the Marshall Plan for the reconstruction of Europe after the Second World War. The current OECD member states are: Australia, Austria, Belgium, Canada , Chile, Korea, Denmark, Estonia, Finland, France, Germany, Japan, Greece, Ireland, Iceland, Israel, Italy, Latvia, Luxembourg, Mexico, Norway, New Zealand, the Netherlands, Poland, Portugal, United Kingdom, Czech Republic , Slovak Republic, Slovenia, Spain, United States, Sweden, Switzerland, Turkey, Hungary, while work is currently underway for the accession of Colombia, Lithuania and Costa Rica. Membership currently reflects on the start of the accession process for 7 other candidate countries (Argentina, Brazil, Bulgaria, Croatia, Peru, Romania and Sri Lanka). As regards the accession process of the Russian Federation, started in 2007 and still ongoing, following the events in Ukraine, the Council OECD Permanent Representatives decided on 12 March 2014 to postpone all of its activities. The ability to become members of the OECD is conditional on the commitment by the requesting state to implement a market economy and to guarantee pluralistic democracy.

would be Italy with the Government Report to Presidential Decree 30 December 1980 n 987, the legislator has, for the first time with a law, expressly declared its intention to comply with the so-called principle of non-discrimination, referring it as a common *principle of international tax law to the OECD Model Convention* ". Not only the OECD, although it was and continues to be the most authoritative to have dealt with transfer prices: but already in 1921, *the League of Nations*[3] had addressed the issue during the work on indirect double taxation.

The documents of those times drawn up by the aforementioned committee referred to the need of each country to identify the most useful and effective system for determining the income of foreign branches that carried out business in the country by carrying out transactions with the subject of exchange of goods. . Model repeatedly modified over the years is considered a forerunner of the normative testimony at Community level, given that it represents the crucial model of the historical and also regulatory evolution of the transfer of prices thus determining the definitive passage from the so-called *Unitary entity theory*[4] to the most used and logical separate *Accounting Theory*[5].

[3] The League of Nations (1919 - 1946) was an organization supranational was created following the Treaty of Versailles, June 28, 1919. Main functions were: 1) the control of international arms; 2) the incentive for the well-being and quality of life of the planet.; 3) the prevention of wars 4) the diplomatic management of conflicts between States

[4] Theory provides that multiple companies linked by financial constraints are to be considered a single economic entity in which the distribution of wealth takes place at a flat rate. This approach is contained in the Model Convention of 1928

[5] This approach is contained in the Model Convention of 1933

The latter, on the other hand, provides that each unit must be considered autonomous above all for the purpose of determining the income in whose calculation the transactions carried out between the multiple units of the group are relevant. It is the first model together with all the others that have followed over the years, which for the first time has used the concept of *Normal Value* or better of *Normality* between associated companies. Precisely the OECD which, as we will see later, has taken up the concept of normality even if in somewhat different terms in the famous *art 9 of the OECD model convention in the first instance in 1963* and subsequently modified until it became the cornerstone of the 1979 guidelines, of 1995 and in the latest *TPG (transfer pricing guideline*) of 2010 approved in July of the same year. If we see from an external point of view the readiness in the disciplinary and in intervening by the various *guarantying authorities* would lead us to think that the matter is well governed by current legislation but it is not so, the problem has always been lacking in a uniform discipline and definitive.

In 1976 the OECD with its intervention responded to a real widespread need to regulate the matter by addressing the problem but with poor results, the subsequent intervention arrived in 1979[6] at the hands of the OECD TAX AFFAIRS

[6] The UN Convention, while adopting the same text as Articles 7 and 9 of the OECD Model of 1963, there are some differences, in particular, it is noted that while the UN was more oriented towards a favorable policy towards developing countries, the OECD showed, on the contrary, more reduced sensitivity to the North-South dialogue in international tax relations, for further details of which refer to AA.VV., UN Draft Model Taxation Convention, Proceedings of a Seminar Held in Copenhagen in 1979 during the 33rd Congress of the International Fiscal Association, Deventer ,

COMMITTEE. Committee that released the important "*transfer pricing and multinationals*" report three years earlier, containing the guidelines that represented the initial document issued by the OECD on transfer pricing and where the criteria are defined[7] about the value to be attributed to the transactions carried out between associated companies and therefore intra-group: the so-called normal value set out in article 9 of the aforementioned model. Article 9 of the OECD model aims to counteract the distorting effects of transfer pricing policies, unless the individual country can issue a specific internal regulation even if leaving clear coordination problems then being applied. This led the OECD in 1979 to issue what is the first complete report on transfer pricing (Transfer Pricing Multinational Enterprise) with the effective purpose of going to determine the directives to coordinate the regulations adopted by individual states with the indication of the fundamental methodologies applicable in order to establish the value of the free market price, called the *arm's length*[8]. Based on what is established by the Report in the

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1979; Bracewell Milnes B., "Collaboration Between Governments", in AA.VV., International Tax Avoidance, vol. A: General and Conceptual Material, Deventer, 1979, p. 175 ss

[7] See Picone P., "International Economic Order", in Picone-Sacerdoti, International Economic Law, Milan, 1983, p. 155 ss.

[8] The principle of the arm's length is contained in all the conventions against double conventions stipulated by the OECD countries. Article 9 of the OECD Model Convention establishes: "[when] the two [associated] companies (... ) in their commercial or financial relations are bound by accepted conditions or taxes other than those that would have been agreed between independent companies, the profits that in the absence of these conditions would have been made by one of the companies, but which due to these conditions do not have been, can be included in the profits of this company and taxed accordingly. "The Commentary on art. 9 of the OECD Model states that:" [no adjustment by the associated companies is allowed] if the transactions between the companies have been carried out at normal commercial conditions of free trade (on an arm's length basis) ". Tax review 5/2006 p1632).

aforementioned article 9, *the sales of goods and the provision of services between companies belonging to the same group must necessarily take place at market prices and respecting the principle of free competition*. Preventing multinational companies from modifying taxable income by overestimating or underestimating prices by drawing "undue" tax savings. This was the purpose of the regulation.

In Italy this has greatly influenced the Financial Administration to such an extent that it issued a special transposition circular through the Ministry of Finance on 22 September 1980[9] which in addition to confirming the provisions of the OECD Report, went to make explicit the first indications of the Italian Financial Administration regarding the problems inherent in the transfer prices[10].

Less than twenty years after the first Report, In 1995 the OECD issued a second document "*Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* "the most important one to date which provides guidelines on the

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[9] In the document, the Italian Financial Administration explicitly refers to the OECD Report, making a referral that allows, de facto, the integration of the instructions and the interpretation of the Italian legislation with the evaluation criteria formulated by the OECD See, for all, Maisto G., The "Transfer price" in Italian and comparative tax law, op . cit .

[10] Capolupo S. ("Transfer pricing and proof of circumvention", in tax, no. 28/2008) highlights the considerable importance of the OECD contribution regarding the regulation of transfer pricing, with particular reference to the procedural aspect ental. The OECD Report of 1995 provides a series of indications regarding the documentary elements, establishing that they must support both the comparability of the transactions being examined and the functional analysis relating to the various units of the group; in addition, the Community Code of Conduct on documentary requirements, although not implemented in Italy with an ad hoc provision, reaffirms two fundamental concepts: - the burden of proof in transfer pricing rests on the Financial Administration; - it is not mandatory to enter into contracts in writing, although it is clear that the documentation of the transactions remains a fundamental prerequisite for regulating relations with the Financial Administration.

topic and above all focusing its attention on the specific methods of determining the free competition prices acceptable by the tax administrations of the acceding countries. The evolution of this relationship was born to overcome what were the problems of the 1975 OECD report and to give multinational companies and tax administrations new and well-founded criteria for the analysis of the different situations in order to facilitate comparability[11] of the exchanges and eliminating the gaps.

From this moment, the first model of *Guidelines* will be subject to continuous additions, modifications and additions to other criteria for determining prices, divided according to the type of goods and services subject to exchange, until approval by the *Committee of Fiscal Affairs* and the OECD Council, and the subsequent publication, in July 2010, of the new version of the *Transfer Pricing Guidelines*.

Again, the backbone of the three documents referred to so far is structured on the highest principle of the *arm's length*, still considered the criterion that best meets the requirements of objectivity and objectivity - and, for this reason, valid for the restatement of the value of the intragroup transaction for tax purposes - of which,

[11] In general, according to the OECD, the examination of the comparability of transactions for the purpose of applying the arm's length principle must be based not only on the analysis of the physical characteristics of the product and services transferred, but also on the analysis of the functions undertaken by the parties, of the assets used for the performance of the aforementioned functions and by the conventional assumption of the greatest market risks.

on the contrary, the settlement transactions carried out by two or more associated companies were frequently lacking. However, one of the main changes introduced by the *Guidelines* compared to the 1979 Report lies in the list of new criteria for determining transfer prices.

In addition to the aforementioned *comparable uncontrolled price method, resale plus method and cost plus method*, in order to resolve situations of exceptional complexity in which the use of traditional criteria did not allow the achievement of a satisfactory price determination, the document offered a range of "alternative" income methods (the so-called transactional profit methods which include the *profit split method and the transactional net margin method*). The introduction of further "alternative" methods was intended precisely to provide a valid answer, in cases where identification through the traditional methods had led to a vain search.

As anticipated in the introduction, the subject of *transfer pricing* will be discussed in various aspects in the following document. On the other hand, the first chapter aims to give a first overview of this discipline and to do this I thought it appropriate to start from the historical background, starting from its first documents with the League of Nations to the most recent of the OECD. But before continuing to analyse in detail the traditional TP methods and it is good to pause and understand the principle of free competition or better named *the arm's length principle.*

## 1.2 The Principle of the Arm's Length

*The arm's length principle* is considered the cornerstone of the legislation which aims at the correct determination of transfer prices by multinational groups. This principle establishes that the operations that take place between associated companies that reside in different States, with different tax regimes, must take place at what is called the *free competition price or the price at arm's length.*

In this way it is established that the operations that take place between the associated companies must be characterized by homogeneous prices to those that would have been set in transactions that took place between independent companies operating in the competitive market. This comparison between prices must be made because Intercompany operations are not influenced by market trends like operations carried out between independent companies, indeed in this case there could be transactions that are not affected by its action at all.

For this reason, the principle of free competition aims to regulate relations between associated companies in such a way that they respect the rules of the free competitive market, and that transactions, especially intercompany transactions and the granting of intra-group loans, are valued on the basis of a *fair value* to avoid that the lack of market influence leads to differences between these and those that occur between independent parties. Multinational companies can minimize the

consolidated tax burden by developing global tax strategies, in particular by exploiting the *delocalization*[12] *of their activities.* The positioning of the companies, which are part of the multinational in different countries, characterized by different levels of taxation, can be used, thanks to the analysis of the regulatory and tax systems of the various states in which they operate, for the transfer of tax bases to countries privileged taxation through price manipulation, overestimating or underestimating them.

In supervising the correct application of the *fair price*, tax administrations must not automatically assume that multinational groups always alter prices in transactions within the group, they must consider that in some situation's companies could find the *fair price* determination very complex due to the absence of market forces.

There are many institutions that try to regulate and study this phenomenon. Among these we find the OECD, which has implemented the *arm's length principle* in the Tax Convention Model. Its rules are set out in Article 9, paragraph 1, where it states that *"(When) the two (associated) companies, in their commercial or financial relations, are bound by accepted conditions or taxes other than those that would have been agreed between companies independent, the profits that, in the absence of these conditions, would have been made by one of the companies, but which*

[12] the transfer of production activities to other countries. Think of the cases of outsourcing, subcontracting or subcontracting

*because of these conditions were not, can be included in the profits of this company and taxed accordingly ".*

This article regulates the taxation of profits of transactions that do not comply with the *principle of free competition*, in this case the unrecognized profits will be included in the taxable income through a correction by the Financial Administrations which will subsequently carry out a correct calculation of the taxes due .

Within the OECD Guidelines on transfer pricing for multinational companies and tax administrations (2010), it is highlighted that when going to adjust profits, according to the principle of free competition, the conditions must be taken into consideration which are usually created between individual organizational units that have independent transactions on the free market between them. This implies that the various organizational units belonging to the multinational group will be considered as independent entities and the operations that will take place between them will have to be valued at *market value*, which is considered the *price of free competition*.

This adjustment of profits can however lead to economic double taxation, for this reason, the objective always in the OECD Guidelines in article 9, paragraph 2 is to avoid the phenomenon of double taxation, a situation in which there is the taxation of different legal entities by several countries.

Within the OECD Guidelines, however, the method to be used to perform the correction and the expected times is not provided, therefore the quantification of these variables is not automatic but depends on the State, which may or may not consider these adjustments homogeneous to the situations that can be found in the free market.

It is important to underline that, in order to avoid the phenomenon of double taxation, *international conventions* have also been stipulated in order to regulate the tax relations between the companies operating in the States that have joined it. They are bilateral agreements that are drawn up following the model for the conventions provided by the OECD, in addition to regulating the phenomenon of double taxation these Conventions prevent evasion[13] and tax avoidance[14].

In Italy these Conventions enter into force after ratification by Parliament, to make the convention executive an ordinary law by the latter is also necessary. To implement these Conventions, the countries that stipulate them can make agreements to facilitate the exchange of information and the implementation of concurrent controls.

[13] By tax evasion we mean all those practices through which the taxpayer tries to decrease or eliminate completely the tax withdrawal by the tax administrations, through the violation of tax legislation

[14] By tax avoidance it indicates a behaviour, albeit lawful, held by the taxpayer who has the purpose of avoiding taxation

Although the principle of free competition is considered a valid tool, situations remain in which its application is difficult, such as when we are faced with controlled transactions involving highly specialized goods and services, in this case the prices of similar transactions.

However, this principle provides the best approximation of market prices and is also adopted by all OECD member countries because it provides the same tax treatment, both for multinational groups and for independent companies, avoiding the creation of tax incentives or disincentives , for one or the other category, which could alter the free competition in the market.

Of course, the Italian legislation has also included in the Italian legal system a regulation for transfer prices and for the principle of free competition, in particular we find that in article 110, paragraph 7, of the Consolidated Law on Income Taxes ( TUIR), where within this regulation it is established that the price that is set for intra-group transactions must be equal to the *normal value*.

The definition of "normal value" for the Italian legal system is enshrined in article 9, paragraph 3, of the TUIR: *"By normal value (...) we mean the price or the average price charged for goods and services of the same species or similar, in conditions of free competition and at the same stage of marketing, over time and in the place where the goods or services were acquired or supplied (...). For the determination of the normal value, reference is made, as far as possible, to the price lists or tariffs*

*of the person who supplied the goods or services and, failing that, to the mercurial and to the price lists of the chambers of commerce and professional tariffs, taking into account the discounts on use. (...) "*. With this expression, the legislator did not want to indicate a precise value, but a method that must be used when identifying the tax base, the result of which varies from case to case. The article shows that the Italian legal system used *the arm's length principle* to define the concept of normal value.

It is important to underline that article 110, paragraph 7, of the TUIR therefore establishes that this discipline is applied to the operations that take place between an enterprise[15] resident and company[16] non-residents who directly or indirectly are subject to *common control*.

The definition of the concept of common *control* is found in the Civil Code in article 2359, companies in which:

1. another company holds most of the votes that can be exercised in the ordinary meeting;
2. another company holds several votes which allows it to have a predominant influence in the ordinary shareholders' meeting;

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[15] The term enterprise refers to the provisions of art. professionally - individually or collectively - an economic activity organized for the purpose of producing and exchanging goods or services "
[16] The term" company "means all transactions carried out with foreign subjects regardless of the that the entity hires

3. in which there are dominant influences from another company in correspondence with specific contractual obligations.

The concept of control, however, also includes simple factual situations, including all contexts where there is a hypothetical current or potential economic influence. We find these situations listed in the Ministerial Circular n. 32/1980, among which we find the exclusive alienation of the goods produced by the other company, the appointment of the members of the board of directors, the importance of the presence of capital, goods and collaboration by the other company and the high financial dependence.

## 1.3 The determination of the sales prices

Italian administrative practice and OECD reports identify a series of methodologies that ideally allow to quantify the price for controlled transactions respecting the main arm's length. If the principle is respected, in the sense that if the transactions take place in such a way as to respect the laws of a free market, therefore by not manipulating the prices according to who the other actor is, it is clear that the legislation cannot be applied and therefore the tax authorities cannot resume taxable matters.

The methods currently envisaged and applicable are those indicated by the new OECD *Guidelines*, to which the Provision of the Revenue Agency of 2010[17] are:

- **Traditional transaction-based methods:**

1. *Comparable Uncontrolled Pricing or CUP Method;*
2. *Resale Pricing Method;*
3. *Cost plus Method;*

- **Profitable transactional methods:**

1. *Transactional Net Margin Method;*
2. *Profit Split Method;*

Before the update of the 2010 *Guidelines*, the OECD foresaw that, in choosing the methods for determining the *transfer pricing*, a strict order had to be respected according to which the method that was to be used mainly was the *CUP method*, while the others methods played a marginal role because they could only be used in situations where the latter could not be used.

After the update, the OECD has established that each company can choose the method it deems most appropriate for each situation, nevertheless a preference

[17] D'Avossa (2011, p.5) underlines that the provision represents a "position taken by the Agency itself on the usability of the Guidelines as a single theoretical source, thereby sanctioning the definitive overcoming of circular (..) n.32 / 1980 and of all the concepts expressed therein which were not aligned with the dictates of the new OECD Guidelines ". In particular, the descriptions of the alternative methods indicated in the circular, such as the comparison of profits, the distribution of profits, the gross margins of the economic sector and the profitability of the invested capital

remains for the use of the CUP method, if it gives reliable results, and for traditional methods, which they are considered more efficient in identifying prices in line with the *arm's length principle*.

In some situations, the use of alternative methods is preferable, such as in the event that an associated company offers a contribution that is not comparable with other transactions or gives an exclusive contribution.

The OECD Guidelines allow companies to also be able to use *other methods*[18] If these are more appropriate for a given situation, but the burden is on the company to demonstrate that these methods respect the *arm's length principle*. Of course, this choice will have to be analysed and the reason why we cannot comply with the methods highlighted in the *Guidelines* must also be exposed.

The OECD establishes that the method must be selected considering:

- The advantages and disadvantages of each method;
- The appropriateness of the method with respect to the case in question, thanks to the analysis of the functions;
- The degree of reliability of the information available;

[18] Other methods include all the methods used to determine the transfer price value that are not listed in the OECD Guidelines

- The degree of comparability between independent and controlled transactions.

The Guidelines specify that the analysis of all methods is not necessary in order to make a choice. However, it is expected that the company, after deciding which method it intends to use, must motivate its choice, including through documents, paying particular attention to the preparation of the comparability analysis and the exposure of the chosen methodology.

### 1.3.1 Traditional transaction-based methods

Traditional methods are focused on the single transaction and the goal is to quantify the normal value of the transaction starting from the definition of the price.

#### *1.3.1.1 Comparable Uncontrolled Pricing or CUP Method*

In this method, the comparison is made between the transfer price of goods or services applied to a *controlled transaction*[19] and the price that is applied in

[19] Transaction that takes place between companies belonging to the same group

transactions that occur between independent companies under comparable conditions.

If the principle of free competition is not respected in controlled transactions, we will have an intra-group transfer price which will be different from the price set in market transactions. In this case the transfer price applied on the controlled transaction will be replaced with the free competition price. The OECD establishes that, in the event that the associated company manages to identify transactions that are comparable, the use of the CUP method is preferable, since it can easily identify prices that comply with the *arm's length principle*. The price comparison can be of two types:

- **internal comparison**, which allows the comparison between the price applied in an intercompany transaction and that applied by a group company in transactions with third parties;
- **external comparison**, when failing to identify this transition internally, one opts to compare the transfer price with that applied in similar transactions between independent parties.

We can analyse the *internal comparison* through an example let's assume that an Italian company sells a production plant for 500,000 € to a French associated company. During a check it was found that this company sold the same plant to an independent French company for € 600,000, it can be immediately understood that the two prices do not coincide despite the fact that the plant is the same. In the *controlled transaction* the principle of free competition was not respected, therefore the transfer price will have to be changed and will go from € 500,000 to € 600,000. Taking the *external comparison* into consideration, we can have for example a situation in which an Italian company purchases 50 barrels of oil at $ 100 a barrel from an associated French company, however it is noted that on that date the price

of oil per barrel is equal to $ 85. In the controlled transaction, the principle of free competition was not respected, and the transfer price will have to be changed and will go from $ 100 a barrel to $ 85.

The tax authorities recommend the use of internal comparison since they believe there is a higher possibility of finding situations that are easily comparable internally, also because the use of external comparison is linked to the presence in the market of transactions concerning homogeneous goods or services, which may be few or no.

In order to correctly apply the external comparison, Valente (2013) stresses that companies must consider the following elements:

1. *The existence of a relevant market*, which has transactions consistent with those in question. Affinity must consider competitive variables, price discipline, exchange rates and costs related to distribution. It is very important that the markets where the same products are sold are examined.
2. *The characteristics of the product*, the products must be homogeneous both from the point of view of the intrinsic characteristics and in the external aspect, if the latter is relevant.
3. *The sales volumes*, which must be similar.
4. *Other requirements*, which take into consideration various elements including transport and packaging, advertising, marketing, conditions of sale, product warranty and promotional sales and customs duties.

In the event that the inequalities[20] between the prices can be calculated precisely, it is appropriate to modify the price of the independent transaction, thus finding the differential value[21], in order to make it homogeneous and comparable.

The CUP method is considered to be the most compliant among the methods by the OECD, however concrete limitations can be found in the application of this method, for this reason it is mainly used in transactions involving fungible goods and raw materials.

#### *1.3.1.2 Resale pricing method*

The *resale price method* is usually used when the CUP method cannot be used.

The method requires that three parties intervene in the transaction: the manufacturer, the Group dealer and a third customer. The normal price is determined by checking whether the margin that the distributor obtains from the resale, taking into account aspects such as functions, risks and resources used, is adequate.

**sale price to third parties**

**- Intercompany cost**

**= dealer margin**

[20] attributable to duties or particular conditions of carriage

[21] Price given by the difference between the sample price and the external elements which, although they are influential in its quantification, are not connected to the marketing and sale of the asset

The quantification of the resale price margin represents the crucial point of this method. It can be determined by referring to the margin obtained against comparable sales between the company in question and an independent company.

Practice suggests that this methodology can be used preferably in cases where:

1. the dealer only carries out marketing activities, without making any changes that may increase the value of the asset;
2. the dealer does not participate in the maintenance of intangible assets related to the goods sold;
3. the period of time that elapses between the purchase and the sale is minimal, in this way the elements that could alter the price (for example exchange rates) will not be affected;
4. an accounting comparison can be made.

The use of this method is not recommended in the case where:

1. semi-finished products are involved which, prior to resale, will undergo further transformations;
2. the goods will be incorporated into another product before being resold;
3. the dealer uses his own technical specialization in carrying out the activity.

Let us now take an example where it could happen that the manufacturer applies a high selling price and that the reseller sells the product at a relatively low price, outside any profit logic. If we assume that the producer is resident in a tax haven (high profits and reduced taxes) and that the reseller is resident in a country with high taxation (therefore high costs, limited revenues, ergo low taxable income) and easily understood as the margin analysis is a valid tool to verify that transactions take place by applying the free competition price.

This method is useful when the retailer markets the goods, on the contrary, if the product undergoes transformation, their application is not recommended. The margin cannot be taken in absolute terms, but an admissibility interval must be defined so that it can be stated whether the price is considered normal. This interval can be determined in two ways:

- *functional comparison*: the margin obtained by the Group dealer compares with that obtained by an independent company that performs similar transactions by performing the same functions and bearing the same risks as the "Group dealer".
- *transactional comparison*: the gross margin that the Group retailer obtains by selling products purchased from the Group manufacturer compares with what it would have obtained by purchasing those goods from other independent producers.

#### *1.3.1.3 Cost plus method*

In the *cost-plus method*, the transfer price can be estimated thanks to the identification of the costs incurred for the realization of the good or service by the manufacturer to which a **mark-up** (or gross profit margin) will be added. This mark-up is a mark-up percentage that considers the activities carried out, the risks and the market situation.

**Mark UP = gross margin / production costs**

Both in this method and in the resale price method, an internal or external comparison is made between the gross profit margin of the transition in question with that of a homogeneous transaction. Usually this method is used when faced

with situations in which a related company buys semi-finished products or when services are provided to group companies.

For a correct use of this method it is essential:

1. determine a cost base (The cost base is composed of the sum of direct and indirect production costs.);
2. identify an adequate mark-up;
3. understand what the significant characteristics of the asset are for the purposes of the transaction.

In this method the qualities of the asset are important because we are faced with two situations:

1. the asset does not have characteristics or technical specifications that make it exclusive and different from other goods, in this case, in order to identify the mark-up, it is necessary to give greater importance to the comparability factors;
2. the asset has big differences compared to other goods; in this case it is necessary to make changes that take into account the differences found with respect to similar transactions.

The analysis of the relevant functions performed by the manufacturer and the determination of the reference market are fundamental. In the event that discrepancies affecting the margins are highlighted, it will be necessary to make changes to them, but if these differences are caused by inefficiencies or efficiencies, no changes will be made.

In the ministerial circular 32/1980 operational guidelines are exposed to the financial administration for the determination of the base cost, which can decide

whether to apply the cost accounting system used by the company, make changes to this system or use a different system.

The circular also highlights the systems for determining costs, among which we find:

1. *standard cost system*, estimate of costs incurred, assuming a certain level of production;
2. *marginal cost system*, given by the change in total costs in relation to the increase in the production of a single unit;
3. *full production cost system*, production cost which includes direct and indirect costs.

The full production cost system is the most used because it allows to avoid the analysis of the fixed and variable costs of the product, moreover it is the most efficient in identifying the level of cost coverage which is indispensable for not being considered out of the market.

The practice indicates that for the calculation of the cost basis, direct and indirect costs must be understood, but the operating costs of the company not directly attributable, which include general and administrative costs, must be excluded.

**Direct costs + indirect costs + mark-up = free competition price**

Given the characteristics of this method, this is suitable in situations relating to the sale of semi-finished products, which will have to be transformed again; to the provision of services or in contexts where a long-term supply contract exists.

### 1.3.2 Profitable transactional methods

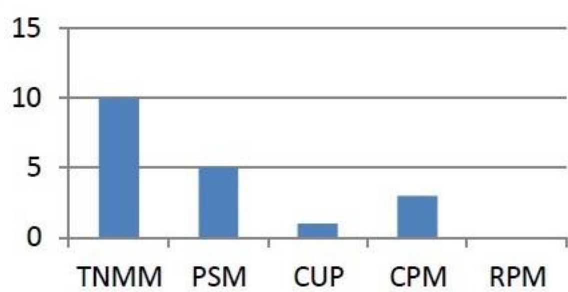
Profit methods aim to quantify the value of the transaction as a result of a process of dividing the "value" created by the company, which is represented by profit, unlike traditional methods that identify the normal value of the transaction starting from the definition of the price.

#### *1.3.2.1 Transactional Net Margin Method*

The TNMM, according to the OECD provision, "examines the net profit margin in relation to an adequate basis (costs, sales, assets) that a taxpayer realizes from a controlled transaction". From the provision, it is clear that the only difference with respect to the *Cost plus* and *Resale pricing* is the calculation object, i.e. the net margin, therefore the TNMM must be used in accordance with the conditions of application of traditional methods, in cases where there is no public information on gross margins.

The comparative analysis is the starting point for the identification of the correct net profit, implemented through internal comparison or, on a subsidiary basis, external comparison.

In the first "Bulletin of the *ruling* of international standard"[22], issued by the Agenzia delle Entrate on April 21, 2010, is indicated that in the period 2004-2009 this trend occurs[23]:




However, this trend does not seem confirmed by Ernst & Young's research data (2010) which still attest to a general preference for traditional methods over profitable methods.

Among the strengths, the doctrine stresses that the net profitability indices used by the TNMM are less sensitive to the differences in the characteristics of the products exchanged in the comparative transactions compared to the CUP method; again, unlike the gross margin used in the *Cost plus* and in the *Resale pricing*, the net margin of the TNMM is affected in a limited way by the functional differences between the compared transactions. In fact, the differences in functions are reflected in an increase in revenues on the one hand and in higher operating costs on the other, keeping the net profitability index almost constant.

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[22] The institution of ruling was introduced into Italian law by art. 8 of Legislative Decree No. 26 September 30, 2003. It is a negotiating tool addressed to companies with cross-border activities that intend to define in advance possible conflicts with the Financial Administration, including the quantification of the normal value for transfer pricing purposes through the Advance Pricing Agreements (Valente 2011).

[23] See "Bulletin of the international standard ruling", p.12, available on: <http://www.agenziaentrate.gov.it/wps/content/Nsilib/Nsi/ Documentation / Ruling + international /> Access date [10/07/2012].

Compared to the various advantages that the method seems to offer, there are several other factors that influence net margins, while they do not cause effects on gross margins, and can constitute weak points of the TNMM. In particular, the gross margins are conditioned by the division between fixed and variable costs of the company and by the level of absorption of fixed costs, i.e. the different degree of use of production capacity by the associated company and the independent company comparable.

### *1.3.2.2 The Profit Split Method*

The Profit Split Method is used in order to allocate the net operating profit (*net operating profit*) expected from the transaction being analysed in proportion to how it would be distributed among independent parties. Although based on a distribution of income between the entities involved in the transaction, this methodology cannot be assimilated and should not be confused with a different approach such as that of the "*non arm's length approach of profit allocation*", as previously outlined in the "*global formulary apportionment method*". In fact, through the method under discussion, the distribution of profits between the entities involved in the transaction is based on a scientific analysis as outlined below, while in the second case the division of profits is based on predetermined formulas[24].

In any case, this method can be used both as a function of an evaluation of the free competition price both *ex ante and ex post*.

[24] In questi termini si esprime V. Chand and S.Wagh "*The Profit Split Method: Status Quo and Outlook in Light of the BEPS Action Plan*", *International Transfer Pricing Journal*, 2014, November/December, secondo cui: "*the profit split method can be regarded as the best transfer pricing method that can align taxation in accordance with value creation.*"

This income methodology requires for its application of information from both related parties and, generally, it is applied when both parts of the transaction perform non-routine functions.

In particular, it is expected that it will be particularly used in the future also by the Financial Administrations[25]. This use would be advisable especially in the context of APA or ruling when the Financial Administration can obtain more information with reference to the companies concerned.

According to the OECD Guidelines, income would be distributed alternatively on the basis:

- To the so-called *contribution analysis*, according to which income is distributed based on the functions performed by related companies;[26]

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[25] M. Milewska & M. Hurtado de Mendoza, The Increasing Importance of Intangible Assets and the Rise of Profit Split Methods, International Transfer Pricing Journal, 2010, p. 162 ss, Journals IBFD.

[26] M. Pankiv, -*Contemporary Application of the Arm's Length Principle in Transfer Pricing*, Online Books IBFD (accessed 22 June 2017) : "*There are a number of approaches that may be used, as appropriate, for estimating the division of profits between related enterprises, based on either projected or actual profits, which would also be used by independent enterprises. The OECD Guidelines discuss two such approaches – contribution analysis and residual analysis – recognized by the OECD as not necessarily being exhaustive or mutually exclusive. Under a contribution analysis, the combined profits (the total profits from the controlled transactions under examination) would be divided between the associated enterprises based on a reasonable approximation of the division of profits that independent enterprises would have expected to realize from engaging in comparable transactions. This division of profits can be supported by comparable data, where available. In the absence of comparable data, it is often based on the relative value of the functions performed by each of the associated enterprises participating in the controlled transactions, therefore taking into account the value of their assets used and risks assumed instead. In cases where the relative value of the contributions can be measured directly, it may not be necessary to estimate the actual market value of each participant's contributions. The OECD Guidelines recognize the difficulty in determining the relative value of the contribution that each of the associated enterprises makes to the controlled transactions, and accordingly the approach will often depend on the facts and circumstances of each case. The OECD Guidelines suggest that the determination might be made by comparing the nature and degree of each party's respective contribution of differing types (e.g. provision of services, development expenses incurred, capital invested) and assigning a percentage based upon the relative comparison and external market data*."

- To the so-called *residual analysis*. This approach involves two distinct steps:

1. Determination of the remuneration of each party on the basis of a traditional method or the TNMM;
2. Breakdown of the profits (or losses) that remain in order to remunerate the functions that are not susceptible of easy evaluation (*intangibles*). The residual profit could be divided according to the share of intangible assets owned by the individual associated companies with respect to the total value of the intangible assets owned by both companies. At the same, marketing or research and development costs could be considered appropriate allocation keys.

The use of both methods is considered possible.

Above all, in the event that one of the related parties performs significant functions or, in any case, has non-comparable intangible assets, the adoption of the so-called *residual analysis* is preferable.

This methodology is based on two conceptual steps. The first step is aimed at remunerating the parties on the basis of the routine functions performed by both.

The second step is to distribute the residual profit between the two parties based on the different non-routine functions performed.

# CHAPTER 2 - TAX HAVEN: A LOOK AT THE EUROPEAN SITUATION

## 2.1 What is meant by tax haven

As a result of globalization and the liberalization of product markets (goods and services) and of production factors, in particular capital, the divergences between tax systems and tax rates adopted by the various countries on the income produced in their territory.

Among the various forms of international tax planning implemented in order to minimize the tax burden, the use of tax structures domiciled in countries with privileged taxation, the so-called **tax havens**, is of particular importance, even socially.

Often, in fact, the states that apply a privileged tax system are also equipped with very simplified corporate and banking law rules. In essence, tax havens are often corporate and banking havens and in some cases also criminal havens in the sense that in corporate and banking simplifications there is a criminal system that does not provide, for example, the crime of tax evasion, false accounting, *insider trading*, bribery and money laundering.

The fight against evasive practices, consisting in the transfer of the tax base to countries with a privileged tax regime, by means of *ad hoc* operations, without various economic reasons and aimed exclusively at the achievement of tax-related benefits, is a priority for countries with advanced taxation.[27]

When we talk about a "tax haven", we want to describe a state regulated by legislation designed to guarantee a low level of taxation. In a broader sense, it can be defined as a jurisdiction that allows you to evade or circumvent regulations that are more restrictive in another country.

"*A tax haven is a jurisdiction that allows you to evade or evade the laws and regulations of another country*"[28]

The question that arises spontaneously is: what profit does a state get if it implements an almost non-existent tax burden? The answer is simple: attracting capital from countries with high taxation which triggers a mechanism of this type:

↓ taxation ↑ foreign ↑ investments ↑ labour ↑ demand ↑ consumption production↑

[27] Manuale del transfer pricing / Piergiorgio Valente. - 2. ed. - [Milanofiori, Assago] : IPSOA, Gruppo Wolters Kluwer, 2012

[28] understanding finance, tax havens, edited by andrea baranes, cultural foundation responsibility ethics ONLUS

This type of taxation makes it convenient to establish the seat of a business in these countries. Tax havens can be classified into four categories:

1. pure tax haven: it imposes low taxes and guarantees absolute banking secrecy, not exchanging information with other states;
2. no taxation on foreign income: only income produced internally is taxed;
3. low taxation: low taxation on income wherever formed;
4. special taxation: tax regime comparable to that of countries with "normal" taxation, but which allow the establishment of particularly flexible companies.

The OECD, in the "Harmful Tax Competition: An Emerging Global Issue" report, sets the key points that allow you to identify a harmful tax regime that defines for competition:

- low or almost no taxation;
- taxation with high disparity between income generated internally and externally;
- lack of transparency of the transactions carried out;
- lack of exchange of information with other countries;
- high ability to attract companies which, by not exercising an effective economic activity in the tax haven, have the objective of concealing capital movements.

Therefore, if on the one hand, they cause damage to the market, on the other hand, their total elimination would cause damage to companies that carry out formally legal activities: companies would have to pay more taxes, there would be less availability of capital which would affect economic development of the company itself but more money available to states in the short term. In the long run, however, if companies are unable to develop, because they are suffocated by taxation, they will not make investments, employment would reduce, therefore consumption, production would fall as well as profits and consequently there would be a lower taxable income which results in lower tax revenue that is harmful to the state.

It is therefore a thorny situation and the right balance needs to be found between the various situations, with greater regulation and harmonization of the tax system.

To understand what we are talking about, assume the following situation:

- Company ITALY: multinational that sells glasses with registered office in Italy;
- BULGARIA company: company that physically produces the goods, resident in a country with low labour costs, such as Bulgaria;
- CAYMAN company: subsidiary of an Italian company residing in a tax haven, such as the Cayman Islands.

The goods are produced by BULGARIA at a cost of 10 and are sold by ITALY to Italian consumers at 100. If the passage were to be made directly from BULGARIA to ITALY, the latter would have a profit of 90 and would have to pay taxes on this profit with the rates provided for in Italy.

But the ITALIA company sets up a CAYMAN subsidiary in a tax haven. It will be the latter to buy assets from BULGARIA at 10 and resell them in turn to the parent company ITALY at 100. At this point, the profit of 90 is realized in the tax haven with irrelevant taxation of profits. In Italy there is no profit because the parent company bought at a high price, for example, 100 and resells at a low price, let's assume 110, generating a profit of 10, so few taxes to pay. If ITALY bought from CAYMAN at 110, it would ask for the exercise at a loss and could even benefit from tax breaks on the use of losses.

It has been shown that the existence of tax havens incentives companies to implement strategic plans aimed at transferring taxable material to these destinations while enjoying lower taxation, this implies the need to adequately regulate these cases.

The concept of free competition combined with that of a tax haven therefore represent the heart of the transfer pricing system.

## 2.2 Tax evasion and avoidance

Directly linked to the definition of tax haven are the concepts of tax **avoidance and evasion**. In our legal system, there is no clear distinction between the two cases. So much so that while the science of finance puts them in analogy, the two concepts differ in tax law.[29]

Tax **evasion** always takes on a negative meaning as it is connected to the production of income or assets by a person legally entitled to the right and the consequent failure to pay the tax to the creditor (financial administration, etc.). It is substantiated, therefore, when the assumption of the tax has already occurred. For this peculiarity, it is always sanctioned administratively by the tax law and, in some countries, also by criminal law when connected to the commission of other criminal acts.

**Avoidance**, on the other hand, constitutes a behaviour which, while respecting the tax legislation, is aimed at exploiting the deficiencies of the legal system, in such a way as to reduce or even eliminate a tax obligation without violating the law and

[29] AA.VV., Materials of International Tax Law, op.cit., p. 349.

without, therefore, incur any sanctions. This is a fraud of a tax law for the sole purpose of reducing the tax burden.

To counter the phenomenon of avoidance, the legislator has acted, both on the level of the definition of tax cases and on that of the tax assessment, by inserting art. 37 bis of D. P. R. 600/1973.

According to this last decree, elusive behaviour can be countered by using three mechanisms:

- introduce a wide range of legal presumptions, aimed at identifying the taxable fact;
- abrogate or modify excessively permissive tax laws;
- apply administrative or criminal sanctions to elusive phenomena.

Therefore, the *transfer pricing* mechanism is nothing more than the implementation of an international elusive practice between companies which redistribute profit margins in countries with more favourable tax regimes by allocating profits, if not even part of the corporate assets, so that they are higher where the tax levy is lower.[30]

[30] The phenomenon was fought with a relative presumption of avoidance, that is, proof to the contrary by the taxpayer is admitted

Therefore, passive operations carried out by companies resident in Italy, which have involved the payment of expenses in favour of foreign companies that have tax domicile in States or territories that benefit from a favourable tax regime, or active operations with a value clearly lower than the free competition price. The purpose of this intervention is to avoid that, through costs / revenues inconsistent with market logic, if not fictitious, the income produced in Italy is subtracted from taxation in our country.

As for the problem of *tax evasion,* however, it has always been present at all times in all the states of the planet.

The term tax evasion, from the more intriguing Anglo-Saxon sound "*tax evasion*", defines "*any commissive or omissive fact of the taxable person who, having established the prerequisite for the tax, subtracts, in whole or in part, from the related obligations established by law* ".[31]

Studies on tax evasion have always tried to highlight the causes that induce a subject to such conduct. The motives to circumvent the tax law find political, economic, legal and psychological inspirations. These behaviours lead to the formation of an illicit apparatus with consequent reduction and / or cancellation of the tax and the

[31] Lovisolo A., Tax evasion and avoidance, in Dir.Prat.Trib., Milan 1984

impossibility, for the institutions in charge, of having an exact view of the taxable amount.[32]

Tax evasion depends - in our tax system and generally - on the chronic information imbalance between the taxpayer and the financial administration. This misalignment was accentuated by the 1973 tax reform which, sanctioning the transition from a static economic system - governed by axiomatic legislation (*by principles and concepts*) to a highly dynamic one - guided by analytical legislation (*by types and subtypes*), ascertained all the inadequacy of the inquisitorial method.

It is relevant as an anti-legal case, since it does not reveal the economic and / or financial advantage that may be acquired by the taxpayer but rather the damage to the interest of the institution. It arises from real fraudulent manifestations such as:

a) use of false or forged documents;
b) issue and use of invoices relating to wholly or partly non-existent operations;
c) indication of false personal details in accounting documents;
d) alienation of invoices or other documents which must be kept by law;
e) other fraudulent behaviours that may hinder the assessment of the facts by the tax authorities.

[32] Cipollina S., The civil law and the tax law: the problem of tax avoidance, CEDAM, Padua 1992, p. 135

Evasion, given its nature, must be countered with a real *intelligence activity* and with the typical tools of police activity, as it can constitute significant criminal offenses.[33]

In modern economies, even if the fight against tax evasion has become more and more qualified and consistent, and tackled internationally, the phenomenon is increasingly difficult to marginalize due to the unreachable expansion of markets.

In any case, the States are masters of their destiny in distributing the tax burden in a balanced way. Logically, the more the tax systems are greedy, unfair and arbitrary in the distribution of obligations, with complex regulations, the greater the resistance that will be placed on them by the subjects affected by the taxes. In order to obtain less evasion, it is desirable to allocate the expense with simple requirements and clear rules.

[33] AA.VV., International Tax Law Materials, op.cit., Pp. 347-48

## 2.3 Countries with privileged taxation

The term tax haven[34] is commonly used to identify countries and territories whose tax regimes show significant privileges, where, for example, there are no income taxes or are provided to a limited extent (es the Bahamas and Bermuda). In the so-called "*Offshore centres*" income taxes are applied exclusively with reference to income from internal sources, and are not applied to income from foreign sources, or preferential tax regimes are envisaged for certain types of companies or for income deriving from the performance of certain economic activities ( e.g. Luxembourg, Ireland). In many countries, such as Italy, tax havens are indicated in specific lists known as "**Blacklists**".

[34] See G. Marino, "Tax havens: application problems and proposed amendments", in Uckmar-Garbarino (edited by), "Tax aspects of international transactions", Milan, 1995; F. Lisi- G. Murano-A. Nuzzolo, "The new tax regime for transactions with tax havens" Rimini, 2004; RA Johns, Tax havens and offshore finance: a study of transnational economic development, London, 1983; B. Bartoloni-G. Sbarra, "Paradisi tax and banking ", in Riv. GdF, 1996; M. Bartimmo, "Guide to the tax haven", in Comm. Int., 1992, n. 22; Id., "Tax havens: the Italian black list", in Comm. Int., N. 14/1992; Id., "Anti-tax havens legislation", in Comm. Int., 1992, n. 2.; G. Pezzuto, "Tax and financial havens: international tax planning, international investigations of the tax authorities and the judiciary", Milan, 2001; J. Blum-M. Levi-T. Nylon- P. Williams, "Financial Havens, Banking Secrecy and Money Laundering", in Technical Series, New York, 1998, n. 8; F. Attac, "Tax havens: or illegal finance", Trieste, 2001; Luppi, voice "Tax havens", in Enc. Jur. Treccani, XXX, Rome, 1993 .; MP Hampton- P. Abbott Jason, "Offshore finance centers and tax havens: the rise of global capital", Houndmills, Macmillan, 1999

More specifically, a blacklist includes those countries which, after a careful analysis carried out by international organizations linked to the OECD, demonstrate that they possess some of the identifying factors of tax havens previously explained.

The listing process follows three stages (*European Commission, 2016*):

1. The commission identifies a group of countries for which an in-depth analysis would be required to obtain more information about them;
2. Member states decide whether it is actually necessary to conduct an analysis relating to the selected countries;
3. The Commission gives its opinion on the countries that should be blacklisted and the member countries, based on this judgment, make the final decision. The registered country will be removed from the list only when it is able to comply with international standards regarding the exchange of information.

The more times a state appears on a blacklist, the more widespread the opinion is that this state constitutes a tax haven. The anti-avoidance legislation aims to counteract those behaviours aimed at transferring income to foreign countries with elusive intentions.

It may be income received in a lawful manner, but with the deliberate aim of avoiding tax and social legislation: paying less taxes and keeping the company's profits hidden.

The phenomenon of the establishment of foreign companies in countries with privileged taxation, by subjects residing in countries with high taxation, in order to reduce their tax burden, has become very widespread in recent years and constitutes a very serious problem for most of industrialized countries. Tax havens, in addition to directly hitting the public coffers of the most industrialized countries, have a further negative impact. Multinationals, through illegal tax savings, exercise unfair competition against those companies that do not exploit the same mechanisms, thus favouring larger companies. This constitutes a further incentive to evasion for other companies.

The challenge to tax havens has become an operational priority. After the G20 of 2009, the OECD prepared three different types of lists:

- *blacklist* (list of states, territories or jurisdictions that have not committed to respecting international standards);
- *grey list* (list of states, territories or jurisdictions that have committed themselves to respecting international standards but which, to date, have signed less than twelve agreements that comply with these standards);

- *white list* (list of states, territories or jurisdictions that have followed international rules, stipulating at least 12 agreements compliant with these rules).[35]

The Grey Lists are working to change their tax system, adapting it to the international one based on clear rules and adequate control tools. The commitments undertaken between the States are aimed at the progressive cancellation of the Blacklist through decriminalization measures in favour of the return of capital and the tightening of the sanctions against banks or companies that have relations with the States present in the Blacklist. The milestone achieved also thanks to the commitment of the OECD marks an important turning point that will require a demanding study of strategies to favour the repatriation of hidden capital and the pursuit of supervision so that financial internationalization systems are translated into tax planning processes legitimate in order to avoid the concealment (evasion) or the artificial decrease of the income charged to the consolidated financial statements of the company through techno-legal constructions without effective economic motivation. To combat harmful tax competition, the OECD had already in 1998 addressed to Member States recommendations aimed at intensifying

[35] see G. Di Muro, "OECD: zero black list, two new entries in the white ", published on 4 June 2010 on FiscoOggi

international cooperation and dismantling those tax measures that undermine the integrity of tax systems and the trust of taxpayers.

## 2.4 Fighting the tax havens in Italian legislation: privileged tax regimes pursuant to art. 47-bis of the tuir

With the issue of Legislative Decree 29.11.2018 n. 142, Directive 2016/1164 / EU (so-called ATAD I) has been transposed into Italian law, concerning the rules against tax avoidance practices that directly affect the functioning of the internal market, as amended in relation to hybrid mismatches with third countries by the Council Directive 2017/952/EU.

It should be noted that the ATAD I Directive is part of the so-called "*Anti-Tax Avoidance Package*"[36] containing a contrast to tax avoidance practices that directly affect the correct functioning of the internal market and is an instrument introduced by the European Commission with the dual purpose of:

[36] The "Anti Tax Avoidance Package" is part of the European Commission's ambitious project for a fair, simple and more effective taxation of companies within the European Union. In order to make the "Anti-Circumvention Package" effective on 20.6.2016 the European Council adopted the Directive (EU) 2016/1164 (so-called "ATAD I")

- induce the Member States to envisage harmonized measures aimed at combating tax avoidance practices;
- align national regulations with OECD recommendations in relation to the BEPS (*Base Erosion and Profit Shifting*) project.[37]

The main objective of the transposition of European legislation by the Italian State was to strengthen the measures aimed at making effective the principle accepted internationally according to which every company is required to pay taxes in the place where the profits and value are generated. [38]

Among the most important innovations, made by Legislative Decree 142/2018, the introduction of art. 47-bis of the TUIR containing the *new requirements necessary for the identification of the so-called "Countries with privileged taxation"*. To this end, the regulation refers to the actual or nominal level of taxation, depending on whether or not the shareholding is controlling. [39]

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[37] The objective pursued by the OECD through the preparation of 15 Actions is to identify unique and transparent rules, shared internationally, aimed on the one hand at countering the policies of "aggressive tax planning" and on the other a avoid shifting the tax base from countries with high taxation to others with low or no tax burden on the part of multinational companies. For further information see Valente P. "International tax avoidance", cit., P. 1904 ff .; OECD "Addressing Base Erosion and Profit Shifting", of 12.2.2013.)

[38] Legislative Decree 142/2018 fulfills the obligations of implementation of the Directives envisaged for the Member States. For further information on the ATAD I Directive and the subsequent amendments made by the ATAD II Directive, see Valente P. "Tax policy manual of 'European Union and supranational organizations ", cit., P. 538 et seq

[39] In the Explanatory Report accompanying the Scheme of Legislative Decree 142/2018 it is explained that: "(i) The new article 47-bis introduces a different requirement for the identification of countries with privileged taxation, referring to the actual or nominal level of taxation, depending

The new legislative provision provides that the tax regimes of states or territories other than those belonging to the EU or those belonging to the European Economic Area with which Italy has entered into an agreement that ensures an effective exchange of information are considered privileged, distinguishing according to whether or not the requirements relating to controlling shareholdings are integrated.

In particular:

a) in the event that the company or entity not resident or not located in Italy is subject to *control*, pursuant to art. 167 paragraph 2 of the TUIR, by a participant resident or located in Italy, the regimes in which the condition referred to in paragraph 4 lett. a) of the same art. 167 of the TUIR (i.e. non-resident-controlled subjects subject to effective taxation lower than half of that to which they would have been subject if resident in Italy);
b) in the case of *lack of the control requirement*, those in which the nominal level of taxation is less than 50% of that applicable in Italy are qualified as privileged tax regimes.[40]

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on whether or not the shareholding is controlling, according to the same notion valid for the purposes of the CFC regulations. This different treatment derives from the opportunity to provide for a simplification criterion, that of the nominal rate, for identifying the level of taxation in the case of non-controlling shareholdings for which it is more complex for the participant to find the information necessary to determine the actual level of taxation ".)

[40] In the latter case, paragraph 1 letter b) of art. 47-bis of the TUIR specified that special regimes must also be taken into account "that are not structurally applicable to the generality of subjects carrying out similar activities of the company or of the investee body, which are usable only

Unlike the previous version of art. 167 paragraph 4 of the TUIR, paragraph 1 letter. b) of art. 47-bis of the TUIR, provides a definition of "special regime". [41]

Specifically, the national legislator believes that those regimes that:

- they are not structurally applicable to the generality of subjects carrying out similar activities of the company or entity involved;
- are usable only according to the specific subjective or temporal characteristics of the beneficiary.

Also included are those schemes which, while not directly affecting the rate, provide for exemptions or other reductions in the tax base suitable for reducing the nominal levy below the aforementioned limit. The rule also specifies that paragraph 1 letter. b) of art. 47-bis applies "*provided that, in the event that the special regime*

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according to the specific subjective or temporal characteristics of the beneficiary and that, while not directly affecting the rate, provide for exemptions or other reductions in the tax base capable of reducing the nominal levy below the aforementioned limit and provided that, in the event that the special only concerns particular aspects of the overall economic activity carried out by the foreign subject, the activity included in the scope of application of the special regime is prevalent, in terms of ordinary revenues, compared to the other activities carried out by the aforementioned subject "

[41] In the Explanatory Report accompanying the Scheme of Legislative Decree 142/2018, the legislator highlighted how: "the particular tax treatment that the foreign system recognizes only when certain extraordinary or specialty requirements, such as those connected to a specific subjective status or to a particular territorial location of the taxpayer, or to the temporary nature of the favorable fiscal discipline. Basically, by "special regime" we can mean the fiscal discipline applicable to certain subjects according to the type of activity exercised (for example industrial activities carried out in "free zones"), or of the particular categories to which they belong (for example "micro-enterprises"), or by virtue of ad hoc agreements or provisions of the foreign financial administration, where in the foreign legal system there is an ordinary, structural and different regime applicable to other co employees who carry out similar industrial, commercial or financial activities ".

*concerns only particular aspects of the overall economic activity carried out by the foreign subject, the activity included in the scope of application of the special regime is prevalent, in terms of ordinary revenues, with respect to the other activities carried out by the aforementioned person*".

The legislator has ordered the non-applicability of the rules relating to the privileged tax regimes upon the occurrence of *two exemptions* provided for in paragraph 2 of art. 47-bis. These specifically in the circumstances in which the taxpayer proves alternatively that:

a) the non-resident person carries out an effective economic activity, through the use of personnel, equipment, assets and premises; or
b) the shareholdings do not have the effect of locating the income in states or territories with a privileged tax regime, pursuant to art. 47-bis paragraph 1.

In order to recognize the presence of two exemptions, the legislator allows the taxpayer to propose a ruling pursuant to art. 11 paragraph 1 letter. b) of Law 212/2000.

### *2.4.1 Transfer pricing in tax havens*

The discipline of transfer pricing is closely correlated with the concept of tax haven. The term "*transfer pricing*" means the control of the fees applied to commercial transactions between companies belonging to the same group but resident in different countries, in order to verify that prices have not been determined in such a way as to "*optimize*" the load tax, that is, moving taxable matters to countries with reduced taxation.

Over 50% of world trade passes through a tax haven, there is a gigantic volume of trade made without any productive purpose, but only to evade taxes and hide profits and income.

Among the various mechanisms used, the most harmful is precisely the fraudulent use of *transfer pricing*.[42]

In fact, in order to concentrate profits as much as possible in countries with a privileged tax regime, the company resident in a country with an onerous tax

[42] According to the OECD, about two thirds of international trade takes place within companies and concerns transactions between different branches or subsidiaries of transnational companies, while only a third concerns the actual sale of products or services on the market. In other words, most import-export operations take place between two subsidiaries of the same multinational company: a branch buys or sells products to another branch in a different country. On this point see Andrea Baranes, "Understanding finance - Tax havens", edited by Cultural Foundation Responsibility Ethics Onlus, 1 December 2009.

regime, for example in Italy, which purchases raw materials or goods from an associated or subsidiary company resident in a low-tax country will have an interest in agreeing to pay an artificially high price so that the Italian company can reduce its profit and the foreign company, which, as mentioned, resides in a country with a privileged tax regime, will be able to achieve a significant profit. The effect, therefore, that is achieved with this mechanism is to transfer a portion of income that should have been subject to higher taxation to the low-tax country.

The abuse of the mechanism, legitimate in itself, of transfer pricing is even more effective and less controllable when it refers to the transfer between different branches of intangible assets to be recorded in the financial statements, such as logos, trademarks, patents and others: it is sufficient to register the trademark in a branch specifically set up in a tax haven.

All production plants and branches, to use the company trademark, will have to pay the rights (*copyright*) to the branch where the trademark was registered in this way, guaranteeing, in a simple and almost automatic way, a continuous transfer of money from the plant's production to the branch created in the tax haven with the sole purpose of "*guarding*" the brand.

Considering then that every company, within very elastic limits, is free to attribute to its logo the value it deems most appropriate, it is possible to understand the strength of such a financial mechanism.[43]

## 2.5 Tax differences: The European situation

Profit shifting, or the shifting of profits to pay less taxes. Many of the protagonists of this practice, which passes *through an "aggressive" fiscal policy with facilitated taxation regimes*, are in Europe. Some small countries namely, **Luxembourg, Ireland, Holland, Cyprus, Belgium and Malta** are the six European champions of the tax haven.

The fact that they are small allows them, in a common market, to attract many investments with favourable taxation, losing little revenue compared to what they recovered with fiscally aggressive policies. What they technically allow is tax avoidance, but it is nothing more than fiscal dumping contrary to the principle of

[43] A case similar to that of the abuse of transfer pricing is so-called mispricing: the transaction, in this case, does not take place between different branches of multinational companies, but artificially increasing or decreasing the price of a product or raw material destined for the market or for export. To give an example, in some cases African diamonds were exported at a price that is only a small fraction of their real value (between 1993 and 1997 Guinea reported the export of 2.6 million carats of diamonds to Belgium, at an average price of $ 96 per carat.

solidarity between the members of the Union provided for by the treaties. It all depends on the mother-daughter directive, adopted to prevent the profits of multinationals from being taxed twice between the parent company and the subsidiary company when these two belong to different EU member states. But if I work in Italy, I send the profits to the Netherlands and the Netherlands does not tax me, that's it. It is therefore necessary to impose a system of rules that makes tax legislation more homogeneous so as not to distort the allocation of resources within the Union.

To allow the common market to function efficiently, the European Union has therefore harmonized various aspects of the taxation of consumption and the raising of capital.[44] Strong differences instead they remain in the taxation of income, particularly in that of corporate income on which some countries impose more accommodative regimes than others. This allows some countries to practice particularly favourable tax regimes. The Commission classifies them as "*fiscally aggressive countries*", but this has no practical consequence, if not through a generic "name and shame" process.[45]

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[44] See the article by Tommaso di Tanno published on lavoce.info on 09/27/16: https://www.lavoce.info/archives/42973/come-avitare-un-altra-caso-apple/.

[45] On the other hand, there are stronger consequences for countries defined as "tax havens" or, more precisely, "non-cooperative countries for tax purposes." These are eight countries, all non-EU: American Samoa, Fiji, Guam, Oman, Samoa, Trinidad and Tobago, Virgin Islands and Vanuatu. These countries are considered tax havens on the basis of three criteria: level of tax transparency, ie adherence to the information exchange system for tax purposes, fair taxation, ie a level of

### *2.5.1 Evade the tax authorities*

As mentioned in paragraph 2.2, the phenomenon of tax avoidance is particularly relevant. In this regard, there are three mechanisms for paying less taxes:

1. The *first* is to establish the tax office where the taxation is lowest: it is enough to prove that the company is "resident" in that country and, that is, that the meetings of the Board of Directors are held there.
2. The *second* is that of "transfer pricing", economic transactions (often fictitious) within a multinational group (such as loans, sale of trademarks or patents, insurance services), all managed by a subsidiary based in a tax haven. Fiat did so with Fiat Finance & Trade, the Luxembourg subsidiary of FCA which for 15 years provided financial services to other companies in the group, a sort of bank with lots of profits that the European Court sentenced to pay 23.1 million euros of back taxes to Luxembourg, the result of an undue tax advantage thanks to an ad hoc agreement with the Grand Duchy.
3. The *third* is what many digital companies adopt: invoicing everything in a foreign country with facilitated taxation. As do Booking, Google and Uber,

taxation consistent with the inflow of investment into the country relative to real economic activity, and a zero corporate tax rate.

whose offices are in the Netherlands and there they also invoice the services they sell in Italy. Tax advantages often pass through the tax ruling[46], as the six EU countries do for example. Formally it is a way for multinationals to request clarifications in advance from the tax authorities to avoid subsequent disputes, but in fact they are private agreements on taxation regimes lower than those required by law. Like the Lux Leaks scandal involving Luxembourg which for years has guaranteed tax discounts on financial flows through secret agreements to 300 companies around the world (31 were Italian).

### *2.5.2 The European champions of avoidance*

*Netherlands, Cyprus, Malta, Luxembourg, Belgium and Ireland* guarantee various benefits to the companies based there. Multinationals are allowed to define ad hoc tax treatments through tax rulings such as those of Starbucks in the Netherlands, FCA and Amazon in Luxembourg and Apple in Ireland, which have come under investigation by the European Commission. According to the Tax Justice Network's "Corporate Tax Haven Index 2019" study, the rates that each country declares in

[46] See article from Il Sole 24 Ore: https://www.ilsole24ore.com/art/sempre-piu-tax-ruling-cosi-stati-ue-si-fanno-concurgo-fiscale-AET3DNHE.

some cases are very different from those actually applied. Italy, for example, has a 28% rate which drops, at the maximum discount, to 26.9%. This is what happens in the vast majority of EU countries. But not in Belgium (where the formal rate goes from 30% to 3%), in Cyprus (from 13% to 0%), in Ireland (from 13% to 0%), in Luxembourg (from 26% to 0%), Malta (35% to 5%) and the Netherlands (25% to 2.44%).

These European tax havens guarantee companies a tax burden that is less than 5%, but thanks to the amount of profits shifted, they manage to collect, in proportion, more than normal countries. The revenue collected from corporate income tax is, according to Eurostat, around 6% of GDP in Luxembourg, 5.5% in Malta and Cyprus and around 4% in Belgium and the Netherlands. In Italy it is 2%. But even more impressive is the volume of foreign direct investment entering these countries. In Luxembourg they represent 6,000% of GDP, in Malta 1,500%, in Cyprus 1,000%, in the Netherlands 550% and in Ireland 200%. Then there are the cases of Bulgaria and Hungary which already guarantee basic rates of 10 and 9%. [47]

[47] Corriere della sera: https://www.corriere.it/dataroom-milena-gabanelli/tasse-evasione-ecco-come-sei-paesi-europei-sottraggono-all-italia-65-miliardi-euro/84ad216c-baf3-11ea-9e85-8f24b6c04102-va.shtml

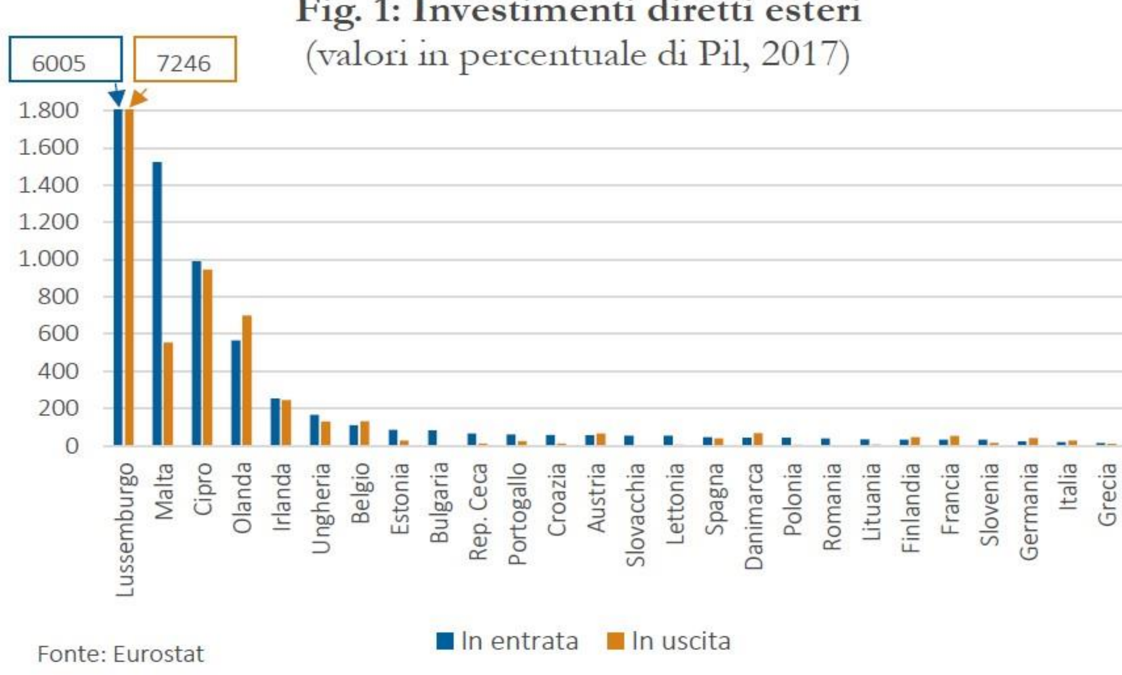



**Fig. 1: Investimenti diretti esteri**
(valori in percentuale di Pil, 2017)

Fonte: Eurostat

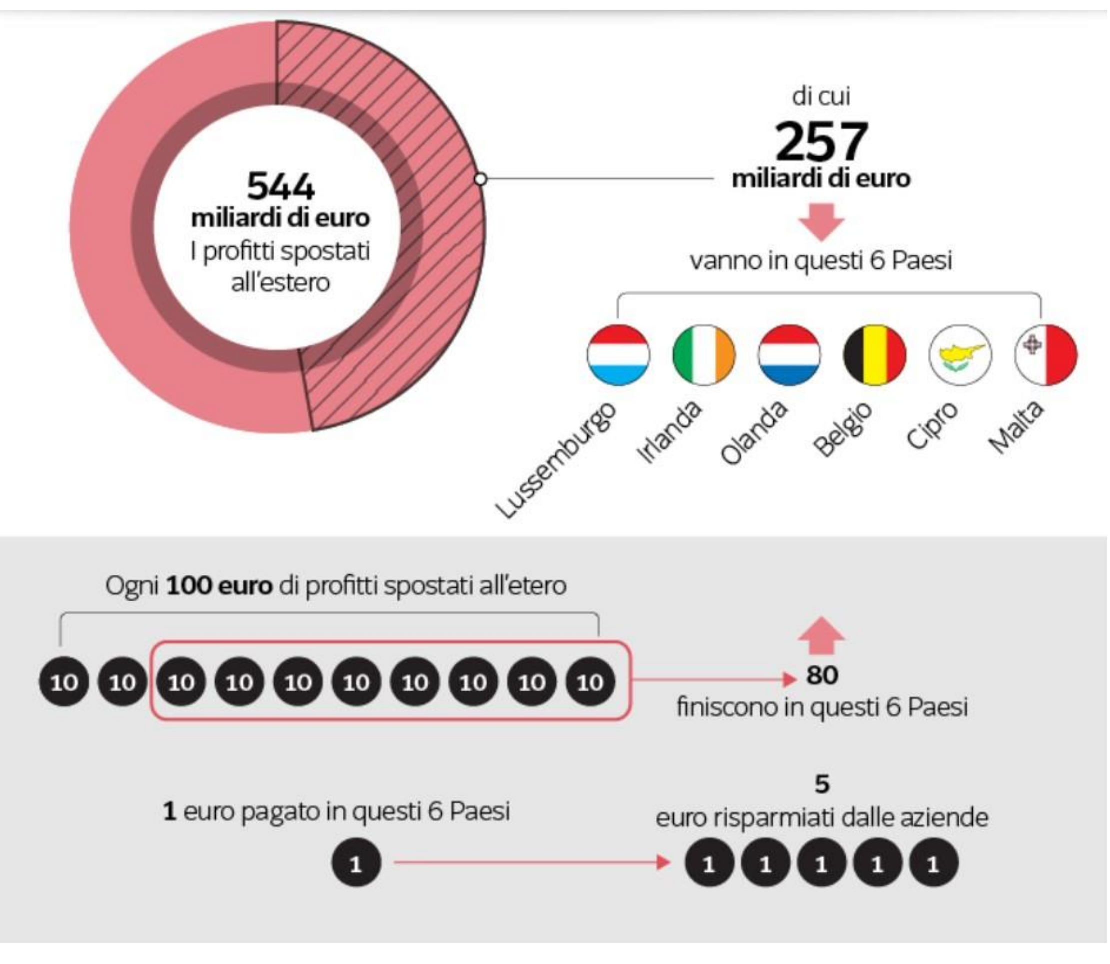
**Fig. 2: Gettito raccolto da tassazione reddito società**
(valori in percentuale di Pil, 2018)

Fonte: Eurostat

### *2.5.3 How much is profit shifting worth?*

Profits moved abroad all over the world reach 544 billion euros: 36.23% of the 1,500 billion euros made by multinationals through their foreign subsidiaries. This is stated in the scientific paper "*The missing profits of Nations*"[48]. Of these 257, 47.24%, land in Luxembourg, Ireland, the Netherlands, Belgium, Cyprus and Malta. The percentage then rises to 52.29% if we consider only the companies operating in the countries that are members of the OECD, the Organization for Economic Cooperation and Development: 207 billion out of 395.85 in profits. The percentage rises even more if we consider only European countries: *"For every hundred euros of profits moved out of a single European country, eighty end up in the tax havens of the EU itself"* [49]

[48] published by the National Bureau of Economic Research of the United States, considered the most authoritative centre for economic research in the world and signed by the French scholar Gabriel Zucman, professor at Berkeley, together with Ludvig Wier and Thomas Torslov of the University of Copenhagen.
[49] Corriere della sera: https://www.corriere.it/dataroom-milena-gabanelli/tasse-evasione-ecco-come-sei-paesi-europei-sottraggono-all-italia-65-miliardi-euro/84ad216c-baf3-11ea-9e85-8f24b6c04102-va.shtml


544
miliardi di euro
I profitti spostati all'estero
di cui
257
miliardi di euro
vanno in questi 6 Paesi
Lussemburgo
Irlanda
Olanda
Belgio
Cipro
Malta
Ogni 100 euro di profitti spostati all'etero
10 10 10 10 10 10 10 10 10 10
80
finiscono in questi 6 Paesi
1 euro pagato in questi 6 Paesi
1
5
euro risparmiati dalle aziende
1 1 1 1 1

### *2.5.4 The Netherlands case*

Directly connected with the IKEA case which will be explained in the final chapter of the thesis, Holland is one of the most aggressive on the fiscal aggression front. Antitrust is headquartered, which deals with the affairs of over 2,812 European and global companies: legal assistance, accounting, administration, financial transactions, intellectual property and treasury. In addition, giants such as eBay (with two branches), Uber (with 16 companies), Google, Nike, Ikea, Starbucks reside.

By crossing the resources (employees, offices) that these companies possess in the Netherlands, and the profits they make here, it turns out that every single Dutch employee generates profits of 530 thousand euros a year, against the European average of 60 thousand (with Italy and Germany aligned around 42,000 and France to 33,000). Significant tax savings is the central theme: The Hague[50] does not tax incoming and outgoing dividends, capital gains from the sale of company shares, interest and royalties. Everything remains, legally, in the pockets of the owners, who are then facilitated to move their capital to other tax havens outside the EU. In

[50] is a city of about 500 000 inhabitants of the Netherlands, seat of the parliament and the state government. The city is home to all foreign embassies in the Netherlands and hosts numerous international organizations, such as the International Court of Justice, the main judicial body of the United Nations, the International Criminal Court and Europol. Wikipedia: https://it.wikipedia.org/wiki/L%27Aia

addition, the Dutch law, on the subject of corporate control, allows to protect yourself from takeovers by giving the opportunity to exercise total control over the company even with a minority stake. For example, Exor, the Agnelli financial company that emigrated to the Netherlands in 2016, owns 28.98% of FCA but has 42.11% of the votes, just as it controls 26.89% of Iveco but has 41, 68% of the votes and 22.91% of Ferrari but has 32.75% of the votes. Caltagirone did the same with Cementir and Berlusconi with Mediaset.[51]

It is a legal way to get out of the free market that has made more or less convenience companies flourish: at least 15,000, according to a report from the Ministry of Finance to the Dutch Parliament in 2018, with a flow of money, in terms of turnover, which goes from 4,500 to 5,000 billion euros every year. Of this mountain of money, only 199 billion are taxed. From the EU member states alone, the Netherlands sucks up to 72 billion euros of corporate profits, of which more than 3 from Italy[52]. In the end, according to a report by the European Parliament, 11.2 billion euros go to the Dutch tax authorities (over 40% of the total revenue on business profits in the country) that should have ended up in the coffers of other

[51] Corriere della sera: https://www.corriere.it/dataroom-milena-gabanelli/tasse-evasione-ecco-come-sei-paesi-europei-sottraggono-all-italia-65-miliardi-euro/84ad216c-baf3-11ea-9e85-8f24b6c04102-va.shtml

[52] according to the estimates of economist Gabriel Zucman

states. For this reason, the Tax Justice Network [53], which ranks the main havens tax for multinationals, after the British Virgin Islands, Bermuda and Cayman.

### *2.5.5 The damage to Italy*

In 2019, Italy would have lost, according to Zucman [54], almost 24 billion dollars in profits (19% of revenues from the taxation of multinational corporations), 21 of which would go to EU countries. 2 billion ended up in Belgium, 8 in Cyprus, 5 in Ireland, 9.6 in Luxembourg, 0.7 in Malta and 3.4 in the Netherlands. Another 3 ended up in non-European tax havens, of which 2.2 in Switzerland. All this translates into 6.6 billion dollars less in taxes: almost 10% of what interest on public debt cost us in 2019. But Italy is in good company: corporate profits drained abroad

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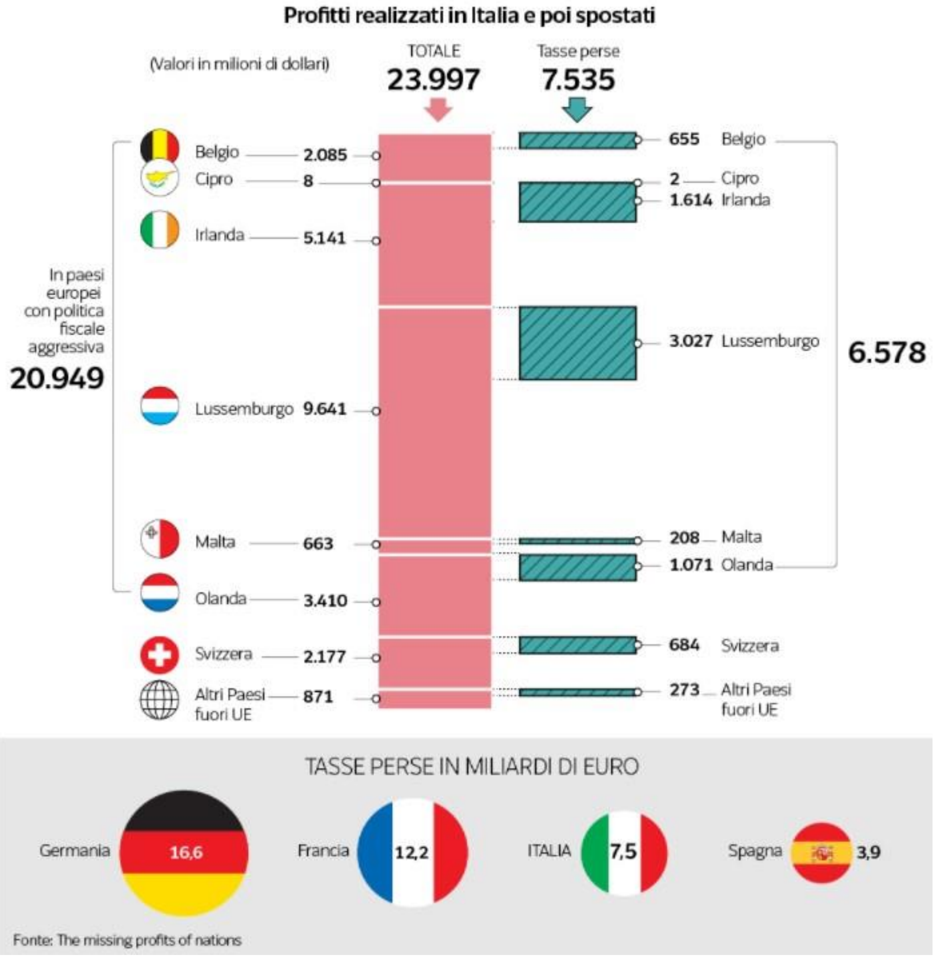
[53] The Tax Justice Network (or TJN), is an independent international network, launched in 2003, focused on research, analysis and advocacy in the area of international tax and financial regulation, including the role of tax havens. TJN maps, analyzes and explains the impacts of tax evasion, tax avoidance and tax competition; and supports the engagement of citizens, civil society organizations and policymakers with the aim of a more just tax system, https://en.wikipedia.org / wiki / Tax_Justice_Network) placed the Netherlands in fourth place among the countries of the Corporate Tax Haven Index 9 (https://www.taxjustice.net/tag/corporate-tax-haven-index/

[54] See "The missing profits of nations", Torslov, Wier and Zucman, Nber, 2018.

amount to 48.4 for Germany and 28.2 for France, for a loss of tax revenue that is worth 14.3 for Berlin and 9.44 billion for Paris. [55]




[55] Corriere della sera: https://www.corriere.it/dataroom-milena-gabanelli/tasse-evasione-ecco-come-sei-paesi-europei-sottraggono-all-italia-65-miliardi-euro/84ad216c-baf3-11ea-9e85-8f24b6c04102-va.shtml

### *2.5.6 Can the Netherlands be considered a Tax Haven?*

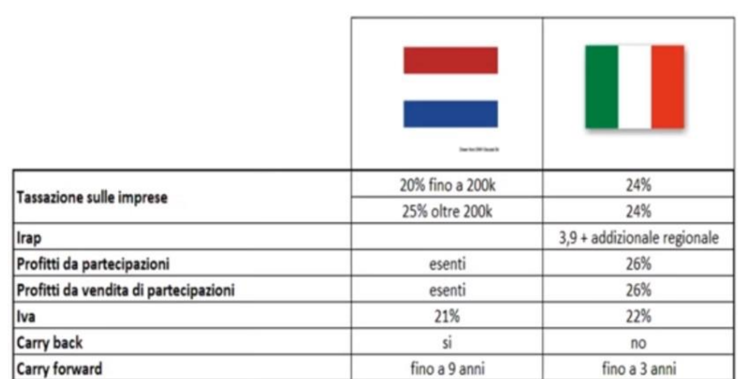
Based on what has been said so far, this question arises spontaneously, therefore with a brief analysis I will show that the answer is NO.

In the updated list of non-cooperative countries for tax purposes (the so-called blacklist), extrapolated from the European Official Gazette no. 386/2019, the name of Holland does not shine through.

However, some recent papers published by the European Commission and the European Parliament show that Holland is among those countries that adopt an aggressive tax policy, which is why many companies, including Italians, have moved their tax offices.

The Total Tax Rate is defined as the total of the sum of all that is subtracted from the profits of companies or from individual income. The graph shows that the difference between the two states (Italy, Holland) is around 15 percentage points: in Italy more taxes, duties and contributions are paid on profits. However, it cannot be said that Dutch taxation, seen in absolute terms, is very advantageous as the tax burden is around 45%.[56]

[56] https://financecue.it/olanda-paradiso-fiscale-italia-tassazione-conti-pubblici/18106/



| | | |
|---|---|---|
| Tassazione sulle imprese | 20% fino a 200k | 24% |
| | 25% oltre 200k | 24% |
| Irap | | 3,9 + addizionale regionale |
| Profitti da partecipazioni | esenti | 26% |
| Profitti da vendita di partecipazioni | esenti | 26% |
| Iva | 21% | 22% |
| Carry back | si | no |
| Carry forward | fino a 9 anni | fino a 3 anni |

Another question arises. If the tax burden in Holland is not as low as they say, why do many companies (IN THIS CASE I TOOK ITALIANS AS AN EXAMPLE) transfer their tax office?

Mainly for two reasons:

1. **The efficiency of the system**: One of the regions that pushes many activities to "do business" in the Netherlands is the divergence of the efficiency of the system, represented by some indicators: legal certainty, ease in starting a business, bureaucratic simplification, the level of corruption, the remuneration of bank deposits. (the table shows the obvious differences between the two countries).[57]

[57] https://financecue.it/olanda-paradiso-fiscale-italia-tassazione-conti-pubblici/18106/

| | Netherlands | Italy |
|---|---|---|
| Durata media giudizio ordinario - Banca Mondiale | 514 | 1250 |
| Avviare attività - Banca Mondiale | 4 giorni | 1-12 mesi |
| Competitività dell'economia - World Economic Forum | 4/140 | 31/140 |
| Doing business - Banca Mondiale | 36/190 | 51/190 |
| Corruzione - Transparency International | 8/180 | 69/180 |
| Durata procedure concorsuali | 1 anno | 5,3 anni |
| Interessi sui prestiti | 0,90% | -1,08 |

*FONTE: La relazione del "Doing Business" della World Bank, Italy v.s. Netherlands*

2. **The environment in which you do business**: Another factor of significant importance is "the environment in which you do business". If we analyse the macroeconomic data of the two countries, the difference in the "state of health" is evident. Among the major public finance indicators to be compared we observe:

   - the GDP growth rate, in 2019, was 1.80% for the Netherlands while Italy is in the rear with a growth of no more than 0.2%;

   - the public debt / GDP ratio, in 2019, is around 49% in the Netherlands while in Italy it reaches 134.8%;

   - net debt (or net credit). The Netherlands in 2019 presented a net accreditation (income> expenditure) of 1.2% while Italy, despite various efforts, has a nominal deficit of 2.4%.

It is important to produce or operate in a country that has public accounts in order because the ability to cope with an economic shock such as the one we are experiencing is different: the fiscal space that Holland can benefit from is far greater than that Italian. Low growth and high debt do not allow our country, in fact, to make excessive use of net debt, in addition to increasing the cost of debt to be paid to investors who lend us money on the market, following the low degree of solvency.

This is why in fact Holland cannot be considered a tax haven. *It is simply an efficient country that has implemented a useful and advantageous tax and governance system for holdings, shareholdings and royalties in order to attract foreign investors, but it is NOT at all a Tax Haven in the true sense of the term, that those are placed such as Dubai, Bahamas, Andorra, Bermuda, Virgin Islands, Cayman, Panama etc which also have free tax zones.*

## 2.6 European initiatives to combat tax havens

Several documents have been drawn up by the OECD and the European Union in order to outline new measures to combat tax havens.

From an international point of view, one of the most important interventions dates back to 2000, the year in which the OECD published the Report "*Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*" subsequently updated in 2004 through the publication of the document "*The OECD's Project on Harmful Tax Practices: the 2004 Progress Report*".

The objective of the OECD has always been to outline minimum *standards* aimed at encouraging the various states to adopt initiatives that favour free competition, focusing on the development and implementation of regulations on transparency and information exchange.

This line was implemented over the years and confirmed on the occasion of the G20 in London, held on the dates of 1-2 April 2009. During this meeting, the representatives of the 20 most influential countries in the world economic panorama

expressed their express desire to implement measures to combat tax havens, which do not comply with international transparency standards. [58]

The issue under consideration has acquired increasing relevance due to the pressing development of the globalization of the economy.

This phenomenon combined with the progressive affirmation of the *new economy* (so-called digital economy), on the one hand, has allowed the diffusion of *new business models* and, on the other hand, has widened the possibility for companies to choose more easily the places where locate your business also in view of tax planning.

For these reasons, the issue of combating *tax havens* was also a central element of the 2013 OECD Report, "*Addressing Base Erosion and Profit Shifting*" ("*BEPS Report*"), and in the consequent "*Action Plan on Base Erosion and Profit Shifting*" ( "*BEPS Action Plan*"). [59]

[58] Specifically, in the report "London Summit - Leaders' Statement", issued on 2.4.2009, it was highlighted in § 15 the intention of the States participating in the Summit to: "to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information ". For further information, the document is available at the following link: http: // www.oecd.org/g20/summits/london/G20-Action-Plan-Recovery-Reform.pdf.

[59] For further information on BEPS Reports, see Valente P. "International Tax Avoidance", Milan, 2014, p. 1895 ff.

The attention to the issue was also confirmed by the surveys published by the "*International Consortium of Investigative Journalists*" (so-called "ICIJ"):

- in April 2016 called "*Panama Papers*";
- in November 2017 called "*Paradise Paper*".

Given the delicacy of the issue, the attention reserved by politics and public opinion, as well as the impact on the global economy of the topic in question and the problems related to it, significant and numerous are the initiatives undertaken by the European Union in this area is necessary to guarantee the revenues of the Member States and consequently strengthen the single market for businesses.[60]

Among the most important documents issued at European level for the pursuit of objectives to combat *tax havens* is document COM (2012) 351, published on 27 June 2012.[61]

Within this Communication, the European Commission analyses how to strengthen measures to combat fraud as well as tax evasion and outlines the various initiatives to be taken in this area.

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[60] For further information on measures to combat international tax avoidance in Europe, see Valente P. "Manual of fiscal policy of the European Union and supranational bodies", Rome, 2017, p. 534 ss .; Valente P. "International tax avoidance", cit., P. 639 et seq.

[61] This is the "Communication from the Commission to the European Parliament and Advice on concrete ways of strengthening the fight against tax fraud and tax evasion, also in relation to third countries "[COM (2012) 351]. Thus, in Valente P., Bagetto L., cit.

The Communication highlights how, in order to ensure compliance with tax obligations, the reduction of fraud and evasion, it is necessary:

- improve collection by Member States;
- make cross-border cooperation between Member States' tax administrations more effective;
- create a coherent European policy towards third countries.

The Commission outlines a definition of tax havens (sometimes also referred to as "*non-cooperative jurisdictions*"). The document underlines that these are "*jurisdictions capable of financing their public services without levying taxes, or by imposing a minimum tax on income, and which offer themselves as places that non-residents can use to escape taxation. in their country of residence*".

In this document, the European Commission states that tax havens constitute a potential damage to the interests of Member States as it is precisely on the latter that the burden of additional compliance costs for the protection of tax bases weighs. The negative effects, materializing in tax revenue losses, due to a deviation of the taxable bases towards tax havens, inevitably fall on individual taxpayers. According to the Commission, this consequence is justified by the need, on the part of individual states, to increase the tax rates in order to compensate for the erosion of the tax base suffered.

It should be emphasized that the intent of all the bodies of the European Union has always been to contribute to the creation of a fair and harmonized taxation system among the Member States in order to be able to counter the presence of tax havens, the problem of the erosion of tax bases efficiently and effectively.

Therefore, to ensure effective action by Member States in the field of combating international tax avoidance, with a decision of 23 April 2013, the European Commission established the so-called "*Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation*".

The components of the Platform, as regards the fight against tax havens, expressed the need to create a *single European blacklist*, in order to ensure greater coordination between the 28 EU Member States. [62]

[62] These topics were addressed by members of the "Platform for Tax Good Governance" in various documents. These include: "Draft Discussion Paper on the" Tax Havens "Recommendation", of 16.10.2013; "Discussion paper on the follow-up of the Commission Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters "of 6.2.2014;" Discussion paper on possible outputs of the Commission Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters ", of 10.6.2014.

## 2.7 Measures to resolve the problem

For all taxes, including income taxes, the European Union has issued the directive against avoidance which entered into force in 2019 and which aims to introduce the conditions for the harmonization of the tax base of corporate taxation , increase coordination at the European level and increase information transparency.[63] The directive has been implemented nationally by each state through its own laws, but in some countries it has achieved modest results, while in others it will take a few years to evaluate the results. In any case, interventions to reduce avoidance do not remove the cause of avoidance, that is, the profound differences in profit taxation policies. These should be removed or at least reduced.

Some argue that competition in attracting investments that countries can make through tax cuts on profits is healthy because it encourages sound management of public spending. This is not the case in the presence of strong differences in the size of countries within a common market. Indeed, small countries have an advantage in lowering their taxation as the small loss of revenue on the profits of companies already operating in the country due to lower taxation is more than offset by the

[63] See EU directive 2016/1164, "Anti-Tax Avoidance Directive" https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax- avoidance-package / anti-tax-avoidance-directive_en.

influx of investment from the rest of the common market.[64] Consequently, small countries do not even need to have efficient spending to attract investment. Harmonizing corporate taxation would instead allow the creation of a true European "*level playing field* ", a single market where investments are allocated on the basis of economic reasons and not distortions caused by the possibility for some countries to conduct competition on taxes as small .

For now, the only law enforcement tool has the Commission, which can brand tax rebates as state aid, but used it sparingly: it condemned Apple to give back 13 billion euros in back taxes to Ireland. Starbucks 30 million to the Netherlands, Amazon and Fiat to give back 250 million and 21.3 million to Luxembourg respectively. He has opened investigations into Ikea, McDonald's and the French energy company Engie. But nothing that brings taxes back to where they were actually evaded. The European Parliament has established a special commission on financial crimes, tax evasion and tax avoidance (*TAX3*) whose conclusion was that, for the first time, to point the finger at some member countries, guilty of aggressive taxation.

[64] See "Are small countries leaders of the European tax competition?", Chatelais and Peyrat, Center d'Economie de la Sorbonne, 2008.

# CHAPTER 3 - THE "APA" AGREEMENTS

For the purposes of analysing the IKEA case, it is first necessary to consider the institution of the so-called *International Standard Ruling*[65] introduced into the Italian legal system by art. 8 of Legislative Decree 30 September 2003, n. 269.

The institution of the international standard ruling arises mainly from the need to make known in advance to companies that carry out international activities, the orientation of the tax authorities on *intercompany* transactions, for the main, but not exclusive, purpose of preventing disputes. The international ruling is expressed in a special form of ruling that offers the possibility of defining in advance with the financial administration the tax treatment of the financial and income components belonging to the company.

[65] (Per maggiori approfondimenti sull'istituto del *ruling* internazionale si rinvia a P. ADONNINO, *Considerazioni in tema di ruling internazionale,* in Riv. dir. trib., 2004, IV, 57; G. GAFFURI, *Il ruling internazionale,* in Rass. Trib., 2004, 488; L. TOSI – A. TOMASSINI – R. LUPI, *Il ruling di standard internazionale,* in Dialoghi di diritto tributario, 2004, 32; M. MAZZETTI DI PIETRALATA – L. ZALLO, *Ruling in materia di transfer pricing*, in Il Fisco, 2004, 948; P. PALMA, *Il ruling internazionale*, in Il Fisco 2004, 194; B. CARTONI, *Profili penali del ruling internazionale,* in Il Fisco, 2004, 250; G. PEZZUTO, *I riflessi del ruling internazionale sull'attività di verifica fiscale dell'amministrazione finanziaria,* in Il Fisco, 2004, 2398; D. LIBURDI, *Commento al Provvedimento dell'Agenzia delle Entrate del 23 luglio 2004,* in Corr. Trib., 2004, 2605.)

Underlying the introduction of the international ruling is the need to prevent conflicts between financial administration and taxpayers and to combat the phenomena of double taxation.[66]

In this regard, the so-called **Advance Pricing Agreements ("APA")**, of which the international ruling represents a first "*attempt*" to implement this discipline in Italy, and the information provided in this regard assumes importance by the OECD which, for years, has constantly focused its attention on APAs as one of the main tools for resolving disputes in the field of *transfer pricing*.

## 3.1 Advance Pricing Agreements "APA" from an international perspective

The 1995 OECD report examines the administrative procedures which the countries belonging to the Organization can resort to in order to prevent and settle disputes relating to transfer pricing, as well as to minimize the risk of double taxation, which occurs in particular when in price adjustment phase, the same income is taxed simultaneously in the countries involved in the transactions.

[66] (Manuale del transfer pricing / Piergiorgio Valente. - 2. ed. - [Milanofiori, Assago] : IPSOA, Gruppo Wolters Kluwer, 2012)

The intensification of international exchanges, transactions between companies belonging to multinational groups and tax controls on transfer pricing have made it necessary to collaborate in the tax field, between financial administrations and taxpayers, as well as between the financial administrations of the various states. , in order to identify both the criteria and the technical methods for the definition and determination of *transfer pricing*.[67]

Among the tools to prevent the emergence of potential disputes relating to *transfer pricing*, through the TP *Guidelines*[68], the OECD in the 1995 report indicated the use of advance agreements, or *Advance Price Agreements (APA)*[69], as an adequate solution. Basically, APAs are preventive agreements between the taxpayer and the Tax Administration, with an average duration of between *three and five years*, on

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[67] Manuale del transfer pricing / Piergiorgio Valente. - 2. ed. - [Milanofiori, Assago] : IPSOA, Gruppo Wolters Kluwer, 2012

[68] (*Cfr. Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, Capitolo IV, Paragrafo F. L'OCSE ha integrato tali Linee Guida, in un supplemento, intitolato *Guidelines for Conducting Advance Pricing Arrangements under the Mutual Agreement Procedure*, contenente indicazioni specifiche per la conduzione di *advance pricing agreements* bilaterali nel quadro delle procedure amichevoli.)

[69] (Testualmente le *TP Guidelines* (paragrafo 4.123 delle *TP Guidelines*, Capitolo IV, Paragrafo. F ) forniscono la seguente definizione in merito agli APA: *"An advance pricing arrangement ("APA") is an arrangement that determines, in advance of controller transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprise, and one or more tax administrations. APAs are intended to supplement the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues. They may be most useful when traditional mechanisms fail or are difficult to apply".*)

the basis of which, before the intragroup transaction is carried out, the criteria and methods that they will lead to the definition and determination of transfer pricing.

More properly, depending on the parties involved in the agreement, the form that an APA can take is that of a unilateral, bilateral or multilateral agreement.

1. *The unilateral APA* represents an agreement entered into between a single Financial Administration and a taxpayer. It is clear from now on that the definition of such an agreement does not determine the resolution of the problems relating to double taxation, since the tax authority of the State competent to tax the income of the company, the counterparty in the transaction, could legitimately disavow the rules established in the agreement itself (in which it did not participate), independently restating the transfer prices.
2. *The bilateral or multilateral APA* differs from the unilateral APA, in that it involves two or more group companies and correspondingly the two or more financial administrations of the countries in which these companies reside. In particular, the conclusion of bilateral or multilateral APAs is brought back to the amicable procedure referred to in art. 25, paragraph 3, of the OECD Model Convention against double taxation, according to which *"the competent authorities of the Contracting States will do their best to resolve, through an amicable agreement, the difficulties and doubts that may arise*

*regarding the interpretation or application of this Convention. They may also consult in order to eliminate double taxation in cases not provided for in this Convention. "*

The *TP Guidelines* therefore call for the conclusion of APAs that involve not only the Financial Administration in which the taxpayer resides (*unilateral APAs*), but also the other party (*bilateral APAs*) or the other tax authorities (*multilateral APAs*) involved in the transactions placed existing by the taxpayer himself; this in order to ensure "*on a negotiating basis*" a uniformity of judgments and evaluations by all the aforementioned authorities towards the contractual parties.[70]

Of the member states belonging to the EU, currently Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, the United Kingdom, Spain, Sweden expressly recognize the adoption of APAs. As regards the worldwide diffusion of this instrument, currently Argentina, Australia, Brazil, Canada, China, South Korea, India, Japan, Mexico, New Zealand and the United States of America

[70] Al riguardo, sempre nelle *TP Guidelines* (paragrafo 4.130, Capitolo IV, Paragrafo F), si afferma che *"Where possible, an APA should be concluded on a bilateral or multilateral basis between competent authorities through the mutual agreement procedure of the relevant treaty. A bilateral APA carries less risk of taxpayers and prolonged enquiries and possible penalties. A bilateral APA also significantly reduces the chance of any profits either escaping tax altogether or being doubly taxed. Moreover, concluding an APA through the mutual agreement procedure may be the only form that can be adopted by a tax administration which lacks domestic legislation to conclude binding agreements directly with the taxpayer".*

provide for the possibility of resorting to agreements with the " Financial Administration on transfer pricing.[71]

### *3.1.1 Some "typical" aspects of APAs according to the OECD Guidelines*

That said and without going too far for the sake of economy of discussion, it seems useful to focus attention on some "*typical*" aspects of the APA, in light of the OECD *TP Guidelines*; this in order to find out how they were (in whole or in part) received and borrowed in the Italian legal system, with the adoption of the aforementioned *international ruling*.

- First - as a corollary of the APA as an agreement between the Financial Administration and the taxpayer - it is necessary to highlight, first of all, the cooperative nature of the negotiation process of an APA; in fact, it does not arise from a unilateral decision of the Tax Administration following the examination of facts and documents, but is characterized by the active participation of the taxpayer, who provides the method he deems applicable

[71] Per maggiori approfondimenti sul punto vedasi P. VALENTE, *Manuale del Transfer Pricing,* op. cit., 1542

in the particular circumstances and the related documents and information capable of to support it - and so for example market data, comparable businesses or transactions, function analysis, etc. In particular, the APA procedure is initiated on the initiative of the taxpayer who submits his method of determining transfer pricing to the tax authorities for examination. In this regard, the APA request - accompanied by the documentation to support the validity of the proposal - must justify the proposed methodology, indicating, among other things, elements such as the profitability of the investments, the analysis of the economic functions performed in the interest with the relative profitability indices, as well as the preparation of a detailed list of transactions or comparable companies. These are assumptions, cd. *critical assumptions*[72] (basic assumptions), on which the validity of the proposed method is based, expression of the

[72] Critical assumptions are a fundamental element of advance pricing agreements. They can be defined in a general way as an objective criterion that underlies the transfer pricing method proposed by the taxpayer in the agreement. As explained very clearly by the OECD TP Guidelines (paragraph 4.125 of the TP Guidelines, Chapter IV, Paragraph F) the importance of critical assumptions in the system of advance pricing agreements derives from the fact that these agreements are essentially aimed at the future, that is, they concern the determination of the normal value with respect to transactions that have not yet taken place. Consequently, it is necessary to formulate a series of assumptions about the economic and operating conditions that may influence these transactions, when they are put into effect. In this regard, it is emphasized that the forecasts are based on reasonable assumptions and that the unchangeable elements in the determination of transfer prices are, for example, the methodology used to calculate them, but not the individual prices. To illustrate, in the case of intra-group loans and an APA relating to the predetermination of an interest rate at normal value, the OECD does not consider it reasonable to set a short-term rate for certain intra-group loans, which will be stipulated in the following three tax periods. , which cannot be changed; on the contrary, it considers it reasonable to foresee that this rate is equal to a reference rate (eg LIBOR) plus a certain fixed percentage.

economic and operational conditions to be developed as well as of the objectives to be achieved, when the transactions become operational. Even later, during the negotiation phase, the taxpayer must make himself available for any further requests for information, which he must fulfil without delay.

- Secondly, it should be noted that the APAs, with respect to ordinary *ruling* procedures, primarily involve an examination of the facts and not an analysis of legal-legal problems. In fact, the object of the APAs are commercial transactions and the methods of their execution in order to determine the price consistent with the market and not the interpretation of rules. In this regard, in the context of the APAs, the facts represented by a taxpayer are the subject of investigation and verification by the Financial Administration; on the other hand, in the context of an ordinary *ruling* procedure, the facts represented by a taxpayer are assumed by the Financial Administration as the basis of its response (*rectius interpretation of the rules*), without any verification in this regard.[73]
- Again, and taking into account that, generally, the APA applies to future transactions, one of the most delicate "*issues*" concerns the duration of the agreement. In this regard, there are two objectives to be reconciled: **1)** on

[73] *cfr.* paragrafo 4.132 delle *TP Guidelines*, Capitolo IV, Paragrafo F.

the one hand, that the duration is long enough to guarantee the taxpayer a degree of certainty about the tax treatment of their transactions for a certain number of years; **2)** on the other hand, that the duration is not so long as to compromise the validity of the basic assumptions on which the agreement is based. The right balance between these two objectives will be assessed from time to time and will be influenced by various factors, such as the conditions of the sector in which the taxpayer operates, the general economic situation and the risk inherent in the transactions covered by the APA. Based on the experience gained to date, the OECD indicates the average duration of the agreement from 3 to 5 years.

- Finally, it should be noted that the Financial Administrations have the right to carry out checks on the taxpayer during the period of validity of the APA, in order to verify that the provisions contained in the agreement are actually respected. These checks can be carried out in two distinct ways: **1)** request to the taxpayer by the Financial Administration to submit annual reports certifying the compliance of the transfer prices applied in the transactions carried out under the conditions established in the agreement; **2)** verification by the Financial Administration of the initial data on which the APA request

is based, in order to establish whether or not the taxpayer has complied with the terms and conditions set out in the agreement.[74]

### *3.1.2 Advantages and Disadvantages of APAs*

To conclude the examination of the APAs from an international perspective, it is finally necessary to indicate - again according to the indications of the OECD - the main advantages and disadvantages of the APAs, as a tool for resolving disputes on *transfer pricing*[75].

**MAIN ADVANTAGES:**

- First, one of the advantages of the APA is the certainty of the method to be used for the valuation of intra-group transactions; in particular, the agreement becomes particularly useful when the traditional methods of calculating prices are difficult to apply.
- Furthermore, the APAs allow for the building of "*friendly*" relationships, based on good faith and "*preventive*" transparency with the tax authorities (avoiding costs for any investigations or, worse, disputes regarding transfer

[74] *cfr.* paragrafo 4.137 delle *TP Guidelines*, Capitolo IV, Paragrafo F

[75] *cfr.*paragrafi 4.139-4.158 delle *TP Guidelines*, Capitolo IV, Paragrafo F

prices); and this represents a clear objective of any company that intends to place itself in the field of "*voluntary*" compliance with tax obligations.

**MAIN DISADVANTAGES:**

- First, the most significant "*vulnus*" concerns the unilateral APA which, as indicated, represents a binding agreement exclusively for the taxpayer and the tax administration to which it belongs. It is clear that this agreement, precisely because it does not bind any other foreign tax authority interested in defining the arm's length price for the same transaction, cannot guarantee the taxpayer from the risk of international double taxation.
- More generally and with reference to all types of APAs (*unilateral, bilateral and multilateral*), the length of time necessary to reach the agreement can also be an element of "*negative value*"; thus it may happen that, during the time frame of the negotiation period of the APAs, the economic conditions change and therefore the agreement is in fact already "*passed*" when it is reached.
- Not only that, but it is also necessary to highlight how, since the APA agreements are essentially aimed at the future, that is to say transactions not yet occurred, there is a real risk of "*crystallizing*" the definition and

determination of transfer prices, regardless of the favorable or unfavorable economic situation (which could justify a different approach in the transfer pricing policy).

- Finally, a certain "*psychological*" character could arise on the part of taxpayers to make use of this institute; this is because there is a fear that the information provided to the tax authorities - especially in the event of failure to reach the agreement - may be used to their "*disadvantage*" during a tax audit of their position.

# CHAPTER 4 - THE IKEA CASE STUDY

As promised, after a broad explanation of the APAs, with the aim of helping the understanding of the IKEA case, where there are two APA agreements between IKEA and the Dutch Authorities (2006, 2011). In this chapter I will now proceed with the analysis in detail of the latter, however, starting from the corporate structure of this multinational, passing through the two agreements signed and then concluding with possible scenarios.

IKEA is a multinational company founded in Sweden by Ingvar Kamprad in 1943. Its main registered office is in Leiden, in the Netherlands, and nowadays, there are 378 IKEA stores operating in 52 countries, with 211.000 employees. In the fiscal year 2019 its income was €41.3 billion.[76]

In order to avoid that IKEA was acquired by others, but also that there were inherited disputes of sorts among their children, Kamprad began to build a complex corporate network that is still in place, appointing different executive management teams for each company group.

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[76] https://www.ikea.com/it/it/this-is-ikea/about-us/

## 4.1 The corporate IKEA structure

*Figure 1. The corporate structure of IKEA*



Source: own elaboration

Being a multinational company, when we talk about IKEA, we are referring to several companies. The above picture shows just a little portion of IKEA wide corporate structure, the one that is relevant for my analysis, since the real business of IKEA includes other several companies that do not play a key role in its fiscal strategy.

The studied companies form part of two legally distinct corporate groups: INGKA Group and Inter IKEA Group, owned by two foundations, respectively Stichting

INGKA Foundation and Interogo Foundation, in turns both controlled by the Kamprad Family.

On the one hand, INGKA Group manage the retail side of IKEA. It includes INGKA Holding BV and the stores that operate as franchises under IKEA brand, paying 3% royalties of its net turnover to Inter IKEA Systems, as compensation for the use of the IKEA Franchise Concept.

On the other hand, Inter IKEA Group includes Inter IKEA Holding SA, founded in Luxembourg in 1991, and Inter IKEA Systems BV, which owns the proprietary rights used to develop the IKEA Franchise Concept and on which we will mainly focus our attention.

Inter IKEA Holding SA has been up to 2011 the owner of proprietary rights which were licensed to Inter IKEA Systems BV, under the payment of a license fee. In 2011 the proprietary rights were sold to Inter IKEA Systems B.V., that, for the purchase, contracted a loan with Interogo Foundation, which yields an interest rate of 6%.

As indicated by the up-left arrow, actually the interests paid on the load do not arrive directly to Interogo Foundation, but go to Interogo Finance SA, in Luxembourg. Thus, dividends from the latter organization go to Interogo

Foundation, which was established in 1989 in Liechtenstein and is the legal owner of Inter IKEA Group.

The path shown in the picture is a schematic representation of the fiscal strategy adopted by the tax management team of IKEA in order to maximize profits by minimizing the tax burden paid, through the strategic allocation of profits in favourable tax regimes countries, with regard to the specific elements used.

In order to retrace the reasons behind each strategic choice adopted by the multinational firm, I tried to answer some questions, such as:

- Why are royalties allocated to Netherlands?
- Why are the licence fees allocated to Luxembourg?
- Why are interests allocated to Luxembourg?
- Why are dividends allocated to Liechtenstein?

### *4.1.1 Stichting INGKA Foundation*

The Stichting INGKA Foundation, based in the Netherlands, was founded in 1982 by Ingvar Kamprad with the mission of "furthering the advancement of interior design". The Stichting INGKA Foundation is one of the largest charitable foundations in the world and the second-largest non-profit organization in the

world. The owner of IKEA also created a subsidiary foundation of Stichting INGKA, called Stichting IKEA Foundation, which receives its income from the former.

The company's main motivation for having a non-profit structure seems business driven. Indeed, Stichting INGKA Foundation owns INGKA Group and, according to its charitable purpose, reinvests part of its funds into it and gives another part to Stitching IKEA Foundation, that is a subsidiary of the other foundation. The non-profit designation saves the company over $4 billion in taxes because it benefits from a 3.5% non-profit tax rate: unlike its founder, the IKEA Foundation has ANBI (algemeen nut beogende instelling, "Institution for General Benefit") status from the Dutch Tax Service. In 2017, the foundation received 159 million euros from the INGKA Foundation, of which 144 million were donated to organizations such as MSF, UNHCR, Save the Children, and We Mean Business Coalition for climate change. In May 2006, The Economist magazine estimated that the parent organization's foundation's endowment was worth $36 billion, making it the world's wealthiest charity at the time.

### *4.1.2 INGKA Group*

INGKA Group is composed by INGKA Holding BV, located in the Netherlands, and the stores spread worldwide. Its name "INGKA" comes from the initials of the name of the IKEA founder Ingvar Kamprad: this element clearly shows how much the group is tied to its origins, since it embraces the same culture and values. INGKA Group represents a separated entity from Inter IKEA Group; indeed, it has its own different management and owners. INGKA received the 90% of the IKEA revenue in 2018. INGKA group manages the IKEA stores under franchise agreements with Inter IKEA Systems B.V. It operates in more than 30 countries and have 378 stores all over the world. However, their major presence is in Europe.[77]

Being under a franchise agreement, the INGKA Group does not own the trademark, for this reason, in order to have the right to use the IKEA concept and brand, each stores pays a 3% franchise fee to Inter IKEA Group, through Inter IKEA Systems BV, located in the Netherlands. The total amount of royalties paid from 2009 to 2014 by each store, was equal to €6.1 billion, as shown in Table 1.

[77] https://www.ingka.com/

*Table 1. Estimated impact of royalties on taxable income of all IKEA franchisees, worldwide 2009-2014, billion €*

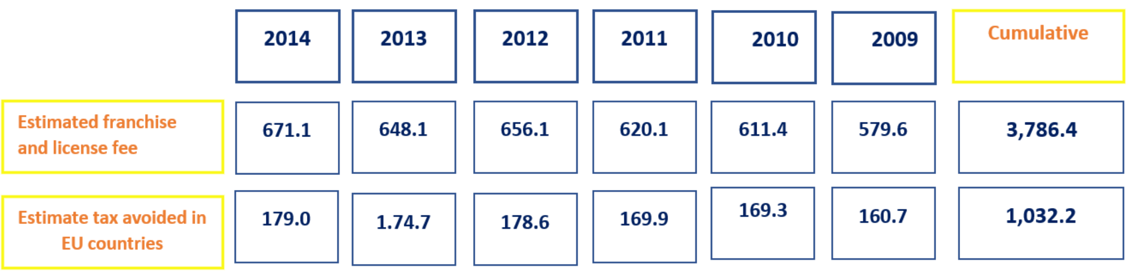
| | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | Cumulative |
|---|---|---|---|---|---|---|---|
| Estimated net profit of IKEA franchisees | 3.8 | 3.8 | 3.7 | 3.4 | 3.1 | 2.9 | 20.7 |
| Franchise and license fees paid | 1.1 | 1.0 | 1.1 | 1.0 | 1.0 | 0.9 | 6.1 |
| Estimated impact on taxable income | -22% | -22% | -22% | -23% | -24% | -24% | -22% |

Source: Auerbach M., *IKEA: flatpack tax avoidance*, European Greens, 2016

Table 1 highlights how much, in percentage terms, the royalties paid to Systems affect the net profits of all IKEA franchisees. The cumulative effect consists in a 22% of reduction on taxable income. Obviously, this value is an average, but it gives a signal of effectiveness of this transfer pricing strategy, that gives to the franchisee the opportunity to pay less taxes.[78]

[78] International tax law University project, IKEA Transfer Pricing Strategy disassembly instructions, Sara Prosperi, Marta Spinsanti, Cristina Suppa, Danahe Miranda, Selcuk Kane

*Table 2. Estimated IKEA royalties and tax avoided in EU countries. 2009 – 2014, million €*



| | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | Cumulative |
|---|---|---|---|---|---|---|---|
| Estimated franchise and license fee | 671.1 | 648.1 | 656.1 | 620.1 | 611.4 | 579.6 | 3,786.4 |
| Estimate tax avoided in EU countries | 179.0 | 1.74.7 | 178.6 | 169.9 | 169.3 | 160.7 | 1,032.2 |

Source: Auerbach M., *IKEA: flatpack tax avoidance*, European Greens, 2016

Table 2 gives us an idea of estimated tax avoided in EU countries, using the weighted average tax rate for each year (at European level). In total, it is estimated that the 234 IKEA stores from EU have avoided 1,032.2 million of euros of taxes in the considered years. To reach this result, the franchise and license fee of EU stores are estimated to be a 61.9% of total franchise and license fees.[79]

[79] International tax law University project, IKEA Transfer Pricing Strategy disassembly instructions, Sara Prosperi, Marta Spinsanti, Cristina Suppa, Danahe Miranda, Selcuk Kane

### *4.1.3 Inter IKEA Holding SA*

Inter IKEA Holding SA was born in 1991, it is based in Luxembourg and owned by Interogo Foundation. Inter IKEA Holding SA in turn owns Inter IKEA System B.V., which nowadays is the owner of the IKEA concept.

Until 2011, things were different: Inter IKEA Holding SA held the intellectual property right related to the Inter IKEA concept. Indeed, due to a special scheme in Luxembourg, explained in the following sub-paragraph, royalties were not taxed. Inter IKEA Holding had the status of "exempt 1929 holding", benefitting from an extremely advantageous tax regime, until 2006, when the Commission declared it illegal under state aids rules. Actually, the already existing holdings were allowed to apply the scheme until the 31 December 2010. The Commission decided to give them a transitory period to unable their complete reorganization and especially not to cause a serious damage in terms of employment and economic development in Luxembourg.

Therefore, Inter IKEA exploited as much as it could the benefits granted by 1929 Regime. When this was no longer possible, it operated a restructure of its fiscal strategy: in 2011, the new APA with the Dutch legislation gave IKEA another

opportunity to reduce tax, but with a different scheme, as it is explained in paragraph 4.1.4.1.

### *4.1.3.1 The favourable regime of Luxembourg*

The so-called "exempt 1929 Holding companies" were the Luxembourg Holdings under the Organic Law of the 31st July 1929. *The legislation allowed the corporate companies to benefit from an extremely favourable tax regime, providing them with a wide range of advantages.*

Firstly, they were not subject to any direct tax in Luxembourg, such as the corporate income tax. Secondly, dividends, interest, royalties and capital gains earned by an "exempt 1929" were not taxable in Luxembourg. Moreover, the payments made by the holding in terms of dividends, royalties and interests were not subject to any withholding taxes. Finally, regarding the interests paid abroad, there was no withholding tax on them, whereas the interest received by non-exempt resident companies was considered as a taxable income.

Despite having all these benefits, the "exempt 1929 Holdings" were excluded from the bilateral double taxation treaties that Luxembourg concluded with other states; and, what is more, they were not subject to the Council Directive 90/435/EEC,

regarding the common system of taxation applicable in case of parent companies and subsidiaries of different Member States.

Not all companies were allowed to obtain this favourable status, since some specific conditions were required. Firstly, in order to be an "exempt 1929 Holding", a company had to be registered in Luxembourg. Then, the activities that could be performed were limited. Inter IKEA Holding SA was able to reach this status, since it is included in one of the particular case described in paragraph 27 (comma g) of the Commission Decision "on aid scheme C 3/2006 implemented by Luxembourg for '1929' holding companies and 'billionaire' holding companies": *"acquiring and holding patents, exploiting them by granting licences to its subsidiaries and receiving royalties in consideration (licences may also be offered to third parties, but there may be no trading therein)".*[80]

Finally, once considered as an "exempt 1929 Holding", the only burden the company had, was the payment of an annual subscription tax ("taxe d'abbonnement") equal to 0.2% of the value of the shares emitted. In addition to a tax of 1% ("droit d'apport") on the share capital, to be paid at the time of its constitution and eventually in the case of its increase.[81]

[80] https://www.world.tax/articles/the-dutch-innovation-box.php
[81] https://books.google.it/books?id=35yoDgAAQBAJ&pg=PT32&lpg=PT32&dq=ikea+lussemburgo&source=bl&ots=yDoisX0BBI&sig=ACfU3U1AsHi-_q68s1hfew3uCXYse97MfQ&hl=it&sa=X&ved=2ahUKEwjprujXko3lAhXE66QKHaUDCvo4FBDoATAJegQICRAB#v=onepage&q=ikea%20lussemburgo&f=false

### *4.1.4 Inter IKEA Systems BV*

Inter IKEA Systems B.V. was born in 1983, when Ingvar Kamprad decided to split the IKEA business into two parts, separating the ownership of the retail operation from the ownership of the concept and the IKEA brand. It is property of the Dutch company Inter IKEA Holding B.V, which is in turn owned by the Luxembourg company Inter IKEA Holding S.A.

It is based in the Netherlands, in Delft, and it is the owner of the IKEA Franchise Concept, from the product development to the logo, and the worldwide IKEA franchisor: up to November 2017, there were agreements with 11 independent groups of franchisees in 49 countries, operating in 378 stores. In particular, the activities developed by Inter IKEA Systems B.V. can be broken down into three sets:

1. *Creation, development and management of the IKEA Franchise Concept and maintenance of Rights*. The intangible asset includes business systems, advertising, marketing techniques and distribution techniques.
2. *Management of the franchise contracts*, coordination and bundling of services provided to external parties. Not only does this activity include the

selection of new franchisees, the negotiation with them up to the conclusion of the contract, but it also concerns doing market researches and surveys.

3. *Catalogue activation*. This activity is linked to the market and transaction risk, due to the price of the catalogues. Other risks Inter IKEA Systems B.V. bears are a limited inventory risk; the liability risk, in case of claims relating to franchise contracts; the product liability risk for the catalogues; the costs of a claim of the return of an incongruous product.

Its main source of income is the franchise fee that franchisees pay, as well as the income from the sale of catalogues. Especially, it receives a commission of 3% of turnover from all the worldwide stores.

Since Inter IKEA Systems B.V.'s legal seat is in the Netherlands, it can take advantage of the "Patent box" regime, introduced by the Dutch legislation, that has to do with the intellectual property. The benefit consists in 80% reduction on the net taxable profits from qualifying intangibles (royalties included), with the important constraint that the incomes deriving from those tangibles must exceed the costs of developing the same ones. Those profits are then taxed at the standard corporate tax rate, 25%. If we put together this element with the reduction on net taxable profits, the effective tax rate is 5%.[82]

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[82] International tax law University project, IKEA Transfer Pricing Strategy disassembly instructions, Sara Prosperi, Marta Spinsanti, Cristina Suppa, Danahe Miranda, Selcuk Kane

In analytical terms:

*Table 3. Patent box*

| | |
|---|---|
| Net taxable profit | 100% |
| Deduction on net taxable profit | - 80% |
| Corporate tax rate | - 25% |
| Effective tax rate | 5% |

Source: https://www.world.tax/articles/the-dutch-innovation-box.php

### *4.1.4.1 THE 2006 APA*

Up to 2011, Inter IKEA Systems B.V. transferred a part of the amount received by the worldwide stores to Inter IKEA Holding SA, as an annual licence fee in terms of compensation for the use of the property rights, owned by the latter. The indirect determination of that annual licence fee is the content of the **2006 APA**, which involves two main subjects: Inter IKEA Systems B.V. and the Dutch tax administration.[83]

The period in which the APA has been in force goes from 1 January 2006 to 31 December 2010. The authorization to the use of property rights is the object of the

[83] https://www.wired.it/economia/finanza/2017/12/19/tasse-olanda-irlanda-lussemburgo/

Licence Agreement between Inter IKEA Systems B.V. and Inter IKEA Holding SA (1983) and with “use” it is intended the exploitation and development by Inter IKEA Systems B.V. of the IKEA Franchise Concept.

The switching of money implied by paying the licence fee is interesting from the tax law point of view, because it is not a “simple” money transfer from a company to another, but it has to be seen as a money transfer from a State to another. Actually, the two companies have their legal seats in two different countries: the Netherlands for Inter IKEA Systems B.V. and Luxembourg for Inter IKEA Holding SA.

The 2006 APA is based on a specific document, called Transfer Pricing Report, which establish:

- how to calculate the licence fee that Inter IKEA Systems B.V. must pay to Inter IKEA Holding SA;
- which level of operative margin obtained by Inter IKEA Systems B.V. can be considered a fair mirror of the activities it actually performs (considering the risks incurred and the assets used).

Regarding the first point, a letter of understanding between Systems and Holding states that the former is obliged to pay the latter a fee equal to the 70% of Systems' franchise income ("basis", as indicated in the APA).[84]

Whereas, with respect to the second point, the 2006 APA fixes a rule: in order to considered at arm's length, Inter IKEA Systems B.V.' operative margin should be equal to a 5% of the franchise income. If the operating margin is higher than 5%, the exceeding portion will be considered as an informal capital contribution to Systems by Inter IKEA and for this reason, it will not be taxed.

In the Transfer Pricing Report is indicated that the method of transfer pricing applied for assessing which is an appropriate level of operative margin for System is the Transactional Net Margin Method (TNMM). I have tried to simplify the steps used for applying the TNMM as follow:

1. Identify the less complex entity, through a functional analysis. The less complex entity is the tested party when you apply the TNMM. The functional analysis basically consists in studying the functions performed, the risks incurred and the assets of the company.

[84] https://www.ft.com/content/45148b5e-e3ea-11e7-97e2-916d4fbac0da

2. Calculate the basis of the less complex party (Inter IKEA Systems B.V. in this case).

3. Calculate the operative profit of Inter IKEA Systems B.V., going back to the already mentioned 5% of the basis (operative profit as 5% of the franchise income). But where does this percentage come from? It is the average level of operative profit that a set of comparable companies has.

4. Allocate the exceeding profit to the more complex entity (Inter IKEA Holding SA). This, basically, is the informal capital contribution already mentioned.[85]

Below, an interesting scheme provided by the 2006 APA that explain how the informal capital contribution is computed:

*Table 4. Calculation of the informal capital contribution*

| Basis |
|---|
| Licence payment (70% of the basis) |
| Costs Inter IKEA Holding SA (60% of the costs) |
| Costs Inter IKEA Systems BV (40% of the costs) |
| Operating profit (fixed at 5% of the basis) |
| Informal capital contribution (operating profit exceeding 5%) |

Source: Investigation UE (State Aid SA.46470 (2017/C) (ex 2017/NN) — Possible State aid in favour of Inter IKEA)

[85] https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:366:0047:0061:EN:PDF

The basis, that corresponds to the franchise income, is computed as the sum of franchise and licence revenue plus net catalogue revenue minus marketing support contributions to franchisees.[86]

This is what physically entered in Inter IKEA Systems B.V.'s bank accounts, but, as it appears intuitive, only a small part remained there. To obtain the value of the informal capital contribution, the first cost voice considered is the licence fee paid by Inter IKEA Systems B.V. to Inter IKEA Holding SA (that corresponds to a 70% of the basis). Then all the costs sustained by Inter IKEA Systems B.V. for the development of the IKEA Franchise concept are subtracted (60% of them are allocated to Inter IKEA Holding SA, the remaining 40% keep on being allocated to Inter IKEA Systems B.V.). The profit resulting from this computation is not entirely considered pertaining to Inter IKEA Systems B.V.: only a 5% of this is its operating profits (as it is established by the 2006 APA), the exceeding percentage is the so-called "informal capital contribution", excluded from the taxation in Netherlands ( Inter IKEA Systems B.V.), because attributing to Inter IKEA Holding SA (for transfer pricing purposes).[87]

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[86] https://www.icij.org/investigations/luxembourg-leaks/leaked-documents-expose-global-companies-secret-tax-deals-luxembourg/

[87] International tax law University project, IKEA Transfer Pricing Strategy disassembly instructions, Sara Prosperi, Marta Spinsanti, Cristina Suppa, Danahe Miranda, Selcuk Kane

To verify whether the infra-group transactions, between Inter IKEA Systems B.V. and Inter IKEA Holding SA, respect the arm's length principle, the Commission performed a functional analysis on both companies involved and the results are interesting, because they differ from the results found by the Transfer Pricing Report and used as basis for the formalization of the 2006 APA:

1) **The Commission states that the less complex entity has been incorrectly identified**: it is Inter IKEA Holding SA according to the Commission, and not Inter IKEA Systems B.V. as it results in the Transfer Pricing Report. Hence, the tested party should be Holding.
2) Even admitted that the tested party was correctly identified, **big mistakes have been found in the application of the TNMM**. An example is given by the calculation of the basis, that was incorrect. According to the Commission, the basis did not have to include catalogue cost and marketing contribution, but only franchise and licence revenue plus catalogue-related revenue. It is evident that this scenario would have been unfavourable for Inter IKEA Systems B.V., because an increase in the franchise income would have increased the operating margin and, hence, the tax due. Another observed inconsistency is the missed addition of net financial results and net

extraordinary results to the operating profits. Again, the concept of minor tax due.[88]

Therefore, to sum up, Inter IKEA Holding SA was the owner of the property rights up to December 2011, while Inter IKEA Systems B.V used them, upon the payment of a licence fee, and developed the IKEA Franchise Concept, which in turn is owned by the latter. In this way, Inter IKEA Systems B.V. was able to provide support to the franchisees spread all over the world, that, in turn, paid a franchise fee directly to it for the aid provided. Hence, Inter IKEA Systems B.V. acted as the collector of franchisees fee, but in the end, the revenues it received and the costs that it sustained for the IKEA Franchise concept were shared with Inter IKEA Holding SA, since it was the ultimate owner of the property rights.

The benefit behind this intra-group transaction has to be brought back to the favourable regime offered to royalties in Luxembourg, where Inter IKEA Holding has its legal seat. Thanks to this trick, Inter IKEA Systems BV was able to shift a large amount of profits to Luxembourg, where they remained untaxed. This opportunity didn't last many years, as I will explain in the next paragraph.[89]

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[88] PWC, *EC releases State aid opening decision in Inter IKEA*, April 2018

[89] New York Times, *Exclusive: IKEA to Face EU Order to Pay Dutch Back Taxes-Sources*, October 2019

#### *4.1.4.2 THE 2011 APA*

Up to 2011, according to the 2006 APA, Inter IKEA Systems B.V. was able to transfer part of the amount received by worldwide stores to Inter IKEA Holding, in Luxembourg, but starting from 2011, it began to move profits to Interogo Foundation, in Liechtenstein.

Indeed, one important event that took place in 2011 was a change in the Inter IKEA structure: after being considered as illegal the mechanism of Luxembourg "Holding 1929", on the 21st December 2011 Inter IKEA Systems B.V. decided to buy, for €9 billion, the intellectual property rights owned by the Luxembourg Inter IKEA Holding, signing an agreement with Interogo Foundation. Therefore, the operation was carried out through two transactions: firstly, Interogo Foundation contributed to Inter IKEA Systems B.V. 40% of the beneficial interest in the property rights, which constituted an amount of € 3.6 billion, as share premium reserves; secondly, Interogo Foundation sold the remaining 60% of the beneficial interest of the property rights for a purchase price of €5.4 billion. The latter purchase price was then converted into an intercompany loan, since it had been provided by Interogo Foundation to Inter IKEA Systems B.V., which remained indebted with it.[90]

[90] International tax law University project, IKEA Transfer Pricing Strategy disassembly instructions, Sara Prosperi, Marta Spinsanti, Cristina Suppa, Danahe Miranda, Selcuk Kane

In the agreement between the two organizations, also the terms of the loan were defined, including a fixed yearly interest of 6% and the fact that the loan is unamortised and has a 12 years maturity. In addition to this, the agreement contains a price adjustment mechanism, according to which, if on the 31st December 2023 the market value of the property rights does not amount to €9 billion, the amount of the debt to Interogo Foundation is adjusted in order to represent the same percentage (60%) of the air value of them.[91]

With regard to the terms of the loan, it had been found out that on 19th December 2011 an advance pricing agreement, named "APA Determination Agreement" was signed between Inter IKEA Systems B.V. and the Dutch tax administration, concerning the "arm's length character of the value of the IKEA proprietary rights at the time of the acquisition of those rights by Systems". The 2011 APA is effective from the 1st January 2012 and lasts for 12 years, thus until 31st December 2023. By the acquisition of the property rights, Inter IKEA Systems B.V. turned into the owner of both the property rights and the IKEA Franchise Concept, therefore excluding the due to give any type of remuneration to anyone for their use. As for the price adjustment mechanism, the 2011 APA gives to Inter IKEA Systems B.V.

[91] *IKEA report: IKEA avoided €1 billion in taxes by using the European taxation system to its own benefit*, European Greens, 2016

the possibility to set aside tax provisions for the interest related to future payment obligations, in case of an increase in the value of the property Rights. The justification provided for the tax provisions is that despite the possible materialisation of those obligations on the 31st December 2013, the risk and the accumulation of the obligation has its origin in the first several years.

The 2011 APA also stipulates that Inter IKEA Systems B.V. shall not depreciate the property rights during the life of the APA, that the interest due on the loan is considered to be at arm's length and that it can be deducted without any limitation. As regards the price adjustment mechanism, the provisions set aside are also be tax deductible, but the 2011 APA does not explain how to calculate them.[92]

Nevertheless, these conditions seem not to be fair by the European Commission, which started an investigation on the functioning of the loan, in 2017, as well as on the acquisition price of the property rights, and on its tax treatment by the Netherlands. In particular, the tax rate of 6% reduced Inter IKEA Systems B.V.'s Dutch tax ball, as the interest payments could be deducted from its taxable profits, as shown in the table.

[92] Financial Times, *Ikea's tax arrangements investigated by EU*, December 2017

*Table 5. Calculation of taxable profit according to 2011 APA*

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| Basis | 800.000.000 - 900.000.000 | 900.000.000 - 1.000.000.000 | 900.000.000 - 1.000.000.000 |
| Operating costs | 100.000.000 - 200.000.000 | 100.000.000 - 200.000.000 | 100.000.000 - 200.000.000 |
| Financing costs (6% annum interest rate paid on the €5.4 billion loan) | 324.000.000 | 324.000.000 | 324.000.000 |
| Allocation to provision | 100.000.000 - 200.000.000 | 100.000.000 - 200.000.000 | 100.000.000 - 200.000.000 |
| Payment transfer functions | 40.000.000 - 50.000.000 | 20.000.000 - 30.000.000 | 10.000.000 - 20.000.000 |
| | | | |
| Profit contribution | 200.000.000 - 300.000.000 | 200.000.000 - 300.000.000 | 300.000.000 - 400.000.000 |
| Other income | 8.000.000 - 9.000.000 | 7.000.000 - 8.000.0000 | 8.000.000 - 9.000.000 |
| | | | |
| Taxable profit | 200.000.000 - 300.000.000 | 300.000.000 - 400.000.000 | 300.000.000 - 400.000.000 |
| Corporation tax | 60.000.000 - 70.000.000 | 70.000.000 - 80.000.000 | 80.000.000 - 90.000.000 |
| Transferable withholding | 10.000.000 - 20.000.000 | 20.000.000 - 30.000.000 | 20.000.000 - 30.000.000 |
| | | | |
| Payable corporation tax | 40.000.000 - 50.000.000 | 50.000.000 - 60.000.000 | 60.000.000 - 70.000.000 |

Source: Investigation UE (State Aid SA.46470 (2017/C) (ex 2017/NN) — Possible State aid in favour of Inter IKEA)

As the table shows, the basis is formed by the franchise income, given by franchise and license income, plus net catalogue income, minus marketing support contributions to franchisees. Then, the basis is reduced by operational costs, financing costs, that represent the 6% annual interest paid on the € 5.4 billion loan for the acquisition of beneficial ownership of the rights, grant to provision, remuneration transfer functions.[93]

According to a report published in 2016 by the Greens in the European Parliament, it appeared that by the intercompany loan, IKEA was able to avoid more than €1 billion taxes in Europe between 2009 and 2014. This was the spark that raised many doubts of the Commission, particularly regarding:

1. **The price of €9 billion of the rights, that does not seem to reflect its market value**. Indeed, that amount may be higher than the price that an independent operator would have paid for the rights in the market at arm's length. Moreover, the calculation of the value of the property rights is disputable since the estimates of the consolidated operating profits of the franchise business made by Interbrand is not clear. The Commission has doubts on the interdependence between the property rights and the IKEA

[93] EU Commission investigation - *State Aid SA.46470 (2017/C) (ex 2017/NN) — Possible State aid in favour of Inter IKEA*

Franchise Concept, already owned by Inter IKEA System B.V.: if on the one hand, the property rights gives an additional value to IKEA Franchise Concept, that would have a high value despite the absence of the property rights; on the other hand, the property rights have a more limited value if deprived from the IKEA Franchise Concept. Thus, to calculate the estimated value of the property rights, the profits of the franchise business that are attributable to IKEA Franchise Concept should have been subtracted. In this way, the value of the property rights would be lower, as well as the loan and, consequently, the interest deducted every year by Inter IKEA Systems B.V.

2. **The terms of the loan granted by Interogo Foundation to Inter IKEA Systems B.V. for the acquisition of the property rights, that appear to be unrealistic.** Indeed, according to the Commission, there is a low probability that, an independent lender would have accepted to grant, at a fixed interest rate of 6%, a non-amortising loan of €5.4 billion, since it would have meant a rise in the risk for the lender. Moreover, with respect to the amount of the loan and, taking into account the exclusion of the possibility to amortise it, a 12-year maturity would not be appropriate. Furthermore, considering the credit worthiness of Inter IKEA Systems B.V., on the basis on its financial statements, it appears that it is not very likely that an independent lender would consider that the company could repay

more than €4.1-4.8 billion of principal over 8 years. The arm's length character of the terms and the amount of the loan also seem not to be justified by the quotation letters provided by ING and BNP Paribas and the internal note prepared by Inter IKEA's chief financial officer. In addition to this, the information provided is limited and there is lack of a financial analysis.

3. **The price adjustment mechanism in 2023, that appears to be impractical.** Firstly, the price adjustment mechanism may have not been agreed between independent undertakings negotiating under comparable circumstances at arm's length. The Netherlands state the impossibility for the tax authorities to verify the accuracy of the cash estimates used to estimate the value of the property rights. Thus, the price adjustment mechanism would allow an ex-post verification before the statutory recovery period has elapsed. Moreover, a price adjustment mechanism could have been agreed in situations where, for instance, the intangible had recently been developed (a new trademark or patent), thus where high uncertainty about the response of the market at the moment of the sale exists. Finally, the Commission notes that the price adjustment mechanism contemplated in the Sale and Purchase Agreement does not specify how such adjustment must be implemented in practice (factors and variables to be considered, method of calculation of the adjustment, etc.). This seems to

leave a wide discretion to the parties to implement a price adjustment on which to base the tax deductions.

4. **The deduction of the provision for future interest payments in connection with the price adjustment mechanism, that seems to be contrary to Dutch law.** Indeed, according to the Dutch corporate tax law, three criteria have to be met in order to form a provision in a tax year for expenses in future tax years: the expenses are caused by facts and circumstances preceding the balance sheet date; the expenses are also allocable to that preceding period; it is reasonably certain that the future expenses will be made. In the Commission's perspective none of these conditions has been met in this case and it does not understand how interest expenses related to a potential future loan and due in future tax years can be considered allocable to a current tax year. Allowing tax deductible provisions in conflict with the general rules under Dutch tax law would constitute a misapplication of the business principle under Dutch, that would allow Inter IKEA Systems B.V. to reduce its taxable profit and hence its tax liability in the years during which the provisions were formed and would therefore confer an advantage to Inter IKEA Systems B.V..[94]

[94] International tax law University project, IKEA Transfer Pricing Strategy disassembly instructions, Sara Prosperi, Marta Spinsanti, Cristina Suppa, Danahe Miranda, Selcuk Kane

To sum up, according to the Commission the 2011 APA may have granted an advantage to Inter IKEA Systems B.V., endorsing a tax treatment that does not seem to reflect a reliable approximation of a market-based outcome in line with the arm's length principle. Furthermore, even if the price adjustment mechanism was to be considered at arm's length, the Commission considers that the deductions may not be compliant with Dutch law.

Therefore, from the Commission's point of view this may constitute a case of "Aid granted by a Member State", according to the art. 107 [95] of the Treaty.

### *4.1.5 Interogo Finance SA*

Interogo Finance SA was founded in Luxembourg in 2011 by Interogo Foundation, which capitalized it with a €5.4 billion claim. Indeed, since 2012 to 2014, Inter IKEA Systems BV paid €972 million in tax-deductible interest to Interogo Finance SA, which therefore paid taxes in Luxembourg at just 0.06% over the three-year period and sent dividends for an amount of €807.8 million to Interogo Foundation.[96]

[95] Art. 107, paragraph 1, Section 2, Treaty of the Functioning of European Union

[96] https://www.interogoholding.com/governance/interogo-foundation/

The decision to set Interogo Finance SA in Luxembourg was strategic since this country does not charge withholding taxes on interest. Nevertheless, there is an interest tax rate of 15%, the same provided for dividends, on profit-sharing bonds and debt instruments with remuneration linked to the issuer's profits. Moreover, in Luxembourg, all expenses defined by law as expenses arising from business activities, including interests, may be deducted from taxable income and at least during the period considered, since there is no specific legislation providing for a restriction on the deductibility of interest on debts.

### *4.1.6 Interogo Foundation*

Interogo Foundation, is an independent entity, founded in 1989, and the legal owner of the Inter IKEA Group. Its main purpose is to secure the independence and longevity of the IKEA Concept.

It has legal personality under Liechtenstein law and its funds can only be used in accordance with the foundation's purpose. The foundation has its own governing bodies and exists for an unlimited period of time. This arrangement remained a

closely guarded secret until it was exposed by Swedish investigative journalist in 2011.

The role of Interogo Foundation is interesting because it receives dividends from Interogo Finance, which are not taxed since Liechtenstein does not tax dividend received from foreign subsidiaries. Moreover, Liechtenstein is a small country where the beneficiaries of trusts and private foundations can remain secret, thus it provides Interogo Foundation with another important benefit. In this way, the Inter IKEA Group is able to shift profits to its legal owner, through tax-deductible interest payments.[97]

## 4.2 The Commission's decision

To present the Commission decisions it is important to introduce the legal framework on which the investigation is based. As I have already mentioned in paragraphs 4.1.4.1 and 4.1.4.2, the Commission investigation aims at assessing whether the two APAs can be considered as state aids.[98]

[97] International tax law University project, IKEA Transfer Pricing Strategy disassembly instructions, Sara Prosperi, Marta Spinsanti, Cristina Suppa, Danahe Miranda, Selcuk Kane
[98] Auerbach M., *Ikea: flat pack tax avoidance*, European Greens, 2016

An APA is not illegal, what is relevant is that an APA cannot turn into a favourable tax treatment for a certain company. The concern is that a state aid, coming from an APA, could alter the competition with the European single market, with a company having a favourable treatment able to give it a selective advantage among other companies operating in the same market, but without any "incentive".

A specific section of the Treaty on the Functioning of the European Union is dedicated to Aids granted by States (Section 2). The article that applies in this case is Article 107, that in paragraph 1 states:

**Article 107 (ex Article 87 TEC)**

*"Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."*

Moving in this direction, the **Article 9 of OECD Model Tax Convention** has a crucial role: it refers to the so-called "**arm's length principle**", a key principle for transfer pricing legislation. The arm's length principle finds application with regard to intra-group transactions: they must happen at a price that reflects the economic reality, in other words, the price applied must be the same price - indicatively - as

if the transaction would happen between two independent companies - not forming part of the same group – operating in comparable conditions.

In the end, what is important to outline is that, arms' length principle is not only a guideline provided by OECD framework, but it is full-fledged incorporated into the Netherlands tax law, as stated by the Dutch Transfer Pricing Decree. In a few words, on the basis of what explained before, there is no doubt: Dutch resident taxpayers must adopt the arm's length principle. No exception is possible for Inter IKEA System B.V.

In the light of what has been told until now: can the 2006 APA be considered as state aid or not? To address this question, we have to look at the functional analysis performed by the Commission, highlight that it is not Inter IKEA Systems B.V. who performs limited functions but Inter IKEA Holding SA. Actually:

*"...contrary to what the 2006 APA assumes, Systems appears to make a unique and valuable contribution to the franchising business."*

For this reason, Inter IKEA Systems B.V. could not be considered the tested party.

In addition, what is relevant is that the level of operating margin attributed to Systems does not seem to reflect the real risks that the company incurred in:

*"Systems assumes risks in a way which appears to be incompatible with the attribution of most of the profit generated by the franchise business to Holding."*

Furthermore, also methodological errors are found in the application of the TNMM.

According to these considerations, at this preliminary stage the Commission believes that the 2006 APA could represent a state aid, because the infra-group transactions that derive from its application are not consistent with the arm's-length principle. In other terms, the same prices would not have been applied in an extra-group context. Consequently, Systems managed to incur in a reduction of its taxable profit, lowering in this way the tax due.

The same conclusions can be set for the 2011 APA, since the Commission considered that it conferred an advantage on Inter IKEA Systems B.V. because it implies a reduction in the taxable profit of it, as a result of the deduction of the interest on the loan.[99]

[99] International tax law University project, IKEA Transfer Pricing Strategy disassembly instructions, Sara Prosperi, Marta Spinsanti, Cristina Suppa, Danahe Miranda, Selcuk Kane

## 4.3 Conclusion

### *4.3.1 IKEA's benefits*

In this paragraph, I tried to highlight the tacit intent of the fiscal manager of IKEA. I also summarized all the benefits obtained by the implementation of his main strategic decisions, in the allocation of profits where the tax legislation is more favourable. I have done it, keeping in mind that the fiscal manager goal is to maximize the corporate profit, by minimizing the amount of tax paid, always following the law. Finally, I was able to answer at the question present in paragraph 4.1.

**Why are royalties allocated to the Netherlands?** In the Netherlands, Inter IKEA System B.V. is able to take advantage from the "Innovative box", before called "Patent box", which provides the 80% of reduction in the taxable profits of the intellectual properties (including royalties). Profits are then taxed at the standard corporate tax rate, 25%. Given this deduction, the effective tax rate on net profits referred to royalties is 5%.
At the same time, the payment of the royalties creates an advantage also for the stores, which have their taxable income reduced.

**Why are the licenses fees allocated to Luxembourg?** Notwithstanding the low taxation of royalties in the Netherlands, there was another strategic move that could have allow Inter IKEA Systems B.V. to reduce even more its net taxable profit. This aim was achieved by moving profit to Luxembourg, where Inter IKEA Holding SA benefitted from a favourable tax regime, "1929 Holding regime", that implied no taxation on the license fee received by Inter IKEA Systems B.V.

**Why are interests allocated to Luxembourg?** In Luxembourg, at least in the considered period, there is no specific legislation providing restrictions on the deductibility of interest on debts. Therefore, it was convenient allocate the interest to Luxembourg, through Interogo Finance SA, since Inter IKEA Systems B.V. had to pay a lot of interest on the debt contract for acquiring the property rights. Moreover, here the withholding taxes on interest are not charged.

**Why are dividends allocated to Liechtenstein?** Dividends are not taxed in Liechtenstein. For this reason, they decided to place there Interogo foundation, which received the dividends from Interogo Finance.

**Other benefits:**

It is strategic to have a no-profit organization in Netherlands, such as Stichting INGKA Foundation, because in this way, it is possible to save over $4 billion in taxes, benefiting from a 3.5% non-profit corporate tax rate.

### *4.3.2 What now?*

The document of the European Commission that has been analysed has its main focus on two actors: Inter IKEA Group, especially Inter IKEA Systems, and the Netherlands. The Commission started investigating on the Netherland's tax treatment of IKEA, in particular on 2006 APA and 2011 APA, in order to discover if the two agreements might be considered as state aid.

Nevertheless, in my opinion it is very likely that the final Commission decision will confirm the preliminary one, since there are too many elements that support Commission's view of the two APAs as state aid. In the case of 2011 APA, I think is likely that the Commission will oblige Interogo Finance to lower the interest rate on the loan.

I have already explained in paragraph 4.1.3.1 that the Commission considered the 1929 Holding Regime as state aid, but in the end, companies benefitting from that did not have to pay back all the received aids because it was recognized the existing aid nature of the regime: therefore it was not applied just to one companies, but to all those ones that respected certain conditions.

However, in the current investigation there is only one company involved, thus the Commission should not be too afraid to ask to IKEA to repay the received aids, in addition to lower the tax rate.

This case shows that maximising profits by minimizing the taxation due is not a so unreachable goal for multinational companies which have a good tax management team. Indeed, that is possible by exploiting several aspect such as: different tax rate from one country to another on the same element; favourable treatment for specific elements in one particular country (as in the case of the Innovation box in the Netherlands); gaps existing in the fiscal legislation of a country regarding the treatment of certain elements (as it has been seen for the lack of a specific legislation in Luxembourg providing a restriction on the deductibility of interest on debts).

My opinion is that the European Union should speed up the process of fiscal harmonisation among the member States, regarding the corporate taxation. This is coherent with the goal of a Fiscal Union, third step of the European Union for building a Federation of States.

In a parallel way, anti-tax-avoidance-legislation should be strengthened, so that companies would be more cautious when implement their tax strategies.

In this direction, norms that oblige States to make public the tax rulings between them and specific companies should be introduced.

# FINAL CONSIDERATIONS

The ultimate goal of this paper is to try to give an explanation to the phenomenon of *transfer pricing*, as well as highlight the phenomenon of *tax havens*.

The latter aspect is part of the IKEA case. Keeping in mind that the objective of the fiscal manager is to maximize corporate profit, minimizing the amount of taxes paid, it has managed precisely thanks to completely legal tax strategies, to avoid paying more than a billion taxes in Europe between the 2009 and 2014.

But continuing in chronological order, we can affirm that problems related to the transfer pricing issue have always existed due to the omnipresent aggressive tax planning that companies put into practice in order to save huge sums of taxes. A first step, the results of which can generally be defined as positive, was carried out through the "OECD guidelines" which, through subsequent "transpositions" and application by the individual States, have buffered the basic erosion and profit phenomenon shifting pursued through treaty abuse or the use of articulated business models that do not make the corporate structure clear.

Instead, many measures have been adopted to combat tax havens. Several documents have been drawn up by the OECD and the European Union in order to outline new measures to combat tax havens.

The objective of the OECD has always been to outline minimum standards aimed at encouraging the various states to adopt initiatives that favour free competition, focusing on the development and implementation of regulations on transparency and information exchange.

It should be emphasized that the intent of all the bodies of the European Union has always been to contribute to the creation of a fair and harmonized taxation system among the Member States in order to counter the presence of tax havens, tackling the problem of tax havens efficiently and effectively erosion of tax bases.

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