

# Cause and Countermeasures on Tax Avoidance: From a Comparative View

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**Abstract.** With the internationalized establishment of multinational enterprises, many of them are trying to win more profits and save more costs for themselves for better development. To eliminate the adverse effects of tax avoidance and maintain international business order, relevant regulations and agreements should be proposed to prevent MNEs from excessively transferring their profits and evading the tax they should have paid. Case study and comparative analytical method have been used in this paper to look at whether or not the tax avoidance of MNEs is problematic for host states and propose appropriate solutions for different entities. From the research, both similarities and differences can be concluded from different MNEs' methods of committing tax avoidance. Also, there is the possibility that relevant entities take corresponding measures within their respective region or scope to prevent adverse effects carried out by tax avoidance.

**Keywords:** tax avoidance, cause and countermeasures, comparative analysis

## 1. Introduction

As the main character of the global economy, MNEs have been playing a more and more important role in promoting global capital flows and resource allocation. However, with the increasing competition between companies from different states, being driven by profits and the desire to get a better environment to develop, some of MNEs start to make use of loopholes in the laws or regulations and business agreements with their subsidiaries or affiliated enterprises to commit tax avoidance, which has infringed on the interests of others.

Until today, much research about MNEs and tax avoidance has been carried out to figure out how and why MNEs commit tax avoidance. Some of these researches include one or more MNEs' examples in their analysis, and some constructive solutions were also be proposed. However, many of the researchers showed their findings just by listing or narrating instead of from a comparative view and the solutions proposed failed to cover the main entities. As typical cases of tax avoidance, Apple and Google are to be analyzed with comparative method in the paper to figure out the unified law and differences in the tax avoidance methods, goals, and consequences. Based on this, it's meaningful to propose necessary measures against the existing or incoming tax avoidance behaviors of MNEs to help maintain the global economy and business order.

## 2. Tax Avoidance Carried Out By Two Famous Enterprises

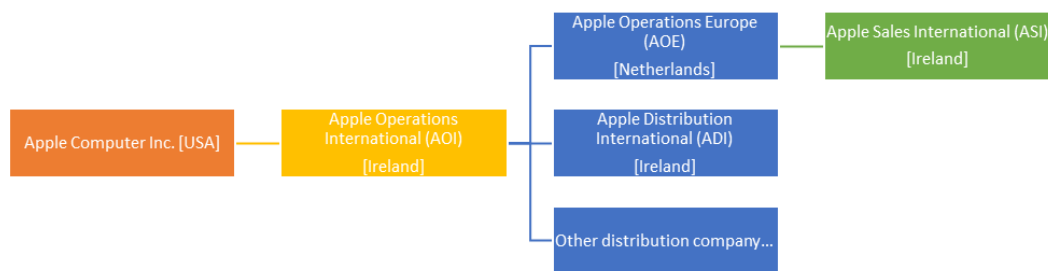
The cases of Apple and Google will be analyzed here to explore and conclude the mode of tax avoidance behavior carried out by MNEs. There are three reasons for electing these two enterprises:

Firstly, both of them are huge MNEs and own the business scope all over the world, which endows them with typical significance and general laws are more likely to be excavated from them. Secondly, both Apple and Google once committed tax avoidance and were exposed to criticism. Finally, although there are many similarities between the two MNEs in tax avoidance, differences still exist, which can help us to explore the potential reasons for them to take different tax avoidance measures or policies respectively.

### 2.1 The Way that Apple Carry Out Tax Avoidance

The most well-known example of tax avoidance is the case of Apple. As one of the world's major MNEs, Apple has attracted much attention as the news of tax avoidance comes out and the income

not being taxed reached \$102 billion. According to relevant research carried out on Apple before, the main measure for Apple to avoid tax is to make use of transfer pricing and cost sharing agreement.



**Figure 1** Apple subsidiary structure

To commit tax avoidance, Apple established its affiliate company Apple Sales International (ASI) in Ireland as the principal of assets, functions, and risks to earn entrepreneur profits, receiving all global revenues outside the United States by selling the Apple products to regions all over the world, which were bought at a relatively low one from the country of manufacture. In fact, these profits would be transferred to Apple Operations International (AOI) at last, which is registered in Ireland but locates its headquarters in the British Virgin Islands. However, it isn't free for Apple to transfer profits from ASI to AOI. To solve this "problem", Apple established Apple Distribution International (ADI) in the Netherlands because Dutch tax law stipulates that transactions between companies in EU member states are exempt from income tax. According to their registration place, ASI, AOI and ADI are all defined as EU companies so the transfer becomes free from tax, no matter from ASI to ADI or from ADI to AOI.

By making use of differences between the Irish internal tax law and the US tax code on resident taxpayers [1], Apple transferred its most profits to its subsidiaries located in Ireland, which are stateless in both Ireland and U.S. [2], enabling ASI to be the main principal through CSA.

In this case, Apple took patent and intellectual property as the media to transfer assets, which means Apple overstretched the value of its intellectual property but overlooked the value of production links. This could be adverse to the interests of the host country, which may be responsible for the production of Apple products as they can't get enough income from the manufacturing process.

## 2.2 The Way that Google Carry Out Tax Avoidance

Besides Apple, Google is also a typical case of tax avoidance. According to Sunday Times, Google has avoided taxes of at least 3.2 billion pounds (about \$4.63 billion) in the past five years. Google's branches or subsidiaries extend to at least 5 regions over the world, including the region with high tax rates like the USA and the region with lower one like Ireland, Bermuda, etc.

Intellectual property developed in the U.S. was sold to Google Ireland Holding and then Google Ireland Limited. On the one hand, this measure reduced the tax Google need to pay in Ireland, on the other hand, it enabled Google to collect royalty fees in Bermuda and evade Ireland tax. Although the tax law in Ireland makes it difficult for Google to send its profits directly to Bermuda without paying a certain amount of taxes, companies located in some EU countries do not need to pay tax under Irish tax policies. Take Google's enterprise in the USA as an example, Google firstly transfer its profits to Ireland (Ireland Limited), whose tax rate is half lower than one in the United States. But this does not reach Google's expectations. In the next step, Google transferred them to the Netherlands, which has multiple tax preferences. Just like Apple, Google established a subsidiary called Google BV in the Netherlands, which is only a nominal company. As a result, the profits were transferred from Ireland Limited to the Netherlands and then Bermuda. As Bermuda's subsidiary is managed by an Irish company, this tax avoidance method adopted by Google is nicknamed "double Irish, Dutch sandwich" [3].

## 2.3 Comparative Analysis

Both Apple and Google took transfer pricing as the main method to commit tax avoidance, and it seems that the "double Irish, Dutch sandwich" has become the typical mode for MNEs to carry out tax avoidance. However, what enables and promotes MNEs to take such a complex method? From the cases of Apple and Google above, some similarities can be concluded and the reasons behind it are possible to infer.

Firstly, in these cases, the origin of profits is divided into two parts: in the home states of headquarters (in the above cases is the continental United States) and outside of it, so two sets of tax avoidance measures are carried out at the same time. From current research, the dual mode is clearer in Apple's case: profits from the U.S. are transferred to the subsidiary located in Nevada while others are transferred to AOL. Although the relevant information in the Google case is not unequivocal enough, it can be confirmed that the same pattern also exists in this enterprise as Google takes customers from the Middle East, Europe, and Africa as a whole to deal with Ireland Limited. By the way, it is worth noting that the tax avoidance measure carried out in the home states is much less complex than that outside of it.

Secondly, both Apple and Google choose Ireland and the Netherlands as the states to help commit tax avoidance and take "double Irish, Dutch sandwich" mode. For Ireland, its own corporate income tax rate is lower than that of other countries and regions. By the way, Ireland often provides preferential policies to MNEs like Apple, Google, Facebook, etc. More importantly, the tax policies of both these two states stipulate that EU member states are exempt from income tax. Different definitions for the nationality of the MNEs and income attribution are also set in the two states' tax policies. These loopholes generated from the setting of Irish and Dutch tax policies offer "opportunities" to MNEs to evade tax, which is also the "blank" mentioned below. All the elements above centered may explain why Ireland and the Netherlands could become the best combination choice for these two giant MNEs.

Thirdly, intangible goods are the main media for Apple and Google to commit tax avoidance. As intangible goods like patents and intellectual property characterize as difficult to set price, without unified tax formula and do not exist as physical products, it's difficult to hold MNEs accountable for tax evasion. In the above cases, Apple and Google evaded the supervision of tax avoidance under regional or international regulations by transferring profits to the target company in the name of patent and licensing fees, which seemed to be lawful. In this way, they become effective tools for MNEs to transfer profits.

## 3. Background Analysis For Mnes' Tax Avoidance

### 3.1 Tax Avoidance Methods of Multinational Enterprises

The "mutations" in incorporations laws disturbed the balance and order originally created by the separate legal person of enterprise entities and result in tax avoidance [4]. In general, most MNEs carry out tax avoidance by taking advantage of the loopholes in international tax rules and the differences among states' tax systems to minimize their global tax burden. It can be specifically summarized as transfer pricing, thin capitalization, cost-sharing agreement, etc. [5].

#### 3.1.1 Transfer Pricing

As the main method for MNEs to commit tax avoidance, transfer pricing can win more profits for MNEs than any other methods [6]. Through this method, enterprises in high tax states sell goods or provide labor services to their associated enterprises in low tax countries at a low price and vice versa. In this way, profits will be transferred from high-tax states to ones with low taxes, so as to minimize the tax burden.

### 3.1.2 Thin Capitalization

Loans and issuing stocks are two main ways for MNEs to raise funds. As regulations of some states allow pre-tax deductions for financing obtained from loans, some MNEs intend to increase pre-tax deductions by concealing shares or increasing the proportion of loans in raising funds.

### 3.1.3 Cost Sharing Agreement (CSA)

By signing CSA with their associated enterprises in low-tax states, some MNEs distribute income from markets of different regions and risk unreasonably, carrying out tax avoidance by centralizing low-risk burden and high return in enterprises located in states with low tax.

### 3.1.4 Base Erosion and Profit Shifting (BEPS)

By taking some measures seemed to be legal, MNEs can achieve the transfer of profits from countries with high tax burdens to ones with low tax burdens, resulting in the erosion of the tax base of countries, which is called Base Erosion and Profit Shifting (BEPS) [7]. In summary, rather than taking BEPS as one of the ways of tax avoidance, it would be more suitable to define it as the result carried out by tax avoidance as can be realized by the other three tax avoidance methods mentioned above.

## 3.2 The Impact of Tax Avoidance on MNEs

But what can tax avoidance bring to MNEs, enabling them to choose to evade taxes at the risk of sanctions from international? The answer can be summarized in two words—money and market. Firstly, it's obvious that huge economic effects can be brought to MNEs. By carrying out tax avoidance measures, taxes including corporate income tax and tariffs will be largely cut, saving unnecessary expenses in the eyes of multinational companies. By the way, markets are the other goal for MNEs. There's no denying that the market is the life of enterprises because the market means resources, connections, and opportunities. By carrying out a series of tax avoidance measures, MNEs invade the interests of other enterprises or investors in host states and transfer these interests to their subsidiaries for better development.

## 4. The Effects of Tax Avoidance on Host States

It is possible to argue that two main effects could be caused by tax avoidance on the whole world. The first point that should be mentioned is the low efficiency of resource allocation. The second effect is that tax avoidance can bring about disorder in the international economic and business environment.

Generally speaking, Herfindahl-Hirschman Index (HHI) and entrance obstacles are the two main factors to evaluate an enterprise's competition power [8], but in some situations, we can substitute them for a more specific element: effective tax rate (ETR). For host states, the existence of BEPS will enable a state's tax base to be negatively affected, and the capital collecting ability of its government will decline [9], which means to maintain the stability and total amount of revenue, the government cannot spare more benefits for local enterprises, even if it wants to support them. Without the support of the government, local enterprises have to bear a heavier burden. In other words, they need to pay more taxes and face a relatively high effective tax rate. As a result, the development of local enterprises can be restricted as the innovation of the enterprise is trapped and they cannot afford to attract or employ more top workers or managers, making them lose both international and domestic competition power compared with the MNEs entering their states and MNEs themselves would become the biggest beneficiary.

On the other hand, as mentioned above, MNEs can carry out tax avoidance by transferring profits to their subsidiaries or permanent bodies in the same host states which can satisfy subsidiaries' funds need for investment while avoiding taxes. It's obvious that if the subsidiaries or permanent bodies of MNEs mature, they may unite with their "boss" and take up the market share of local enterprises, creating a monopoly in the host states' market at last.

## **5. Methods of Solving Tax Avoidance Problems By Different Entities**

### **5.1 The Existing Efforts in Preventing Tax Avoidance**

In order to avoid the economic damage tax avoidance has brought to the world and relevant states as far as possible, a series of measures have been carried out on a global scale. Among these measures, two of them deserve the most attention.

#### **5.1.1 BEPS Action Plan**

The first measure is the BEPS Action Plan, which was first carried out by Organization for Economic Co-operation and Development (OECD) to address the BEPS problem of tax avoidance in 2013. BEPS action plan makes suggestions on the adjustment of international rules and national legislation so that countries can deal with the problems of BEPS in a coordinated and comprehensive manner. It is characterized by its pertinence to BEPS problem and it has become the most influential systematic anti-tax avoidance measure around the world.

Until today, BEPS Action Plan has released 15 achievements including “Develop a Multilateral Instrument” and “Data Methodologies”, etc. to relieve and hold back BEPS from all sides and made certain achievements. From TEI’s comment, the OECD’s efforts have enabled the international tax system to keep up with the changing economy and business environment. However, as some countries took one-sided and arbitrary implement, it is difficult to reach consensus and the Action Plan is facing with challenges [10].

#### **5.1.2 Efforts from Other Organizations: Take G8 as the Example**

G8’s recent erecting of a global minimum tax is the second measure that should be paid attention to as it is the newest tax avoidance measure. Last year G8 (actually only 7 countries participated in the meeting) adjusted the tax payment place and set the lowest tax rate for enterprises to avoid MNEs to transfer their profits and evade the tax they should have paid. To some extent, it is also a good measure to prevent tax avoidance by regulating the operating behavior of MNEs.

By the way, other regulations and rules like “the Multilateral Convention on Mutual Administrative Assistance in Tax Matters as amended” and Common Reporting Standard (CRS) have also been established and played an important role in countering tax avoidance.

### **5.2 Suggestions for Future**

#### **5.2.1 Measures for Host States**

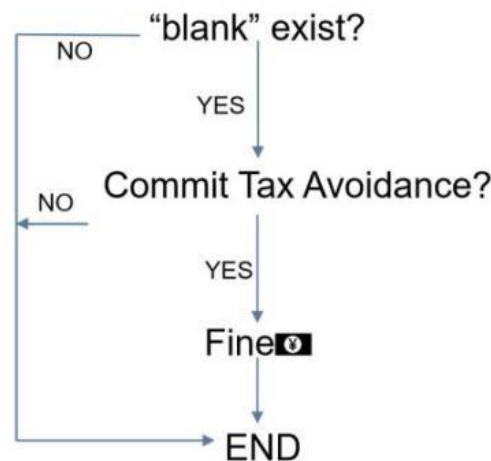
As the main victim of tax avoidance, host states should always be vigilant and take corresponding measures to protect themselves from being affected by tax avoidance and defend their core interests.

##### **5.2.1.1 Active Participation**

Firstly, it’s necessary for host states to actively participate in international contracts or conventions against unreasonable tax avoidance. Under normal conditions, the leading authors of international conventions or policies are countries that have achieved a certain degree of results in specific areas, and tax avoidance addressing is no exception. Although international conventions or rules formulated by international or regional organizations are not as forceful as laws, host states can receive some protection and relief for their international influence.

##### **5.2.1.2 Double-standard Blacklist Setting**

Secondly, host states should set a double blacklist for the MNEs who have entered or have the plan to enter their states. A two-level standard is been talked about here.



**Figure 2** Procedure for Double-standard Blacklist Operation

In the first level, the host states should make sure that the MNEs can bring benefits to them, including investment, jobs, R&D resources, etc, which determines whether the MNEs are qualified to enter the state for development. As some of these targets could be realized through bilateral or multilateral market access agreements to some extent, the second level seems to be more important.

In the second level, the host states should make sure that the entered MNEs will not damage the states' economy, which is the negative element of MNEs' entry and continuation. With this standard, the host states have the right to prevent MNEs suspected of BEPS from continuing to operate or occupy market share in the states and to add concerned MNEs to the blacklist. By the way, if the MNEs are found on the blacklist, other subsidiaries of the same MNEs or other MNEs from the same home states will be restricted when they enter this state. This solution can force both the parent enterprise and the home state to actively participate in the management of MNEs.

### 5.2.2 Measures for International Organizations

Nowadays, international organizations have made great efforts to address the tax avoidance problem caused by tax avoidance, but it is far more enough.

Because of the differences in each country's tax systems around the world, some MNEs use the loopholes and information gaps to carry out tax avoidance measures. To address the problem, a unified registration and report procedure is necessary. Specifically, under the procedure, every MNEs is obligated to report its net profit, tax amount, and its home state and host state. The specific department of concerned organizations should review this information and figure out whether there is a "blank" between the two states' tax systems.

The "blank" exactly means the loopholes caused by the differences between the two states' tax systems which MNEs can make use of to commit tax avoidance. The current agreement for the avoidance of double taxation between states basically adopts the OECD Model Tax Agreement. However, when the agreement is used with the domestic laws of some states, there will be loopholes. In the cases of Apple and Google, the "blanks" are similar. As mentioned above, after knowing that it is impossible to reduce tax under the regulation of the U.S., MNEs take "tax avoidance heaven" - the British Virgin Islands and Bermuda - as destinations for profits. But MNEs cannot transfer money directly to "heaven" and tax still exist in profit transfer within one state. So, Ireland and the Netherlands play the role of transfer action because both their tax policies stipulate that EU member states are exempt from income tax. With the help of different definitions for the nationality of the MNEs and income attribution, both of them can achieve not paying taxes in both U.S., transfer action Ireland and destination.

**Table 1** Criteria for determining the nationality of MNEs & relevant policies (Ireland and the Netherlands)

	<b>Ireland</b>	<b>the Netherlands</b>
<b>Criteria</b>	location of the parent company or headquarters	location of registration place
<b>Relevant tax policies</b>	profits flowing to a foreign parent company or headquarters are exempt from tax	/
	EU member states are exempt from income tax	

**Table 2** The effect of profits transfer route on tax

<b>Transfer Route</b>	<b>Tax?</b>
Ireland → Ireland	YES
Ireland → the Netherlands	NO
the Netherlands → Ireland	

If the “blank” does exist and the MNEs have committed tax avoidance, the organization can collect a fine in proportion to the amount of tax avoidance from the MNEs concerned in the organization’s name, even if the MNEs’ behavior seems to comply the tax law or regulations of both states, which shows the "essence justice" in tax avoidance problem instead of the "procedure justice".

## 6. Conclusion

In conclusion, for the sake of capital, interests, and markets, many MNEs start to take various kinds of measures to commit tax avoidance. Such behavior of MNEs can bring damages or threats to host states’ economy development and order. The drawbacks of tax avoidance can extend from the decline of the capital collecting capacity of the host states’ government to the lack of competitiveness of other companies in host states. As the core element for MNEs to carry out tax avoidance, measures like thin capitalization, CAS, and BEPS all play an important role in the process, especially transfer pricing. This can be seen from the comparative analysis of Apple and Google, both of which regarded transfer pricing as one of the most important measures and applied almost the same “double Irish, Dutch sandwich” mode to commit tax avoidance.

To solve the issue, based on existing solutions, not only international organizations should continuously innovate standards or conventions with global applicability, but spontaneous action should also be taken by host states. This paper proposed diversified solutions according to the MNEs’ tax avoidance mode and characteristics of different subjects, filling the gap of existing solutions that failed to cover all the main entities.

However, this paper only uses two giant MNEs as the objects of comparative analysis and concludes similarities from the measures they took to commit tax avoidance, which makes the conclusion typical, but lacks universality to a certain extent. In the future study, the number of research objects can be increased and more MNEs cases, including giant and small, can be analyzed so as to make a deeper study of this topic.

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