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APPLE'S INTERNATIONAL TAX STRUCTURE AND ITS TAXATION AVOIDANCE ISSUE

Elena Goncearuc

DIRECTOR

Maria del Mar Rubio Varas

Pamplona - Iruña

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1. Abstract

This thesis' main purpose is trying to bring some light over Apple´s international taxation system and its tax evasion issue, although I did not want to stop there. I am using Apple Inc. just as an example trying to explain a much more relevant issue, which is the flexibility and weakness of our current international tax laws, principles and rules. Therefore before getting to your innovative company, I tried explaining some other popular taxation schemes used by notorious multinationals like the ¨Double-Irish¨ and the Luxembourg schemes that were made public of the Luxembourg tax leaks scandals. I continue discussion what countries should be doing in response to the double non-taxation, not forgetting the Big Four consulting companies who play an important role in shaping the legislation.

Key words:

Tax avoidance, double non-taxation, multinationals, governments, legislation, transparency, the Big Four, complexity, low tax jurisdictions, corporate residency, tax structure, CFC, international.

2. Introduction

Confidence in our tax system is crucial and at the same time quite hard to be maintained, if not every company or individual is paying their fair share of tax. Recent tax evasion scandals of multinational companies like Google, Amazon, Vodafone, Apple, Microsoft, Starbucks have risen questions like ¨why do multinationals get away with it?¨ and ¨how did they do it?¨. You know there is a problem (or an opportunity) when despite enjoying a large amount of business worldwide, multinationals pay ridiculously law amounts of corporation tax.

Most of the multinationals have access and can financially afford significant resources to make sure that they minimize their tax liability. There is an important and increasing demand for fiscal advising companies, the most popular being the Big Four consulting firms, on how to take full advantage of the international tax jurisdictions. The Big Four (Deloitte, Ernst and Young, KPMG and PwC), for that matter, employ thousands of professionals in the field and earn 25$ billion from their tax work globally.[1]

Nowadays, due to technology, multinationals would need as little as a computer and some employees to found a business in a tax haven. Under the present tax rules, this is more than enough for them to be able to pay their tax in a low-tax jurisdiction country instead of the location where the business truly takes place. This is not moral to responsible companies and citizens who do pay their fair share of tax.

Each country´s Government engagement in reforming the current international tax laws is more than necessary, but the process will most definitely be a slow and lengthy one. Until then, the reality is that the companies will continue to discover ways to avoid paying taxes where they actually do business and not even.

It is believed that international tax law major flaw is that it is way too complex and simplicity is key in fighting tax avoidance. A simpler system is in everybody's interests. A problem represents what is believed to be the line on the difference between what defines tax planning and aggressive tax avoidance. A recent report issues by Oxford University Centre for Business Taxation explains this complexity: "Tax avoidance has no fixed legal meaning, although courts have sought to elucidate it in some cases and, for example, to distinguish tax avoidance from tax planning or tax mitigation. Matters are often

[1] Evidence 26,29,30,31, House of Commons Hearing, 44 Report session 2012-13

complicated but not usually clarified by the addition of adjectives such as “aggressive” “abusive” “unacceptable””.[2]

Taxations schemes, explained next, have become lately a reputational risk especially for tax advising companies which, after the late scandals, are seen as the ones who incentive tax avoidance, but also for the taxpayers who use the schemes, especially since such effort is described in the media as “aggressive” not considering the magnitude of the such practices.

The main source that will be used during this thesis will be US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.), by Homeland Security & Governmental Affairs (United States Senate)[3]

3. The Double Irish

Before continuing with Apple Inc., I thought it would be interesting and very helpful to analyze one of the most popular tax evasion schemes among multinationals. I will give two example of how countries, in this case Ireland and Luxembourg could be used for tax evasion reasons.

If we search for countries who represent tax havens, we stumble across jurisdictions like Switzerland, Luxembourg, U.S. (State of Delaware), Cayman Islands, the U.K. (City of London), Ireland, the Bahamas, Belize, Bermuda, Singapore, Belgium and China (Hong Kong).[4]

[2] Tax avoidance, Oxford University Centre for Business Taxation, 3rd December 2012
[3] http://www.gpo.gov/fdsys/pkg/CHRG-113shrg81657/pdf/CHRG-113shrg81657.pdf
[4] Tax Justice Network and Forbes “World’s best tax havens”, by Richard Murphy

Table 1. - Corporate tax rates table [5]

Tax paradises between 2006 and 2014.

Location	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Albania	20	20	10	10	10	10	10	10	15	15
Bahamas	0	0	0	0	0	0	0	0	0	0
Bahrain	0	0	0	0	0	0	0	0	0	0
Bermuda	0	0	0	0	0	0	0	0	0	0
Bonaire, Saint Eustatius and Saba							0	0	0	0
Bosnia and Herzegovina	10	10	10	10	10	10	10	10	10	10
Bulgaria	15	10	10	10	10	10	10	10	10	10
Cayman Islands	0	0	0	0	0	0	0	0	0	0
Cyprus	10	10	10	10	10	10	10	12.5	12.5	12.5
Georgia								15	15	15
Gibraltar	35	35	33	27	22	10	10	10	10	10
Guernsey	0	0	0	0	0	0	0	0	0	0
Ireland	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5
Isle of Man	0	0	0	0	0	0	0	0	0	0
Jersey	0	0	0	0	0	0	0	0	0	20
Kuwait	55	55	55	15	15	15	15	15	15	15
Latvia	15	15	15	15	15	15	15	15	15	15
Lebanon								15	15	15
Liechtenstein						12.5	12.5	12.5	12.5	12.5
Lithuania	15	15	15	20	15	15	15	15	15	15
Macau	12	12	12	12	12	12	12	12	12	12
Macedonia	15	12	10	10	10	10	10	10	10	10
Mauritius	25	22.5	15	15	15	15	15	15	15	15
Montenegro	9	9	9	9	9	9	9	9	9	9
Oman	12	12	12	12	12	12	12	12	12	12
Paraguay	10	10	10	10	10	10	10	10	10	10
Qatar	35	35	35	35	10	10	10	10	10	10
Serbia	10	10	10	10	10	10	10	15	15	15
Vanuatu	0	0	0	0	0	0	0	0	0	0

[5] KPMG official website, tax, Corporate tax rates

For American multinationals to open its path in Europe, Ireland is considered to be one of the most attractive countries for opening subsidiaries or the so called "operations centers", because of the perfect synergy between the Irish corporate tax regimes and the US tax law, which will be later explained in more depth. An example could be that on active business income Ireland charges as little as 12.5%[6] of corporate tax rate, known to be the lowest in the world, and certainly in the EU:

Table 2. - EU Corporate tax rates table [7]

Global corporate tax rates between 2006 and 2014

Location	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Austria	25	25	25	25	25	25	25	25	25	25
Belgium	33.99	33.99	33.99	33.99	33.99	33.99	33.99	33.99	33.99	33.99
Bulgaria	15	10	10	10	10	10	10	10	10	10
Croatia	20	20	20	20	20	20	20	20	20	20
Cyprus	10	10	10	10	10	10	10	12.5	12.5	12.5
Czech Republic	24	24	21	20	19	19	19	19	19	19
Denmark	28	25	25	25	25	25	25	25	24.5	23.5
Estonia	23	22	21	21	21	21	21	21	21	20
Finland	26	26	26	26	26	26	24.5	24.5	20	20
France	33.33	33.33	33.33	33.33	33.33	33.33	33.33	33.33	33.33	33.33
Germany	38.34	38.36	29.51	29.44	29.41	29.37	29.48	29.55	29.58	29.65
Greece	29	25	25	25	24	20	20	26	26	26
Hungary	16	16	16	16	19	19	19	19	19	19
Ireland	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5
Italy	37.25	37.25	31.4	31.4	31.4	31.4	31.4	31.4	31.4	31.4
Latvia	15	15	15	15	15	15	15	15	15	15
Lithuania	15	15	15	20	15	15	15	15	15	15
Luxembourg	29.63	29.63	29.63	28.59	28.59	28.8	28.8	29.22	29.22	29.22
Malta	35	35	35	35	35	35	35	35	35	35
Netherlands	29.6	25.5	25.5	25.5	25.5	25	25	25	25	25
Poland	19	19	19	19	19	19	19	19	19	19
Portugal	27.5	25	25	25	25	25	25	25	23	21
Romania	16	16	16	16	16	16	16	16	16	16
Slovakia	19	19	19	19	19	19	19	23	22	22
Slovenia	25	23	22	21	20	20	18	17	17	17
Spain	35	32.5	30	30	30	30	30	30	30	28
Sweden	28	28	28	26.3	26.3	26.3	26.3	22	22	22

[6] Irish Tax and Customs, Corporation Tax Basis of Charge
[7] KPMG official website, tax, Corporate tax rates

United Kingdom	30	30	30	28	28	26	24	23	21	20
Europe average	23.7	22.99	21.95	21.64	21.46	20.81	20.42	20.6	19.68	20.24
EU average	24.83	23.97	23.17	23.11	22.93	22.7	22.51	22.75	21.34	22.15
OECD average	27.67	27	25.99	25.64	25.7	25.4	25.15	25.32	24.11	24.77
Global average	27.5	26.95	26.1	25.38	24.69	24.5	24.4	23.71	23.64	23.68

The reasoning behind a 12.5% tax rate is that Ireland thinks that a low-tax regime for corporations will create a lot more wealth and ironically even tax profit when you consider its citizens who do pay taxes. Ideally in the future, Ireland will try to work against tax schemes like the double Irish by creating anti-abuse or transfer-pricing measures, especially since they have encountered some pressure from Europe. However, so far, Ireland joyfully accepted its "loss" in tax collection in exchange for an important economic wealth generated by foreign investments. As other tax havens, Ireland is a good example of the fact that when it comes to taxing business profits, less is definitely more.

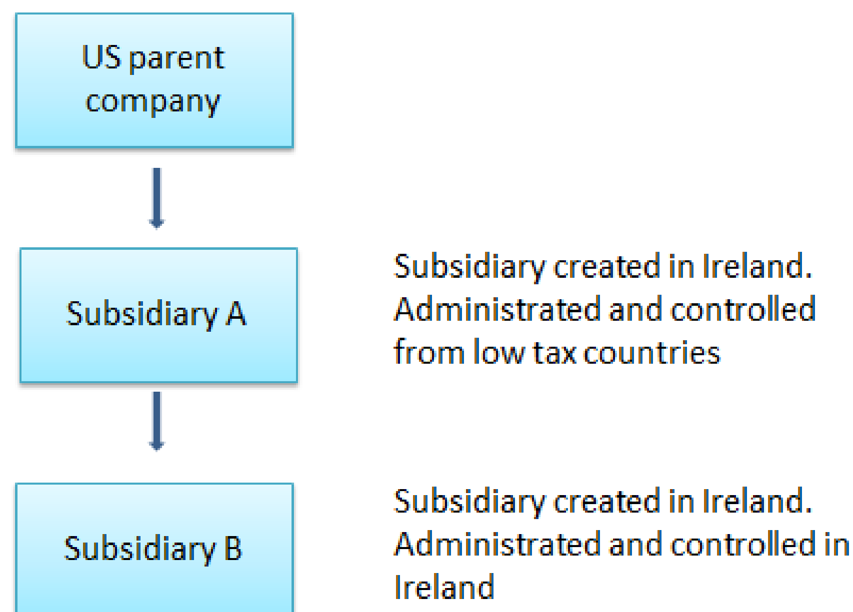
In 1999 Ireland implemented a regime where the taxable income is split into two categories: trading income and non-trading income. In this case, the one that interest us most is the trading income that includes income from active businesses and is subject to a low, flat tax of 12.5%, which, as already mentioned, is one of the lowest in the world, and when combined with a substantial amount of Irish tax treaties, generates a tempting tax incentive to create businesses operations in Ireland. When these important tax revenues are grouped with Ireland's English speaking and high-educated workforce, it is becoming more than obvious why exactly Ireland is chosen as foreign business operations center for most US technological multinationals.

Another great competitive advantage is that Ireland didn't apply yet some of the most used "anti-abuse" tools present in the tax regimes of the majority of advanced countries. An example that could be added to give a better understanding is that Irish tax legislations do not contain well specified transfer pricing rules. This kind of rules are carried out in other advanced countries with the purpose of making sure that arm's-length principles apply in related parties transactions. The arm's-length principle is the fact that in a transaction the parties are fully independent and enjoy equal opportunity. Usually transfer pricing laws are of prime concern for a country that anchors important economic activities, because they help protect a countries tax revenues by preventing the diversion of profits to low-tax jurisdictions.

3.1. The double Irish structure

One of the most used ways to take advantage of the flaws in the international tax system by multinationals, in this specific case by the convenient Irish tax structure and the US entity classification rules, is creating a hybrid arrangement that allows technology driven, but not only, multinational's sales to be made through an Irish subsidiary to outside US customers while reducing, US, Irish and worldwide taxation. This common scheme used by multinational is known informally as "Double Irish" and consists of a US parent corporation who creates two Irish subsidiaries, "A" and "B". Subsidiary A is usually a first-tier Irish subsidiary of the US parent company that is organized under Irish law but managed and controlled from Cayman Islands, let's say, or any other low-tax jurisdictions. Subsidiary B is exclusively owned by Subsidiary A and it's organized, managed and controlled in Ireland.

Figure 1.[8]



Under the US rules, a corporation is considered US resident based on the physical location of the corporation (national)[9]. Under Irish law, tax residency concentrates mostly on the location of a company's administration and control activities[10]. For that matter, an enterprise incorporated in Ireland but whose management and control activities occur in

[8] Own elaboration
[9] Internal Revenue Code of 1986, U.S. Code ,Title 26, Subtitle F, Chapter 79, § 7701, 30(a), https://www.law.cornell.edu/uscode/text/26/7701
[10] Ireland Tax Consolidation Act 1997 , § 23A, http://www.irishstatutebook.ie/1997/en/act/pub/0039/

US will be treated for US tax purposes like an Irish corporation, but for Irish tax purposes as a non-resident if that company:

- controls an Irish company that conducts an active business in Ireland
- is "controlled" by one or more residents of a country with which Ireland has a double taxation treaty.

"Control" is satisfied by 50% or more stock ownership and the Ireland- US treaty qualifies as a double taxation treaty. [11]

Using these tax rules on the double Irish structure, the result will be that Subsidiary A will be considered a Cayman Islands company for Irish tax purposes because:

- it will control Subsidiary B, which will conduct active business in Ireland, and
- will be controlled by the US parent, which is a treaty-eligible resident of the United States.

Meanwhile, for US tax purposes, the tax strategy is to create hybrid structures, which in most cases are dual residence companies. The idea behind hybrids, as mentioned, is to have the same profits treated differently by different countries for tax evasion. Continuing with the example, subsidiary B will file a US check-the box election to not be taken into account as an entity separate from Subsidiary A. The check-the-box meaning will be explained better later using Apple Inc. as an example. As a result of this, Subsidiary A and subsidiary B will be "merged" and treated as a single Irish corporation for US federal tax purposes, but at the same time will continue to be dealt with for Irish tax purposes as two different companies, a Cayman Islands resident corporation and its Irish subsidiary. Transactions between Subsidiary A and subsidiary B will have no effect for US tax purposes.

In the next step for the application of the Double Irish structure, Subsidiary A will enter into a cost sharing agreement with its US parent for the development of intellectual property, for example. This intellectual property will be fully owned by the US parent and will enjoy all the rights within the US territory, while Subsidiary A will pay the US parent in exchange for the rights to exploit the intellectual property outside the US. The US parent and Subsidiary A will fund together the development of the intellectual property, for example by creating a newer version of the software program. This newly created software will be licensed by Subsidiary A and Subsidiary B to produce software products in Ireland, latter to be sold outside the country.

Under the US legislation, the license payments from Subsidiary B and Subsidiary A will

[11] Ireland Tax Consolidation Act 1997 , § 23A(3), available online

not be taken into consideration, while Ireland will consider such payments as royalty paid by an Irish corporation to a Cayman Islands corporation for the use of the Cayman Islands corporation's intellectual property in Ireland. At the same time, Subsidiary B will treat the royalty payments made to Subsidiary A as a trade expense against its Irish taxable income.

Subsidiary A and Subsidiary B may position the royalty payments at the most advantageous level to reduce Subsidiary B's taxable income in Ireland, since Ireland's transfer pricing rules are very light. The tax applied on the remaining profit will be fixed at the flat 12.5%, which, as we said, is applicable to active business profit. The royalty payments to Subsidiary A will be subject to taxation in Cayman Islands, at for example, zero tax rate. In conclusion, very little or even no tax will be paid on the profit earned in Cayman Islands, and only 12.5% tax will be paid on profits earned in Ireland. The next step could be for the US parent to repatriate the profit (through a dividend, for example) and only then such income will be subject for US taxation.

3.2. End of Double-Irish strategy?

In 2014, the Irish government started the process of changing its tax code in an attempt to close the so popular corporate tax loophole, the "Double Irish". The tax change would require the companies registered in Ireland to be tax residents in Ireland within the next six years. As it is expected, this will affect an important number of U.S. companies, especially the ones in the technology sector.

The decision to change the legislation was due to increasing tension coming from the European Union governments. During a parliamentary hearing to introduce the 2015 budget, the Irish Finance Minister, Michael Noonan, said that the aggressive tax schemes implemented by multinationals are criticized by governments across the whole world and it has damaged the reputation of many countries. Therefore this upcoming tax change has as main goal to make it difficult for companies like Apple Inc., Google, Microsoft to gain billions in offshoring profit in tax havens such as Bermuda and the Cayman Islands.

EU government responded with prudent positiveness to Ireland's legislation changes, saying they endorse a policy of forcing multinationals to make changes while continuing creating new laws within the Organization for Economic Cooperation and Development (OECD). At the moment, The EU is forbidding Amazon.com Inc. to have any tax

arrangements or schemes with Luxembourg, and also alleged that tax schemes between Apple Inc. and Ireland could be crossing the fine line to illegal.

The new tax changes will be effective in January 2015, although, according to Mr. Noonan they won't be applied to multinationals currently using the structure until the end of 2020.So far, tax advisors and European politicians have been vocal about the lengthy period, doubting its effectiveness. "The transition period…is not very ambitious. It is very long." said Lothar Binding, financial spokesman for Germany's ruling Social Democratic Party.

At the same time, Mr. Noonan said Ireland will not change its 12.5% corporate tax rate and would introduce measures to convince multinationals to stay in Ireland, where especially technology companies have brought in significant foreign investments. He added that Ireland will create a new tax rate for income coming from intellectual property, making it easier for companies that with that tax change will have to declare tax residency in Ireland.

In my opinion, with the resources multinationals have they will restructure their operations, but will find another way to avoid taxes. It is also quite probably that both Ireland and other countries will jump to create other incentives to make companies stay.[12]

4. Lux leaks: how to use Luxembourg to save tax?

We have probably all heard about the scandal regarding the Luxembourg Leaks in the media.[13] Hundreds of companies were involved by signing secret deals with Luxembourg. The target? To save billions of dollars in taxes.

The investigation was led by a journalism group based in the US known as the International Consortium of Investigative Journalists (ICIJ) in collaboration with Suddeutsche Zeitung, the Guardian, Le Monde and more, who over six-months reviewed nearly 28,000 pages of leaked documents making public complex financial arrangements

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[12] The Wall Street Journal, "Ireland to Close 'Double Irish' Tax Loophole" by Sam Schechner Oct. 14, 2014, http://www.wsj.com/articles/ireland-to-close-double-irish-tax-loophole-1413295755

[13] Financial Times, "Leak reveals scale of corporate tax deals with Luxembourg" by Vanessa Houlder, November 6, 2014, http://www.ft.com/intl/cms/s/0/93e75c1a-6545-11e4-91b1-00144feabdc0.html#axzz3cPi0bIUF
The Wall Street Journal, "New Leak Shows Scope of Luxembourg Corporate-Tax Deals", by Tom Fairless, Dec. 10, 2014, http://www.wsj.com/articles/new-leak-shows-scope-of-luxembourg-corporate-tax-deals-1418177757

with Luxembourg.

Companies like IKEA, Burberry, Procter&Gamble, JP Morgan Pepsi, Deutsche Bank were among many other taking advantage of tax avoidance schemes and according to ICIJ, some of them were paying as little as 1% effective tax on income. Deutsche Welle affirms that ¨The leaked documents included hundreds of private tax rulings - known as comfort letters - secured with Luxembourg that gave corporations favorable tax treatment.¨[14]

Of course the Luxembourg authorities have denied signing any "sweetheart deals." "The Luxembourg system of taxation is competitive - there is nothing unfair or unethical about it," Nicolas Mackel, chief executive of Luxembourg for Finance, was quoted as having said in an interview. In a report on the investigation, the Guardian newspaper said the methods were "perfectly legal."

The Organization for Economic Cooperation and Development (OECD) together with authorities from fifty countries agreed to make public financial data in order to obligate infamous tax havens to reveal the names and fortunes of tax avoiders. 28 EU members signed the framework, but not the United States. The deal is expected to start in 2017.[15]

4.1. Save tax

The same as in the Double-Irish, the key in avoiding taxes in Luxembourg stands behind companies creating intellectual property and deriving their revenues from intellectual property rights. The intellectual property regime of Luxembourg is wide and covers patents, domain names, knowhow, trademarks, designs, models, copyrights, trade secrets, industrial design rights, and so on.

A Luxembourg enterprise should pay on average 29.22% of effective corporate tax.[16] However, the net revenues related intellectual property rights enjoys a deduction of 80% of income tax.[17] 80% from 29.22% results in an effective tax rate of 5.8% on intellectual property revenues.

[14] Deutsche Welle, "Tax deals with Luxembourg save companies billions, says report" http://www.dw.de/tax-deals-with-luxembourg-save-companies-billions-says-report/a-18044340

[15] OECD, Automatic Exchange of Financial Account Information; Background information brief; 29 October 2014, http://www.oecd.org/tax/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf

[16] Deloitte, Corporate Pocket Tax Guide 2015 Luxembourg, http://www2.deloitte.com/lu/en/pages/tax/articles/corporate-pocket-tax-guide-2015.html

[17] KPMG, Luxembourg - A Hub for Intellectual Property, https://www.kpmg.com/LU/en/IssuesAndInsights/Articlespublications/Documents/Luxembourg-IP.pdf

The 80% exemption also applies both when an enterprise sells intellectual property rights with a profit as well as when they don't commercialize the intellectual property they've created. Therefore a company who uses intellectual property in its own activities is entitled to an 80% tax exemption of the net revenues that they would have been received if the use of the intellectual rights would had been licensed to another unrelated company. This creates many opportunities for tax advisors.

However there are restrictions on the 80% exemption rule. It, for example applies only to intellectual rights acquired after 31st of December 2007. Also, this exemption is active only for income from intellectual property rights which haven´t been bought from a related company, which are the parent companies and subsidiaries. Intelligent tax advisors know how to get around these restrictions.

Understanding tax schemes is not an easy tasks, since many factors are involved and each country has its own rules and principles. A different short explanation on how both Luxembourg and Ireland together could avoid taxes. This only emphasizes the hundreds of ways that could be used to avoid taxes.

Figure 2.[18]

5. Apple Inc.

Apple has become one of the world's most value tech companies of the 21st century, thanks to its innovation and creativity, often setting the standard for the product categories.

[18] Own elaboration

One field that Apple has proven to be equally creative is it taxation system managing to successfully avoid paying $44 billion from taxation anywhere in the world.[19] As most big multinationals (Microsoft, Starbucks) rely on the classic Double Irish structure, Apple distinguishes from all them by implementing a rather simpler tax structure and not using the Double Irish system and equally succeeding in achieving tax evasion. That is the reason I chose this particular company as an example, as Apple is a particularly interesting case partly due to the relative simplicity of its tax structure as compared to other US multinationals, as well as the total amount involved: Apple's worldwide gross income is equivalent to the California state budget.[20] Apple's tax structure is difficult, if not impossible, to discern from its financial statements (as most companies are).

Apple's CEO, Tim Cook, affirmed during the Parliamentary Committee Hearings in the US that the company "fully complies with both the law and spirit of the laws. Apple pays all its required taxes, both in the US and abroad"[21]. However, the $44 billion tax evasion has caused outrage in both the US and the source countries where Apple makes solid income, but pays comparatively minor tax amounts.

According to the single tax principle, "all income would be taxes once and only once", in other words, the international tax rules should avoid both double taxations and double non-taxation. The reality couldn't be far from this principle, since what it is perceived is that for tax competition reasons, more than one country are accepting to create norms that reduces tax responsibilities on <u>their</u> multinational enterprises in their <u>abroad</u> affairs.

5.1. Apple's international tax structure

The goal from breaking down Apple's international tax structure is to facilitate the comprehension on how exactly does the company create of double non-taxation both in US and the countries it most operates. As mentioned before, Apple's tax structure is simpler when compared to the rest of multinational giants that use the Double Irish structure.

It all started in 1980, before going public on the New York Stock Exchange. The company created 3 main subsidiaries: Apple Operations International (AOI), Apple

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[19] Forbes, Apple Used Loopholes To Skip Paying U.S. Taxes On $44 Billion In Offshore Income, Senate Committee Claims
[20] L.A. Sheppard. "Apple's Tax Magic" (May 26, 2013)
[21] Testimony of Apple Inc. before the permanent subcommittee on investigations. US Senate. May 21, 2013

Operations Europe (AOE) and Apple Sales International (ASI)[22]. As can be expected, nowadays, the company has a lot more subsidiaries, but this 3 are most important in order to understand the taxation avoidance issues.

Apple Operations International (AOI) was created in Ireland, although the subsidiary is management and control in the US. Apple Inc. has 100% of AOI's control. According to US Hearing Report, it has just 3 employees, all directors, 2 of whom are employees of Apple Inc. and reside in California. Only one employee actually resides in Ireland.[23]

The fusion of both the US and Ireland corporate taxation rules seems to behave in absolute harmony as the corporate tax residence complements the US one. Apple Operations International is not an Ireland resident, because by Irish law corporate residency is only determined by the location of a company's central management and control. At the same time the subsidiary isn't a resident of the US, as the US tax law considers the residence of a company exclusively in terms of the place of corporation.

AOI has 100% control of the 2 other subsidiaries: Apple Operations Europe and Apple Sales International. According to US Hearing report, between 2009 and 2011, AOI collected $30 billion in dividends from its subsidiaries, but at the same time has paid zero corporate income tax in any country for many years[24]. Apart from the 2 subsidiaries, the only asset it possesses is cash, which aren't even held in Irish bank accountants, but in New York.[25]

Apple Sales International was created in Ireland as well and its parent company is Apple Operation Europe. Like AOI it is not a tax resident of any country, due to the same principle explain for AOI. The company began having employees in 2012 (250 in total)[26]. Apple Sales International has different contracts with manufacturers in China to produce the goods, and sells those products to distribution subsidiaries in Europe and Asia.[27] In the majority of cases, those products never physically pass through Ireland.[28]

What the parent company, Apple Inc., did was to sign a cost sharing agreement with Apple Sales International (ASI) , under which the subsidiary gets the economic rights to

[22] Antony Ting: iTax—Apple's International Tax Structure and the Double Non-Taxation Issue, 2014
[23] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 22
[24] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 53
[25] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 22
[26] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 24
[27] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 27
[28] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 2

Apple's intellectual property outside US, although the legal ownership of the intellectual property belongs to Apple Inc. in the US. Explaining better the consequences of the cost sharing agreement through an example, in 2011, ASI paid 60% of the group's R&D costs ($1.4 billion) to Apple Inc. as more or less 60% of Apple's worldwide sales happened outside US. By paying the costs, ASI lowers its income, which ultimately benefits them for taxation issues.[29]

The US Hearing Report, by Homeland Security& Governmental Affairs (United States Senate), for that matter, brings to light interesting information about this intra-group agreement between the parent company and its subsidiary. An audit regarding Apple Sales International that compares the income earned and the quantity of costs paid under the cost sharing agreement suggests that from the commercial point of view the numbers are not logical. In particular, the profits to cost ratios under the cost sharing agreement were 7:1 for Apple Inc. and 15:1 for ASI.[30] My question is if Apple Inc. would accept similar deal with other companies under the same conditions. And I highly doubt it would.

What is even more interesting to me is the Apple's claim in the US hearing that "Apple's cost sharing agreement is regularly audited by the Internal Revenue Service (IRS) and complies fully with all applicable Treasury regulations."[31] What clearly occurs to me is that either the IRS turns a blind eye on these intra-group sales arrangements, or the company manages to hide the truth.

All in all, ASI has actually paid corporate tax returns in Ireland, by reporting income sourced in the country. However, what we are facing with is another inconsistency when we compare the company's income to its tax liabilities. To be more exact, the company paid $10 million while its income was $22 billion in 2010 and $7 million in 2011 while its income was US $12 billion in 2011.[32]

[29] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 26
[30] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 29
[31] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.), Cook, quest. 22
[32] San Jose Mercury News, Apple's Tim Cook in hot seat as reports detail Apple's tax avoidance

Paid taxes in Ireland		
2010	Income	22$Billion
	Tax Liability	10$Million
2011	Income	12$Billion
	Tax Liability	7$Million

Apple successfully avoided paying any tax on US $44 billion from 2009 to 2012.[33]

In the US hearing, what is implied it's that there is no doubt that Apple's tax structure is in full agreement with the tax laws of the countries involved. However, my personal opinion is that the numbers and the results go against common sense. From the information we have seen so far the final conclusion is that there is a disproportional amount of income booked in the Irish subsidiaries that have few employees and economic activities (R&D, sales), and the tax liability rate on the income was very low.

As a final conclusion to this part, the success to Apple's tax structure is due to the fact that the income gained in the Irish subsidies were not taxable in the US, the residence country of Apple Inc. At the same time, the income gained in the Irish subsidies was not taxable in the source countries where the Apple products were sold to end customers.

In my opinion, and the question that I was asking myself most during my research was how is this possible and how comes the US controlled foreign corporation regime, which was created to apprehend this tax evasion issues, or other EU institutions, for that matter, didn't capture this profit shift issues.

5.2. US and Ireland tax laws that facilitate the double non-taxation

The answer to how Apple achieves double-non taxation of the profits gained in its subsidiaries (AOI and ASI) is not due to one singular factor, but to a combination of various which perfectly complement each other and play in the company's favor.

[33] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 17

5.2.1. Corporate residency in the US and Ireland

If we pay attention to what the definition of corporate residence is by law, we can see that there is a perfect arbitrage among the two, which is too tempting to ignore by Apple or any other multinationals. More specific, US define corporate tax residence based on the place of incorporation and Ireland based on the company's central management and control. So, a company created in Ireland with central administration and control in the US it basically a resident of none of the countries.

Next, according to the source principle, an Irish subsidiary would be liable to pay taxes in Ireland only on its profits sourced within its territory. Going back to Apple Inc.'s subsidiaries, as their central management and control is done from US, the nonresident status of ASI in Ireland is that its foreign source income is tax free in the country.

What Apple does is nothing more than taking advantage of these complementary definitions of corporate tax residence and the source principle in the mentioned countries resulting the double non-taxation. It´s hard to blame them when their schemes are legal and they are not the only ones beneficiating from these arbitrage opportunities, since Ireland seems to be the perfect partner for the US to create a company. It's interesting how for competitive reasons, the states are enabling the creation of these laws, since I doubt we are staying in front of a loophole.

5.2.2. Transfer pricing rules

The cost sharing agreement accentuates an important issue of the taxation practices of multinational corporate groups, therefore it´s important analyzing the issue. We have already mentioned before that under the cost sharing agreement the parent company transferred the economic rights of Apple's intellectual property to ASI. As a consequence of this intra-group contract, ASI owns the marketing and production rights of Apple's products for Europe and Asia. Although other subsidies do that, ASI doesn´t have to pay any royalties to Apple Inc. because of the division of economic ownership of the intangible assets among the two.[34] So, although the economic rights are located in Ireland, in reality the R&D activities are all carried out in the US.

What is important is that all the legal ownership of the intellectual property is owned by Apple Inc. in US, which is quite common among big American corporations, the reason

[34] US Joint Committee on Taxation, question 29.

being "the protections offered by the US legal system and the importance of protecting such rights in such a large market."[35] Actually, transferring intangible assets and shift profits to a low-tax country is a very common tax planning technique used by big corporations for more than 45 years now.[36]

Technically, under the cost sharing agreement, a US company may share with its foreign subsidiary the R&D costs on a 40:60 basis, 60% going to the subsidiary, for example, this number varying from one company to another. By being liable of 60% of the R&D costs, the subsidiary can claim 60% of the income coming from the resulting intangible, not mattering the location of where these R&D activities take place, which has already said, in Apple´s case it´s US.

How does a subsidiary company pay for all this R&D costs, since AOI, for example, apart from 3 managers, doesn´t have any employees and it´s basically a virtual company? As it can probably be guessed, it´s the parent company who funds the operation and the subsidiary, in return pays back as cost sharing payments.[37]

The next issue is why the US Government turned a blind eye to this loophole for such a long period of time? The cost sharing agreement was not created so that company uses it for tax avoidance issues. The true idea behind it was that multinational corporation cannot predict whether its R&D activities will succeed or fail. If the research program is to fail the multinationals will lose the invested money. It was assumed by tax authorities that this regime will not be used in such an aggressive way as multinationals do nowadays. What reality has shown is that for tax avoidance purposes, the corporations abuse this system, because by being in the best position to know the risk of a research program (information advantage), the companies will enter into a cost sharing contract only if the project is likely to succeed, converting this regime in a perfectly legal mechanism to shift profits for intangibles out of the US to tax havens. In fact, in most cases the only purpose of a cost sharing agreement is exclusively tax evasion reason.

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[35] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 8

[36] Avi-Yonah, Testimony for Hearing on Profit Shifting—US Senate Permanent Subcommittee on Investigations (Washington DC: US Senate Committee Homeland Security and Government Affairs, September 20, 2012),

[37] Avi-Yonah, Testimony for Hearing on Profit Shifting—US Senate Permanent Subcommittee on Investigations (Washington DC: US Senate Committee Homeland Security and Government Affairs, September 20, 2012),

So why the US tax authorities do nothing about the issue? The US Government clearly knows about the loophole, but, by wanting to increase US companies' global competitiveness, it is willing to support the regime by permitting the corporations to account their profits, especially if it was created out of US. This, and also because of the power big multinational benefit nowadays. In fact, their power is so intense that the removal of a tax principle that beneficiate the companies that much can create significant political problems.

What would be the right thing to do would be to review the issue of how tax authorities should treat intra-group transactions, especially in the context of tax avoidance?

The Organisation for Economic Co-operation and Development (OECD) were the ones working on the issue. Including a small introduction, the OECD is an international economic organisation founded in 1961 and operating in 34 countries to improve economic development and international trade. The OECD on its own words "uses its wealth of information on a broad range of topics to help governments foster prosperity and fight poverty through economic growth and financial stability. We help ensure the environmental implications of economic and social development are taken into account." [38] The OECD is an international institution where countries can compare domestic and international policies, solve problems, and decide on good practices.

Coming back to the question, the OECD has been addressing the transfer pricing problem for some years now expressing the following: "transfer pricing outcomes in cases involving intangibles should reflect the functions performed, assets used, and risks assumed by the parties. This suggests that neither legal ownership, nor the bearing of costs related to intangible development … entitles an entity within a multinational enterprise group to retain the benefits or returns with respect to intangible without more."[39], argumenting that a parent enterprise should not be entitled to receive profits from intangible assets exclusively based on a cost sharing contract.

5.2.3. Controlled Foreign Corporation

The Controlled Foreign Corporation (CFC) was ¨designed to limit tax deferral of certain passive or highly mobile income, including intra-group dividend, interest and royalty

[38] OECD website; What we do and how?

[39] OECD Committee on Fiscal Affairs, ¨Discussion Draft—Revision of the Special considerations for Intangibles in Chapter VI of the OECD Transfer Pricing Guidelines and Related Provisions (2012)¨

payments, and intra-group sales income¨.[40] In other words, this regime was created to attack the income shifting to foreign subsidies by multinationals, and therefore to avoid the evasion of tax liabilities. For that, the regime obligates taxation on specific profits that come from foreign subsidies.

Saying that, the effectiveness of the regime was put in compromise after Apple and other multinationals´ hearings, since it has proved to be highly inefficient in dealing with tax evasion. The main reasons behind it is the fact the CFC accepts a series of exceptions, exceptions that work perfectly for big companies, including Apple Inc., denying the application of the regime. The exception was created because there should be a balance between tax collection and maintaining the competitiveness among US companies. It is important that the tax system promotes economic growth, therefore the creations of exceptions.

Just to give an example for more clarity, one of the US CFC exception most used by other multinationals, not Apple though, is the "manufacturing exception", which was created to exempt income from taxation if the foreign subsidiary was a manufacturer that added important value to the goods.[41] The logical reason behind this exception was to not discourage multinationals from growing their manufacturing operations outside US. With time however, if the company could prove that the foreign subsidiary provided important contributions to the goods it didn´t matter if it was a manufacturer or not. Also note the ¨important contribution¨ is also a quite subjective term, quite open for different type of interpretations.

Applying this exception to Apple Inc., its subsidiary, Apple Sales International could perfectly apply this manufacturing exception, thanks to its manufacturing activities. However, it is not really necessary since the check-the-box regime is more than enough for Apple to evade taxation.

The explanation above however highlights how flexible US taxation system is, if Apple as a corporation has not one, but two regimes that play in its favor.

[40] US CFC rules, US Joint Committee on Taxation, pag. 36–46.

[41] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 16

The FCF regime caught international attentions, especially from OECD BEPS project. It is trying to "strengthen CFC rules", as the OECD mentions that "the CFC rules of many countries do not always counter BEPS in a comprehensive manner."[42]

All in all an effective CFC regime is crucial in the fight against BEPS, as it protects the tax base of the residence country and has "positive spillover effects in source countries because taxpayers have no (or much less of an) incentive to shift profits into a third, low-tax jurisdiction."[43] Analysing critically the issue, US has traditionally been very influential in the direction of international tax rules, therefore it´s not an easy path for OECD in achieving its objectives.

The curious fact is whether Apple will still apply its tax structure if the CFC regime were stricter about capturing the profit accounted in the Irish subsidiaries. Although, with Apple´s army of tax advisors, the company would probably find other creative ways.

5.2.4. The US check-the-box regime

The check-the-box regime is a relatively new one (18 years) and it permits the taxpayers to choose between classifying themselves either as a corporation or a pass-through entity.[44] A flow-through entity is a legal business entity that is used to minimize the effects of double taxation. The company's income is allocated among the owners, therefore it doesn't pay income taxes at a corporate level but taxes are paid at the individual owners' level.[45]

The check-the-box regime was created to "relieve both taxpayers and the IRS from the need to expend considerable resources in determining the proper classification of … entities, when classification was effectively elective for well-advised taxpayers."[46]

Again, as in the case of FCF regime, the effectiveness of the check-the-box regime was highly questionable, since shortly before its implementation, the U.S. Treasury and the IRS themselves announced that the regime flexibility was over the board, creating important tax evasion opportunities to bypass the CFC regime using hybrid entities. Hybrid entities are the one that are elected as a pass-through entity in the U.S. but at the same time are treated

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[42] OECD, BEPS Action Plan, Public Discussion Draft, BEPS Action 3: Strengthening CFC rules; 12 May 2015, part 12

[43] OECD, BEPS Action Plan, Public Discussion Draft, BEPS Action 3: Strengthening CFC rules; 12 May 2015, part 12, part 7, 16

[44] US Joint Committee on Taxation, page. 47–49 - check-the-box rules

[45] Terms, Investopedia.com

[46] US Joint Committee on Taxation, page. 48

as a separate entity under foreign tax rules. According to the OCDE, hybrid entities were considered to be one of the principal tool in tax evasion.

The check-the-box regime in U.S. in many cases basically disables effectively the CFC regime. As mentioned before, the CFC regime was created to grab income shifted from a parent company to a subsidiary created in a low-tax country through, for example, intra-group contracts, and is registered as a separate entity under which each group company is considered a separate taxpayer.

Using Apple as an example, Apple Sales International provides goods to other group distribution companies, which sell the good in Europe. By doing so, an important part of the income coming from the sales is shifted to Apple Sales International and the current amount should have been subject to the CFC regime. However, by applying the check-the-box regime for all the subsidiaries AOI (AOE and ASI), the subsidiaries ASI and AOE are converted as a part of AOI for U.S. tax purposes.[47] Thanks to checking-the-box regime, AOI is considered as gaining sales profit directly from the final customers under U.S. tax law and the income was absolved from the CFC regime under the active business exception.[48] As a consequence, the intra-group sales between ASI and the distribution companies were ignored and the CFC regime became irrelevant. Or what would be the same, the check-the-box regime debilitated the CFC regime by assuming intra-group transactions were non-existent.

During the US Hearing, at the demand of the US Senate Committee, Apple estimated that a total income of $35 billion evaded from the implementation of the CFC regime by checking- the-box for the years 2011 and 2012. The amount of US tax avoided for the mentioned two years was $12.5 billion.[49]

The possible benefit for the US of the checking-the box-regime is that an American multinational reduces its foreign income tax and since it won´t keep the profits outside US forever it will eventually repatriate the benefits. But this strategy could back fire since by maintaining low the foreign tax rates, the multinationals will only feel encouraged to further shift profits outside US. Reality actually shows that the majority of American corporations keep their foreign income overseas permanently.

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[47] A. Ting, The Taxation of Corporate Groups under Consolidation: An International Comparison (Cambridge Tax Law Series, 2013), 73–75.
[48] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 35-36
[49] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 34

So far, the hearings on Apple and other American multinationals (Microsoft & Hewllet-Packard) didn´t have any substantial impact on the check-the-box or other regimes in the US. The only possible pressure is coming exclusively from abroad, more specifically the OECD BEPS project, which in their action plan recognized the hybrid entities as one of the main topics to discuss. In the Action Plan, the OECD plan to develop "model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities."[50]

5.2.5. Low tax jurisdictions

For instance, according to the IMF, in 2010 Barbados, Bermuda and the British Virgin Islands received more foreign direct investment (FDI) than Germany (5.11% of global FDI for the islands versus 4.77% for Germany) or Japan (3.76%). During that same year, these three small "jurisdictions" also made more foreign investments (4.54% combined) than Germany (4.28%).[51] A study in 2008 found that out of the 100 largest listed US corporations in terms of revenue, only 14 had no foreign subsidiaries. Among the 86 corporations that had foreign subsidiaries, 83 had subsidiaries in tax havens or financial privacy jurisdictions.[52]

Now it has to be clear that having subsidiaries in low tax jurisdictions doesn´t necessarily mean that the companies apply taxation evasion schemes, however tax avoidance should really be taken into consideration for having subsidiaries in tax havens.

However, again, taking advantage of this tax rates differentials is proving to be extremely daring especially since US is known to have kept its tax rate fixed for almost 30 years (Tax reform Act of 1986) now at a rate of 35%.[53]

The reason Ireland is a popular low tax jurisdictions are the following:

- Its corporate tax rate of 12.5%, one of the lowest worldwide.

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[50] BEPS Action Plan: Neutralise the effects of Hybrid Mismatch Arrangements (Treaty issues); 19 March 2014-2 May 2014, page 4

[51] OECD report on Addressing base erosion and profit shifting (BEPS)

[52] United States Government Accountability Office, Report to Congressional Requesters, International Taxation, Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions December 2008, Page 4

[53] ¨The dynamic economic effects of a US corporate income tax rate reduction¨, Oxford University center for business taxation, April 2014, page 2.

- Ireland is an EU Member State, therefore the subsidiaries created in Ireland could take advantage of the EU laws which allow them to avoid corporate tax.
- Ireland proved to have a quite flexible tax regime for multinationals. As mentioned before the Irish definition of corporate tax residence complements perfectly that of the US so it facilitates tax evasion.

5.2.6. Solutions

One of the solutions I would propose for the double non-taxation issue is the implementation of the so known enterprise liability doctrine, which is a doctrine under which individual entities can be hold jointly responsible for an action only because of being part of a group company. Therefore a corporate group under the management and control of a parent company is treated as one single enterprise.[54] This doctrine is not new, the first attempt being in 1933 in the League of Nations report. The advantages of the enterprise liability doctrine are that it reflects better the economic reality and also is more effective as an anti-BEPS measure. A potent and functional CFC regime would be actually a part of the enterprise liability doctrine to a corporate group.

The OECD is the organization that through its base erosion and profit shifting project is trying to make a change in the system. In its Action Plan on BEPS it has recognized the predominance of the separate entity doctrine to the enterprise doctrine is a problem and lies at the center of the double non-taxation issue.

Another solution would be information transparency about multinational tax affairs. There is an important problem with "information asymmetry" between the multinational, the tax authorities and the general public.

Another solution in the battle between the authorities and the multinationals against BEPS, would be a specific disclosure requirement consisting of country-by-country reporting. Under this reporting, the multinationals should disclose certain details and information about its tax affairs to the tax authorities. This information could include the amount of taxable earnings, accounting earning or tax payments each one of the countries is operates.[55] Information about the book value of assets in each country or the total number of employees would also be important to sense the magnitude of the present of a

[54] P.I. Blumberg, The Multinational Challenge to Corporation Law: The Search for a New Corporate Personality (Oxford: OUP, 1993)
[55] OECD, Memorandum on Transfer Pricing Documentation and Country by Country Reporting (2013)

company in a country. If this disclosure would be available, tax authorities in both the residence and source country would have been warned by the low tax rate companies pay.

Also, the less information about their internal affairs is made public, the greater the chance for the company to engage in doubtful actions. If multinational would know that certain country-by-country information would have to be disclosed to authorities, their incentive would drop if there would be risk of audits and tax investigation. And if multinationals would be obligated to make this information available in its financial statements, the effect would be even more powerful. Reputation is a primordial asset and putting it at risk could be a deal breaker for most of the companies. Apple Inc. for example could afford selling their product at such a high price compared to its competence in part due to its reputation and how the customers perceive the product. A reputational scandal could be of great cost for Apple. An interesting reaction to public anger over tax manipulation experienced Starbucks. The company tried to buy peace from an indignated public by voluntarily paying 20 million pounds to tax authorities in 2013 and 2014.[56]

This incident states two important observations. The first one is the fact the multinational rely on its reputation and it is concerned about it. This is especially true for companies who deal directly with customers on a daily basis, since it is relatively easy for their clients to simply go to the competence. Secondly, and the most alarming is that this type of voluntary tax payments could rise even more distress about our international tax system. Taxation should not be voluntary and in fact more than a noble act, it is an insult to the current tax system. Conor Delaney, tax lawyer at Milestone International Tax Partners, said it "made a mockery" of the tax system. He continues: "You have a fundamental principle that you can only be taxed by clear legislation and yet you have this process where a company is hauled up and publicly embarrassed and blackmailed into volunteering more tax."[57]

5.3. What can or should countries do in response to the issue of double non-taxation?

According to the US Hearing, Apple gains 61 per cent of its revenue in foreign countries and the rest in US. This numbers could be interpreted as Apple expanding

[56] Starbucks speech at London Chamber of Commerce and Industry.
[57] The guardian, “Starbucks to pay £20m in tax over next two years after customer revolt”, December 2012

internationally, but when we look at the percentage of the tax rate it pays in US (20%) and offshore (1.8%)[58], the image changes. This numbers suggest that the foreign profit have not been subject to fair levels of taxation in Ireland and any other source countries. The problem appears when the company doesn´t pay its fair share in the residence country as well.

Next, ¨95 percent of Apple´s R&D, the engine behind the success of Apple products, is conducted in the United States¨[59] and the profits to cost ratio of ASI (15:1) is double that of Apple Inc. (7:1) itself[60]. On one hand, this numbers would most probably suggest that the cost sharing intra-group contract allocates a disproportionally low level of costs to ASI and that the parent company has shifted profits out from the US and accounted them in a low tax country.

The problem regarding an international allocation of profits for multinationals is not an easy one and so far has no specific or correct solution. As well, there is no international guide that allocates the fair allocation of tax rights between the parent company and its subsidiaries and obviously between the residence and source country. It should be a political agreement between countries, but the conflicting competitiveness among countries policy made the process so far extremely difficult in reaching an international agreement. Plus is also appears that the US Government has been turning a blind eye on the fact that its multinational haven´t been paying its tax fair share. In fact, according to Professor Edward Kleinbard, US could have actually strongly encouraged the multinationals success in tax evasion[61]. This tendency of the companies to evade taxes will go on the US expense as well this, since as long as the jurisdictions on the source and residence country permits it, the enterprises will try to maximize their benefits coming from tax to the fullest, avoiding US income tax as well. Adding that the enterprises haven´t only shifted profits from the source countries, but from US as well, the final outcome is not desirable at all for the US. Ideally United States would respond with a fundamental taxation reforms on multinationals, beginning transfer pricing regime.

So far the most ambitious attempt to change the present international law was done by Common Consolidated Corporate Tax Base (CCCTB), an European Commission project.

[58] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 48
[59] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 6
[60] US Hearing Report, Offshore profit shifting and the U.S. Tax Code – part 2 (Apple Inc.) quest. 29
[61] Prof. Edward D. Kleinbard—Hearing Titled 'Tax Reform: Tax Havens, Base Erosion and Profit-Shifting' of US House of Representatives Committee on Ways and Means (June 13, 2013), page 2

In fact, what is needed is a worldwide tax consolidation system. The answer is a system where the multinationals are taxed based on their worldwide net income, while allowing for foreign tax credits. But as long as there will be conflicts of interest among the EU Member States, the BRICS countries and the US, little progress is expected in the near future, since a global consensus would be needed, and such an idea sounds quite utopian to me. Plus we should think about the costs that replacing the current international tax law would suppose. Nowadays, after a severe economic crisis where is still pay the consequences, extra costs will not be very welcomed.

6. The role of the four firms in providing tax advice

There have been many scandals lately where the Big Four consultancy companies (Deloitte, Ernst and Young, KPMG and PwC) where more than involved in tax avoidance issues. One of the most famous is the Luxembourg documents leaks by PwC, which was a financial scandal brought by a journalistic investigation directed by the International Consortium of Investigative Journalists. It consists on confidential information about Luxembourg's tax schemed created by PricewaterhouseCoopers from 2002 to 2010. This investigation ended in making public in 2014 tax schemes for over 340 multinational companies (Microsoft, Disney, Koch Industries) in Luxembourg.

Nowadays the big four firms stand by them not providing anymore the type of very aggressive avoidance schemes which they sold 10 years ago, like for example cases they have lost in court. This statement is clearly open for discussion but what I personally believe is that they have just shifted to advising on other forms of tax avoidance which are equally profitable for the multinationals they do business with. The big four firms have created internal principles on where exactly the sublime line between tax planning and aggressive evasion lies.

The power these companies possess is also a factor to be taken into account. The solid relationship the big four firms enjoy with governments generate a perception that they could impact on the tax regime that they use to their benefits. According to House of Commons (HMRC) the big four offer the government technical advice on changes or improvements on tax laws, hence the overall intuition that they are capable of influencing legislation to benefit their bigger clients on the expense of smaller businesses. Also, while assessing the governments on "improvements" to legislation they get full access and a complete knowledge of EU tax law, and also the possibilities to discover loopholes in new

legislation.

PwC agreed on the fact they are responsible on not taking advantage on their position of power.[62] In Parliamentary committee hearings in the UK, the big four firms came quick to assure that they do not give advice on tax evade evasion, which would be illegal, although they recognized that some schemes they provided were ruled against in court and would be unlawful to be used again.[63] The companies acknowledged that the differentiation between tax planning and tax evasion using tax laws never identified by the Parliament is difficult to define and remains an area open for interpretation.[64] PwC and KPMG said they had internal guiding principles or codes of conduct to specify what advice is acceptable and what not.[65]

According to HMRC, the evidence the companies provided in the hearing proves that tax services provided to multinationals and also wealthy people is an impressive industry, worth almost $25 billion globally:[66]

Table 4.

	PwC	Deloitte	E&Y	KPMG	Total
Global revenue due to tax schemes	**7,944 million**	**5,900 million**	**6,011 million**	**4,860 million**	**24,715 million**

7. The complexity of international tax law

The international tax rules are not only complex but also outdated. The 1920s and 1930s treaties followed by the 1970s transfer pricing models, were founded on the correspondent domestic economies, when globalization wasn't an issues and companies' operations and transactions were mostly national. Therefore the laws, treaties and principles on which international tax laws are based were not created for the modern economy we have nowadays.

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[62] Question 10, House of Commons Hearing, 44 Report session 2012-13
[63] Question 63, House of Commons Hearing, 44 Report session 2012-13
[64] Question 78, House of Commons Hearing, 44 Report session 2012-13
[65] Question 34-39, 78-82, House of Commons Hearing, 44 Report session 2012-13
[66] Evidence 26,29,30,31, House of Commons Hearing, 44 Report session 2012-13

At the moment, countries are increasingly using tax incentives to increment their competitiveness and to attract both national and foreign investments. Some of them create incentives to persuade specific activities, while others act as tax havens.

What would make international tax regime more equitable would be to make sure tax and revenues are recognized in the right place. For example, in some US states, companies are taxed considering the enterprises' global revenues based on business activity, like sales level, capital amount or the number of hired employees.

The report published by the Organisation for Economic Co-operation and Development informs what we mentioned before: those global solutions are needed to make sure that tax systems do not unfairly favor multinational enterprises, leaving citizens and small businesses with bigger tax liabilities.[67]

8. The transparency of companies' tax affairs

There is way too much secrecy over the exact amount of tax liabilities companies have and the way this amount is calculated. I believe that companies would measure twice what they do if there was more transparency over their tax responsibilities

An increment in transparency will increase people's trust in the tax regime. Achieving this goal is not an easy task though. Ernst and Young, for example, is against adding company's tax liabilities in their financial accounts, arguing that they are too long and complex to offer transparency. They think the information needs to be concentrated. The approach they are defending is greater information in companies' statutory accounts.[68]

The big four also weren't big fans on multinational companies making public their turnover, income and tax on a country-by country basis. Deloitte explains that the cost and the difficulty of gathering this data would be significant and not in the advantage of any multinational, including for commercial and confidentiality reasons. KPMG explains that even a trained tax professional would not necessarily be able to understand the tax position from this data alone. They continue saying that all internal information can be crucial in understanding a tax position and a company might have no tax liability in a low tax

[67] Organisation for Economic Co-operation and Development, "Base erosion and profit shifting", February 2013, http://www.oecd.org/ctp/beps.htm, accessed 14 February 2013

[68] Committee of Public Accounts, Tax avoidance: The role of large accountancy firms, Forty-fourth Report of Session 2012-13, HC 870, April 2013, Qq 210-212

jurisdiction because it is making important investments and obtaining tax deductions on those investments. Each company agreed that there were better ways of explaining companies' tax positions.[69]

In the end though, no matter the arguments, the reality shows that greater transparency is needs to be provided quickly and should be mandatory.

9. Final conclusions

In conclusion, what can be said about our international tax system is that there are no specific codes or rules about where exactly stands the fine line between a unanimous acceptable tax planning and an aggressive tax evasion scheme. Nowadays, unfortunately multinational are still subjectively interpreting what schemes are ethical and which are not. The Treasury departments of each country should create a code of conduct for tax advisers, clearly specifying what is considered acceptable in terms of tax planning.

Next argument would be regarding that fact that the tax principles, treaties and laws are outdated and need urgent revision. The modern economy experience accelerated changes and the international tax rules have not changed accordingly to indicate how companies operate globally. It has become too accessible for multinational to take advantage of the current rules by creating structures in low-tax jurisdictions, which temp them not to pay taxes where they truly operate their business and sell their goods.

The following argument is regarding the international tax system being way too complex. A simplification of the system is needed. Again, the correspondent Treasury of each country should be held responsible to gather all the needed resources, since they claim they are always running low staff and financial support, and make more drastic progress in simplifying the tax rules.

Another big problem is created by big tax advising companies, especially the big four, giving their input on tax law. As was mentioned before, the big four firms advice the Treasury departments on "shaping" the legislation. This gives a general impression to the public that they are able to influence and also manipulate on their benefit the tax policies, which is very unfair to smaller businesses and citizens. This only emphasizes the huge power that now big corporations have. Although the big four claim their involvement to be

[69] Committee of Public Accounts, HM Revenue&Customs: Annual Report and Accounts 2011-2012, Nineteenth Report of Session 2012-13, HC 716, December 2012, Recommendation 1

minimal, in the line with what the Parliament intends and in good faith, what I, as a citizen, am concerned is that this very companies that try to "improve" our tax system are then the ones who give advice to their clients on how to use those laws to avoid tax. This is a clear conflict of interest. A code of conduct is extremely needed especially on how conflicts of interest should be managed.

An eye should also be kept on the transparency issue we are dealing with nowadays. A bigger transparency will pressure multinationals to be liable on a fair share of tax in the countries they operate in. There should be more explicit details on where multinationals make income and pay their taxes. This information should be comprehensible and facilitate fair comparisons. Tax returns are indeed difficult documents that are hard to be interpreted by non-experts, but this shouldn't be an excuse. The problem is that we don't have access even to complicated documents, for that matter. There is no information on tax returns at all. One of the countries who stepped out is United Kingdom who stated "HMRC will continue to work in partnership with HM Treasury to ensure strong standards are developed and maintained through relevant international for a such as OECD". All in all what we need is to improve the quality and credibility of public information about companies' tax affairs.

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