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## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
</tr>
<tr>
<td>CFC</td>
<td>Controlled Foreign Corporation</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>DTAA</td>
<td>Double Taxation Avoidance Act</td>
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<td>EU</td>
<td>European Union</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GAARs</td>
<td>General Anti-Avoidance Rules</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>MAP</td>
<td>Mutual Agreement Procedure</td>
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<td>MNE</td>
<td>Multinational Enterprise</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>PE</td>
<td>Permanent Establishment</td>
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1: Introduction

1.1: Problem Area

In the last three decades, the momentum of globalization has increased dramatically resulting in many economic processes moving from a local to a global level. It is widely acknowledged that this shift was due to the progress of technological innovation in the area of transportation and communication, in combination with greater liberalisation and deregulation of cross-border trading. The result is that MNEs can now operate at markets without being physically present and have the ability to easily move capital from A to B (Palan et al., 2009).

This development has created new circumstances for MNEs to work in environments, which previously were not present. Some MNEs make use of these new circumstances by exploiting unintended loopholes and grey areas existing within tax and trade legislations between two countries (Palan et al., 2009). This is why some scholars, such as Sharman (2006), argue that the pace of globalization has exceeded several nations’ capabilities to control the new circumstances created by globalization.

Since MNEs enjoy greater capital mobility than what they previously had, competition among states to attract corporate investment has increased, which has caused governments to implement investor and market friendly policies in order to attract business from MNEs to the country. This competition among states can especially be seen in the area of taxation, and arguments on a ‘race to the bottom’ is often used to criticize the competition as it gradually erodes governments’ tax bases. It has come so far that some nations draft their legislation in the scope of creating ‘the perfect place’ for MNEs and they have become known as tax havens (Sharman, 2006).

Tax havens facilitate many financial activities, but tax evasion and tax avoidance are what they are best known for. Tax evasion is the illegal activity of evading taxes by, for instance, money laundering or not declaring your taxable income and so on. On the other hand, tax avoidance is the legal activity of avoiding taxes by setting up and managing one’s business planning in a specific way. This is why tax havens are considered a key component in creating this race to the bottom regarding corporate taxation, gradually eroding the average global tax base (Palan et al., 2009).
Many MNEs gladly make use of the facilities of the tax havens, because tax avoidance (or tax planning as it is also referred to) is just another way of profit maximizing. MNEs such as Google, Amazon and Microsoft, with annual revenues of billions of dollars, are openly avoiding taxes, and are proud of it, as they see it as an obligation or duty to do so (Fisher, 2014). As the chairman of Google stated: “I am very proud of the structure that we set up. We did it based on the incentives that the governments offered us to operate.” (Fisher, 2014 p. 349)

The magnitude of the use of tax havens are well described by Mark Hampton and Prem Sikka: “Total funds passing annually through tax havens are estimated to be around US$ 7 trillion. The value of the assets held in tax havens is estimated to US$ 11 trillion, which is over one-third of the world’s GDP. Almost half of the world trade passes through tax havens even though they account for only 3% of the world GDP, mainly because multinational corporations book many transactions through tax havens with the sole aim of avoiding taxes” (Hampton & Sikka, 2005 p. 2). Due to a great deal of monetary resources lost to tax avoidance, scholars are arguing that the tax avoidance activities are socially harmful, because these resources could have generated government revenue. Therefore, they argue that tax havens, and the activities they facilitate, are mechanisms which have an impact on the distribution of wealth in favour of the already wealthy (Palan et al., 2009).

There have been several attempts to address the issues associated with tax havens and the OECD’s “Harmful Tax Competition” report from 1998 was the first impactful global attempt to address the problems of the tax race and the socially harmful activities. However, scholars argue that it had little actual effect, but what it did do, was to draw a lot more attention to tax havens. Since the publication of the report, there have been similar reports from other organisations such as the EU, but without major results, even though it is argued that such organisations have the magnitude to arguably be more impactful, than the OECD on its own (Palan et al., 2009). Sharman (2006) and Palan et al. (2009) are both convinced that to address the problem, a truly global effort must be undertaken.

Most recently, the Financial Crisis of 2008 prompted increased attention towards tax havens. Not only do many states rely on their tax revenue more than ever and do not want it shifted away to another country, but tax havens were also an integral part of the financial activities, which caused the crisis (Palan et al., 2009).

The most recent and biggest response came in 2013, when the G20 finance ministers asked OECD to make a plan and the “Action Plan on Base Erosion and Profit Shifting” (G20 BEPS Action Plan) was the
result. It consists of 15 action plans, which are to be implemented over the course of a few years - with the main goal of combating tax havens through various ways (OECD, 2013). According to the views of scholars such as Palan et al. and Sharman, this Action Plan could have the opportunity to really make a difference.

First, the project will identify and examine the relationship between tax avoidance, globalization and neoliberalism. The project seeks to understand how this concept came to be, by identifying the economic factors that led to the development of tax avoidance through a neoliberalist mind-set, and similarly identifying the elements of globalization that have allowed the practice to take place.

Second, the project seeks to understand the issues caused by tax avoidance. By investigating how tax avoidance creates negative externalities, the project aims to understand the burden of such practices on society, and how governments respond to them. We will apply market failure theory on different cases, to explain how tax avoidance creates negative externalities, which then creates the basis for regulation.

Finally, the project will examine the G20 response to tax avoidance, through the regulatory aspects of the G20 Action Plan in relation to market failure theory. We will use content analysis to identify, whether or not the actions of the Plan will deal with the specific methods found in our cases. This will enable us to understand, if the Plan intends to correct the social cost of our cases, thus making market failure theory a tool with which we can use to identify if the Action Plan intends to recreate equilibrium in the market.
1.2: Research question

*Can market failure theory explain the economic and political issues of tax avoidance and is the G20 BEPS Action Plan a response to the issues identified by the theory?*

**Hypothesis:** We believe that tax avoidance has a social cost, based on the loss of tax revenue that is used to fund public goods, necessary for society. This social cost is a negative externality of production, which causes market failure. According to the market failure theory, we believe that this must be addressed through regulations. The G20 BEPS Action Plan presents potential solutions to the methods used to avoid taxes, which we believe represent this regulation, thus is a response to market failure. Therefore, we believe that market failure theory explains the issues of tax avoidance and justifies the governmental response to the issues of tax avoidance, which is the G20 BEPS Action Plan.

1.3: Working questions

1.3.1 Context

A. How is tax avoidance a product of neoliberalism and globalization?

**Purpose:** To explain relation between neoliberalism, globalization and tax avoidance and how neoliberalism and globalisation has created circumstances in which tax avoidance has become a political and economic problem.

**Why is tax avoidance relevant and which problems does it entail?**

**Purpose:** To demonstrate and explain key figures and estimates on economic consequences of tax avoidance, put in perspective by associating it with negative externalities.

B. What is the G20 BEPS action plan and what does it aim to achieve?

**Purpose:** To provide an overview of the G20 BEPS Action Plan, produced by the OECD in 2013. The text will portray the aim of the Action Plan and at the same time give a brief a background to the reason behind the Action Plan.
1.3.2 Analysis

A. Can tax avoidance be identified as a social cost, and if so can the social cost theory justify the G20 Action Plan

*Purpose:* Explain market failure theory and explain why the issues caused by tax avoidance require regulation. Use different cases to show how tax avoidance is a social cost in both developed and developing countries.

B. Does the G20 BEPS Action Plan seek to create a basis for regulation on tax planning schemes identified in our analysis, thus solving market failure?

*Purpose:* To test for convergence between methods identified in the first part of our analysis and the methods the G20 action plan aims to create basis for regulation of.
1.3: Project Design

1.3.1 General outline and project aims

First, this project intends to examine how tax avoidance is related to globalization and neoliberalism. The project will do that by looking into the circumstances that gave rise to tax havens, which are the facilitators of tax avoidance, and by connecting the neoliberal economic mind-set to the reasons why tax avoidance is prominent.

Second, this project intends to examine why tax avoidance has become a problem. The project will do so by examining the harmful externalities of tax avoidance, which are being addressed in the Action Plan on Base Erosion and Profit Shifting of OECD and the G20 countries. We will use social cost theory to examine, how this regulation can be justified as a counter to the negative externalities created by tax avoidance.

Third, this project intends to examine the possible effects of the Action Plan, in relation to the tax avoidance methods that are used in the cases in our analysis. By analysing the regulatory aspects of the action plan, this project wants to look into whether an argument can be made in regards to whether or not the G20 Action Plan combats the tax avoidance methods, and to what extent does it equilibrate the market failure created by tax avoidance.

To sum up, this project intends to look into tax avoidance in our capitalistic global society and see whether the G20 BEPS Action Plan solves the market failure created by tax avoidance.
1.3.2 Chapter overview and purposes

Chapter 1 - Introduction
Firstly, chapter one forms the introduction of the project and as explained thus far by our problem area, provides a general outline and overview of the project and which areas it will explore. Secondly, our research and working questions explains how we seek to approach our problem area and clarify the purposes of our questions. Finally, our project design aims to provide the reader with a major outline of the contents of the project and what we seek to accomplish with our different chapters.

Chapter 2 - Theory, Theoretical framework and Methodology
Firstly, chapter two aims to define the theoretical framework we will utilize in our project. Which exact theories were used in the project and explain how we operationalise the theory to form the basis of our analysis. Secondly, we explain our choice of sources, methods and general methodological approach that forms the development of the project. Finally, we outline and explain the delimitations of the project and our considerations we have had during the development of the project. The purpose here is to provide the reader with insight to our thought process and aims to assist the comprehension of the project’s main goals, ideas and approaches.

Chapter 3 - Definition of relevant concepts, entities and phenomena
Firstly, we have defined the different concepts we work with in the project, that forms key parts in the general comprehension of the project’s content. By clarifying the concepts identified, we assist the reader by providing an understanding of how we understand and work with these concepts. The defined concepts in this project have two main purposes; firstly, to clarify how we understand them and secondly to demonstrate how they relate to our context and theory. The concepts will explain in a general manner and how they are operationalized with regards to this project. The explanations of the concepts will only include information that is concurrent with this project.

Chapter 4 - Context
The purpose of the context section is to explain the settings and circumstances in which the concepts and problems researched exist. We seek to explain the role of neoliberalism and globalisation in creating circumstances leading to tax avoidance, and explain how tax avoidance becomes a relevant political and economic topic directly related to the above-mentioned concepts. Furthermore, we seek to provide empirical data on the magnitude of tax avoidance schemes utilized by MNEs and the impact
it imposes on states and their opportunities for prosperity and funding of public goods. We give concrete examples of how estimated figures of tax avoidance in specific states relative to state budgets deprives them of “some” opportunity for economic advancement. Finally, we seek to outline the G20 BEPS Action Plan, in order to give the reader an introduction to the Action Plan and hence summarize the Plan and the aims of the general plan. This will form the context, in which the last part of our analysis can take place and help us answer our last working question.

Chapter 5 - Analysis

Our analysis will consist of two parts. First part explores the usefulness of market failure theory in explaining how social cost associated with tax avoidance creates negative externalities, causing market failure, and the appropriate solution to the issue. By exploring the issues of tax avoidance in three cases, in both developed and developing countries, we can generalize the global effects of tax avoidance.

Second part of our analysis uses content analysis to link the response by the G20 BEPS action plan to our cases in order to evaluate whether this regulation will in fact resolve the market failure caused by tax avoidance.
2: Theoretical framework, Theory, Methods & Methodology

2.1: Theoretical Framework

In order to answer our research question and working questions in the best possible manner, the project must first identify the mind-set behind tax avoiding MNEs. By identifying the concepts that enable the practice of tax avoidance, the underlying intentions of the MNEs can be understood. This will put the issue in perspective in relation to the main theory used in the project, which is market failure theory. In order to apply market failure theory it is necessary to identify the social costs of tax avoidance, in order to prove the existence of negative externalities, which cause market failure. The first part of the analysis will use three cases to identify social costs and the methods of tax avoidance that cause them, and explain how these lead to market failure. The second part of the analysis will study the G20 BEPS Action Plan to evaluate, whether the actions within are aimed to create basis for regulation to solve the issues identified in the specific cases. If this is the case, market failure theory will explain how this regulation corrects the market failure proved in the first part of the analysis.
2.2: Theories

2.2.1: Market failure theory

This theory will be used to identify how tax avoidance places a burden on society. The cost of such a burden is a negative externality that rational actors in the market do not have to pay for, which ultimately causes market failure. The theory will explain how this social cost causes market failure and ultimately will seek to justify the governmental response, in the form of the G20 Action Plan, to this issue.

Market failure theory is based on the concept of externalities, or an external harmful or beneficial effect of producing or consuming a product. Positive or negative externalities occur when the social cost of producing or consuming a product is not equal to the private cost of doing so. This project will deal with cases of negative externalities of production, in which the social cost of production is greater than the private cost of production. If this is the case, the producers and consumers of a free market will ignore this externality and act based on their rationality in order to profit maximize. Profit maximization occurs at the quantity of output where marginal private cost is equal to marginal revenue, in other words where the cost of producing an additional unit is equal to the revenue of producing an additional unit. However as marginal social cost is higher than marginal private cost the market does not operate according to the true cost of production, meaning that the quantity of output does not reflect the true equilibrium between marginal revenue and marginal cost. This is known as disequilibrium, meaning that the firm does not pay for the external costs of production, placing the burden on society (Pindyck & Rubinfeld 2012).

Economically this creates an inefficient allocation of resources since more units of the product is being created than the market should dictate, based on the true cost of production, which is known as market failure. In order to solve this issue equilibrium must be established, which can be done by increasing the private cost of production so that the point of equilibrium, where marginal private cost is equal to marginal revenue, is also equal to marginal social cost (ibid.).

The theory argues that this can be achieved through government intervention in the form of taxes, subsidies or regulation. Taxing the firms that cause negative externalities, with a Pigovian tax, increases their private cost of production, reducing the output at the point of profit maximization, causing them to acknowledge the externality. A Pigovian tax is specifically designed to increase the private cost of production to the point where the equilibrium point is where marginal private cost is
equal to marginal social cost (Frank 2006). Regulation can be used in various forms to enforce certain rules that limit the production of firms that cause negative externalities (Pindyck & Rubinfield, 2012) (see Figure 1 in Appendix A).

In order to apply this theory it is necessary to associate the four main concepts of the theory to the case of tax avoidance. These four concepts are:

**Private cost:** The private cost of production of a given product in a market is the cost of production as seen from the point of view of a firm, consisting of the costs of the factors of production (labour, raw materials, rent, tax, etc). Based on the ideas of utilitarianism a firm will maximize utility in order to reduce the costs of production, thus maximizing profit (ibid.).

**Social Cost:** The social cost of production is the sum of the private cost of production and any external costs to society that private actors do not take into account. Any harmful effects, of producing a good or service, on society is a burden that must be paid for by society. Therefore, the social cost of production is the total cost of production to society and the private actors (ibid.).

**Externalities:** The aggregate choices of individuals determine the equilibrium in a free market. These individuals base their decisions on utility maximization, and are therefore not concerned with social costs, that they do not directly pay for. This means that in a free market equilibrium exists where marginal private cost is equal to marginal revenue, or where profit is maximized. As previously mentioned social cost is higher than private cost meaning that the true cost of production is not being accounted for in the market, creating a disequilibrium. This is a negative externality of production (ibid.).

**Market failure (Inefficient allocation of resources):** Market failure is caused by a disequilibrium in a market. When the actors of a free market do not take the external cost into account, too much of a product is being produced based on the ‘invisible hand’ (Hunt and Lautzenheiser 2011). This means that the market is inefficient as the invisible hand dictates incorrect levels of output, and must therefore adjust to once again achieve equilibrium where marginal social cost is equal to marginal revenue (Pindyck & Rubinfield, 2012).
2.3: Methods & Methodology

2.3.1: Methods

**First part of analysis: Deductive method**
The first part of the analysis which will be based on market failure theory, will use a deductive approach. The deductive approach tests a hypothesis based on theory against data to validate the use of the theory. If the data complies with the theory one can use the theory to prove a cause-and-effect relationship corresponding to the hypothesis.

This approach makes use of the key elements of post-positivism in combination with a deductive use of empirical data. It will rely on a pre-existing theory, which will be connected to the case of tax avoidance by equating the core concepts of the theory to empirical data available. A hypothesis can be created in relation to the project to explain the cause-and-effect relationships of the concepts of the theory (Hesse-Biber and Leavy 2011).

By empirically proving the social cost of tax avoidance, the analysis shows the negative externalities of tax avoidance. According to the theory, this causes an inefficient allocation of resources, causing market failure, which can be resolved through government intervention. The hypothesis will explain the cause-and-effect link between negative externalities and government intervention, based on the theory.

**Second part of analysis: Content analysis**
Content analysis will be the method utilized in the second part of our analysis. Content analysis can be applied as an instrument of analysing documents, quantitatively or qualitatively, in a variety of approaches across different disciplines and therefore has usefulness in regards to our research. Krippendorff (2013) also argues that "qualitative approaches to text interpretation are not incompatible with content analysis" (p. 89)

The general methodological application though seems to be rather focused around quantitative approaches where frequencies are monitored and analysed in very organized mathematical approaches. The literature we have been reviewing mainly offers insight to these approaches and some general descriptions of some of the features and characteristics of qualitative content analysis. One of the arguments by Krippendorff (2013) in relation to qualitative approaches is that “qualitative scholars resist being forced into a particular sequence of analytical steps”. They see the “holistic
qualities of a text” meaning that all parts of the text are interrelated and thus interpret the text as a whole, making it difficult to standardize which arguably limits the amount of content which can be analysed with sufficient consistency (Krippendorff, 2013, p.89). We will only be looking at one specific text and therefore based on above-mentioned feel that a rather loose approach to our analytical design is justified. We will also attempt to apply specific elements into the design in order to define and ease the analytical approach, based on Krippendorff’s work. This will provide structure to the analysis and make it easier for the reader to understand how we link our first and second part of our analysis.

Krippendorff (2013) also argues that: “Qualitative content analysts support their interpretations by weaving quotes from the analysed texts and literature about the contexts of these texts into their conclusions, by constructing parallelisms, by engaging in triangulations, and by elaborating on any metaphors they can identify” (p.89).

This is largely what we will be doing by utilizing methods identified in part one of our analysis to create links to specific sections that can be seen as parallel(s) to above mentioned definitions. Based on that we have chosen a fairly basic design of our method application, which will be described later in this section. We realize that focusing only on one document has certain limitations, however given the nature of the document and its relation to the context of our project, we feel that it will sufficiently provide a basis for answering the working question at hand, supplementing our findings of the first part of our analysis section. Our goal is to conclude whether market failure theory can explain the issues of tax avoidance and whether the G20 Action Plan be identified within our theoretical framework.

Content analysis has the capacity to both deductive and inductive, separately or in a hybrid methodological approach and is not constrained to either quantitative or qualitative application regardless of approach (Hesse-Biber and Leavy, 2011, p. 227-228). A common distinction between qualitative and quantitative approaches lies within the research design. Quantitative approaches will mainly follow a linear model, whereas qualitative approaches follows a spiral model. A linear design will go step by step through the research process, where a spiral approach will allow for repetition of stages. In a qualitative content analysis data is coded by categories - a process that is repeated as additional knowledge is gained, hence the typical application of the spiral model allowing the research to reflect on knowledge created. (Hesse-Biber and Leavy, 2011, p. 232-236). An important factor to consider when studying documents is how you position it in relation to your research. This can be divided into four different approaches based firstly, on the primary focus on either content or use and
function. Secondly, how you either characterize the document as a resource or as a topic (Prior, L., 2008). Prior’s “repositioning” of documents provides some very useful general ideas on how to consider your approach to documents in your research.

Based on this we have chosen an approach where we will analyse the document as a resource and focus on the content itself in order to code the data in according to the tax avoidance methods identified. We will apply a deductive qualitative approach in our analysis. The categorisation will be deducted from part one of our analysis. We will work within a spiral model of research design, where the data will be reanalysed to adjust coding of the data. This allows for us to redefine codes and reanalyse data to check fittingness of in regards to context and the categorizations.

Based on Krippendorff’s (2013) definitions we go through the general components of a content analysis to justify our choice of analysis design.

1. Unitizing

   By unitizing the content analysed, the researcher can divide the content into defined units, to better measure the content. In this project the definition of sampling units and recording units are rather irrelevant as they are embedded in the specific choice of document and therefore nullified. However, for the purpose of legitimacy of our analysis design we have chosen to include them with a very short description. In relation to this project sampling and recording/coding units can best be explained as one unit embedded in the specific document being analysed.

   **Sampling units** are one of the types of units described in Krippendorff’s work, however sampling units refer to an overlying categorisation of the material processed (Krippendorff, 2013). Given the fact that we only analyse one specific document in this part of our analysis it becomes irrelevant. If a sampling unit were to be described it would be the G20 BEPS action plan.

   **Recording/Coding Units** are equally irrelevant to this analysis.

   These can best be seen as an underlying categorisation within the sampling units (Krippendorff, 2013). As we are only examining one single document recording or coding units are not helpful in narrowing down the exact area of focus.
**Context Units**

Context units are “units of textual matter that set limits on the information to be considered in the description of recording units” (Krippendorff, 2013, pp. 101). The purpose of context units is to further delimit sampling and recording units into meaningful units relevant to the context at hand. One might consider the whole body of text relevant or one might chose to look specifically at sentences or paragraphs depending on the nature of the research (Krippendorff, 2013). In this project we will be defining our context units in two ways. Firstly by the specific points in the action plan, and secondly by the paragraphs surrounding those points constituting the broad purpose of the action itself.

2. **Sampling**

Sampling is not relevant to this project as it only looks at one specific document. As defined in Krippendorff (2013) “A sample is said to be representative of a population if studying it leads to conclusions that are approximately the same as those that one would reach by studying the entire population” (pp. 113). Given the fact that the G20 action plan is a culmination of initiatives based on OECD suggestions and G20 countries combined effort to combat a specific problem, there is no need for sampling. We argue that it is safe to say that it represents the overall efforts of those countries to combat the problems of tax avoidance. This does not mean that sampling is generally not relevant to qualitative approaches, however in this particular setting we argue that it is not relevant.

3. **Recording/Coding**

Recording and coding is the process of systematically recording and code the data. These systems set the boundaries in which the content analysts or “coders” analyse the data. The recording refers to “recording” how the data came to be within the specific coding system (Krippendorff, 2013).

We intend to code the data based on previous mentioned “context units”. As argued in previous sections of the components of the analysis our simplistic design and the fact that the coding will be done by numerous members of project, simultaneously, then requires minimum definition. Our documenting of recording constitutes the quoted and summarized paragraphs of the specific action points of the G20 action plan.
4. Data language

“The data language used in an analysis prescribes the form in which the data are recorded. The syntax of a data language consists of” a variety of descriptions, which we will not go into detail of (Krippendorff, 2013, pp. 152-153). Given the qualitative approach of our content analysis and the fact that it does not rely on statistical analysis of the data, the need to define the data language is essentially irrelevant. The interrelations between our ‘units’ can not be measured as such, nor can our interpretations of the data.

To sum up this section, our purpose was to demonstrate how specific approaches are described and structured. By going through a basic structure of a content analysis and its components we justify our specific qualitative approach by describing the relevance of those components in regards to our project.
2.3.2: Methodology

The methodology of the project will apply a “multi-method approach” (Hesse-Biber and Leavy, 2011), consisting of a deductive hypothesis-based theory testing method and content analysis, in combination with elements of a multiple case study, utilized as means of empirical data. The core idea is to apply a theory to explain the concept of tax avoidance, specifically the problems caused by it. We use elements of a multiple case study approach to construct examples through which we can generalize the global issues of tax avoidance (Hesse-Biber and Leavy, 2011). This constitutes an important part of our empirical data and links the theory to concrete well researched examples, facilitating important argumentation in our analysis. We then test convergence between responses to those problems, dictated by the theory, and the G20 action plan (which we argue is a global response to market failure). We use content analysis to establish those links by categorizing our findings, based on theory and empirical evidence, and coding the G20 action plan accordingly. Finally, based on this methodology we are able to conclude on the usefulness of market failure theory to explain problems caused by tax avoidance and the global society’s response to those.
2.4: Selection of sources and empirical data

Types of sources
In this project, we utilize both primary and secondary data for our research, gathered from a broad field of sources. The primary data used in this project was collected from the website of OECD, who publish their documents online. Our main primary source is the G20 Action Plan BEPS which was made by the OECD. The secondary data used in the project was obtained from various books, journal articles, websites and textbooks. In the production of this project we have not created or generated empirical data ourselves. Instead we have used sources which already had produced empirical data, with which we have made use of in order to answer our research and working questions.

Use of data
The secondary data have primarily been used to give us a broad understanding of our topic of concern, while at the same time creating the foundation of our working questions except the last one. Some of the secondary data we have made use of have been a great help to the project, particular those we have chosen to include in our state of the art literature review further below.

For our context in chapter 4, sections from economic text-books have been useful in order to gain a better understanding of neoliberalism and its relation to tax avoidance with Hunt (2008) and Chang (2014) being helpful. To link globalization and tax avoidance, various documents from OECD have been useful though with provision to the bias it may have. In order to understand the relevance and problems of tax avoidance, articles by Sikka and Willmott have been of great use, since they elaborate in-depth on the problem while backing up their arguments with empirical data.

For our analysis in chapter 5, the Christian Aid Report (Hogg 2008) have been used in order to create the base for the first part of our analysis. The main argument of the Report and the cases within was useful for our analysis since it provides empirical data through which we can apply our theory on Market Failure. Instead of creating our own empirical data, the Report provided us with exactly what we needed. Our case of US MNEs is essentially not a single case, but a construction of characteristics and behaviour of American MNEs in relation to tax avoidance. By researching how some of the largest enterprises do, we construct a setting in which we can work.
2.5: State of the art - a literature review

Since taxation accounts for a lot of money on a national and global level the literature regarding tax avoidance is vast. The literature covers various elements of tax avoidance such as political, social and economic issues. Some scholars have produced exceptional and in-depth work on this topic and are cited and referenced widely by other scholars. Their work have been of great use and importance for this project and have provided us with a deeper understanding of our concerned topic, which is why we define them as state of the art.

**Tax Havens: How Globalization Really Works**

Written by Palan, Murphy and Chavagneux (Palan et al), the book cover an array of things connected to tax havens. The book links globalization to the historical origins of tax havens and the financial activities they facilitate. It argues that since tax havens account for a big percentage of the world’s trade, tax havens and the financial activities they constitute play an important role in contemporary global society, despite accounting for a small percentage of the world’s population. This makes the base of their view which is that the tax havens curve the positive and negative effects of globalization in favour of a global elite. They critique the political initiatives undertaken so far to address tax havens, calling for a much more global cooperation between nations before change will occur (Palan et al).

**The Christian Aid report - Deaths and Taxes: The true toll of tax dodging**

The report is made by Christian Aid, a relief organization with the aim of eliminating poverty, and looks on the impact of tax avoidance of different cases in relation to developing countries. It argues that links can be established between tax avoidance with many social problems found in developing countries, with its main argument that tax avoidance causes the death of hundred thousands of children on an annually basis (Hogg 2008). The report has been useful for the project in order to apply the theory of market failure, as the issues caused by tax avoidance as identified in the report can be labelled as social cost. We have kept in mind the hidden agenda the report may have, since it is a relief organization with a specific aim, and have checked up upon its sources to verify the statements it makes.
The Dark Side of Transfer Pricing: Its Role In Tax Avoidance and Wealth Retentiveness

This journal article has been utilized widely in the development of this project as it highlights the extent of tax avoidance in the global economy, explains key figures and provides a thorough understanding of transfer pricing practices, one of the key tax avoidance methods. The article explains relations between tax avoidance and corporate behaviour and how it in turn affect states ability to provide public goods. Furthermore one of the co-authors of the article, Prem Sikka, is a very active scholar within the field and has provided the opportunity to identify the author's other works and relevant references.

2.6: Delimitations

In this project, we have chosen to exclusively focus on the G20 BEPS Action Plan while leaving other global initiatives out of the picture. At the starting phases of the project, we planned to look into global initiatives by the EU within a timeframe of around 10 years. The project wanted to look at how the initiatives gradually had changed in the way they addressed our topic of interest. However, after we began our research we learned that the task we had set to do was too hard to operationalize. The initiatives over such a long period of time were hard to find; We even wrote with an EU department of taxation, but it did not help us. This is why, in order to operationalize our project, we chose to delimit ourselves and focus only on the G20 BEPS Action Plan. We were convinced that the Action Plan would be good to use since it is still relevant and in effect and at the same time it represents the world’s most powerful states.

A concept which we also chose to delimit ourselves of was Corporate Social Responsibility (CSR). There are a lot of literature discussing the concept, arguing that if paying taxes can be defined as a social responsibility for MNEs, it could be a way to address the problem without the need for regulation (Fisher, 2014). However, we felt that going this route could create a complete project on its own. It could have been another way to look into the problems of tax avoidance but after our initial research we came to the conclusion that global initiatives in form of regulation addresses the problems in a more tangible manner, which is why chose to leave out CSR.
3: Definition of relevant concepts, entities and phenomena

3.1: Concepts & phenomena

3.1.1: Tax Avoidance

Multinational companies exploit tax regulations by shifting profits between subsidiaries, joint ventures and international divisions to avoid taxations in specific countries, by reporting a low or negative surplus. However, they do so on a legal basis, which is termed as tax avoidance and then there is an illegal prospect referred to as tax evasion. Palan et al. (2010:9-10) defines tax evasion to be an illegal action made in failing to account one’s income, and defines tax avoidance as a legal approach in cutting one’s taxes through loopholes in jurisdictions and by using various methods such as transfer pricing. Although the level of exploitation practiced vary, the purpose is clear; to avoid paying the high tax of a given nation by shifting profits to tax havens or low tax nations, essentially deriving governments of their fair share of profits earned within their country (Sikka & Willmott, 2010). This project will be focusing on the BEPS; Base Erosion and Profit Shifting. BEPS is a term used by government and international organizations to define the negative effects on national tax bases, made by the use of tax avoidance methods by multinational companies. BEPS includes various tax avoidance methods amongst those, transfer pricing. There are many methods of transfer pricing, applied within both import/export of physical goods, but also in relation to intangible goods such as intellectual property (trademarks/licenses) and services such as R&D etc.

**Tax Havens - a phenomena of the concept of tax avoidance**

Due to different tax regimes of various governments, this generates a consequence, which is that a MNE is able to exploit the international tax system. Administration that provides close to zero tax payment enables such exploitations. These administrations are known as tax havens, and are a crucial element of tax avoidance. Although, there is no concrete definition of tax havens, Aijaz (2013:125) defines a tax haven as “a place that tries to attract non-resident funds by offering light regulation, low (or zero) taxation and secrecy.” However, the OECD campaign defined tax havens (described as preferential tax regimes by OECD) to incorporate three elements (OECD 1998: 22-23):

a. Zero or close to zero taxes, and is perceived to offer a place used by non-residents to escape from tax in their own country of residence.
b. A law administrative that prevents the exchange of relevant information with international governments

c. Lack of transparency

3.1.2: Capitalism

Capitalism is an economic system, which is a prime aspect of today’s economic world. Capitalism is to a great deal focused on the market economy and the relations between production and consumerism. Many of the classic economists have had a role in forming the key fundamentals and theories of the ideology. Put in other words,

“Capitalism is a social system based on the principle of individual rights. Politically, it is the system of laissez-faire (freedom). Legally it is a system of objective laws (rule of law as opposed to rule of man). Economically, when such freedom is applied to the sphere of production its result is the free-market.” (The Capitalism Site, 2015)

One of the main principles of capitalism, the laissez-faire principle, basically refers to a free market. A free market is where MNEs are privately owned and there is no governmental intervention in this market. A reason for this is that they thought the capitalistic market economy would regulate itself, because they saw it as a living organism. As Adam Smith writes it in his “Invisible Hand Theory,” he believes that the market would also regulate itself, using the invisible hand as a metaphor, that if a market goes in depression or crises, it would itself find a solution to the problem, and hence not need any government intervention (Hunt & Lautzenheiser, 2011) This has however changed after the Great Depression. John Maynard Keynes believed that government intervention was necessary in order to stabilize the market, and hence came with the fiscal and monetary policies (Hunt & Lautzenheiser, 2011) Nowadays, many governments apply the use of fiscal and monetary policies in their regulation and policies. If regulations are needed the government will implement them, to ensure stability or prosperity of the economy.

Another part of capitalism is profit maximizing and rational thinking. Profit maximizing can be understood as the process where companies do nearly everything morally accepted to maximize their profits.
3.1.3: Globalization

The concept of globalization defines the era that we are living in today. There are many theories regarding globalization; however, in general terms it explains that due to technological advancement, companies are able to expand their operation to new markets and produce goods at a global scale. Although globalization has brought wealth and prosperity to certain aspects of the world, it has also created negative circumstances, which in turn has created problems such as tax avoidance. It is due to globalization that MNEs are able to exploit tax policies and regulation- As Sharman (2006:3) puts it,

“Many observers believe that the economic change caused by globalization, particularly the rise in cross-border trade and financial flows, has far outpaced states capacities to control the process of globalization itself subsequently raising fears surrounding global capitalism.”
3.2: Entities

3.2.1: OECD

The OECD stands for Organization for Economic Co-Operation and Development. It consists of 34 member states and was originally founded in 1961. The OECD was founded to stimulate economic growth and world trade. As the OECD themselves put it they are,

“A unique forum where governments work together to address economic, social and environmental challenges of globalization. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance.” (OECD 2013: 1)

The OECD plays an important role in this project. Due to the re-politicisation of the issue; tax avoidance, the OECD has previously and currently fighting to find a solution to the problem. They have produced an action plan, “Action Plan on Base Erosion and Profit Shifting,” in 2013 faced for the G20 countries (explained on the next page). This project will use the action plan for analysis section, in order to answer the research question.

3.2.2: Multinational Corporations/Multinational enterprises (MNEs)

A multinational corporation/enterprises, an MNE, is a corporation, which operates not only at a national level but also at a global level, hence the multinational (Investopedia, 2015). Multinational enterprises, due to their global context, now entail a great deal of the world’s GDP (OECD 2013: 7).

3.2.3: G20 countries

The G20 countries is an association of multiple countries that consist of “the world’s largest advanced and emerging economies, representing the world’s population, 85 per cent of global gross domestic product and over 75 per cent of global trade.” (G20, Ageinig et al.) The G20 countries often ask for policy advice from several international organisations, such as OECD, and therefore it is a crucial part of our project. It was the G20 countries that asked for advice from the OECD on tax avoidance, for which the OECD then generated the Action Plan.
4: Context

4.1: How is tax avoidance a product of neoliberalism and globalization?

4.1.1: Capitalism and the emergence of the neoliberalist ideology

Capitalism is the dominant economic system in today’s global economy. It has its roots from the 16th century in Western Europe and the industrial revolution became an important marker in capitalist economies as it enhanced efficiency, lowered labour costs and enabled capitalists to gain market share and increase their profits. This led to worse living conditions for the workers embedded in longer working hours, bad sanitary conditions and generally hazardous working conditions. This further led to dissatisfaction and created an uprising of anti-capitalist factions known as social democrats, amongst others Eduard Bernstein and Karl Kautsky. They believed that the use of reforms and regulations could improve working and living conditions, creating a welfare state. The reforms were successful as the average life expectancy went up alongside worker wages. It was also during this period of the eighteenth century that the liberal countries, such as the USA and UK advocated free trade, which was a step towards the capitalistic market economy that we know. These ideas were indoctrinated by a political ideology called liberalism. Liberalism was a word socialized with freedom, for instance freedom of speech and freedom to pursue individual goals. A man could use his own property for his own interest with minimum intervention from the government to keep law and order. This kind of governance is called a minimal state. After the liberal period, followed the neoliberal period (Chang, 2014).

We draw on this quote from Murray (2009), to link capitalism with neoliberalism:

“The culture of neoliberalism forms part of the wider regulation of the capitalist system and is tied to Western ideas of modernization, civilization, individualism, materialism, accumulation, and rationality.” (Murray, 2009 p. 379)

Furthermore, E.W Murray links neoliberalism to the capitalistic market economy system. As mentioned above, neoliberalism is a product of different ideas and a capitalistic system. Larner explains the term neoliberalism in this phrase:

“Neoliberalism is a shorthand term referring to a new emphasis on markets, minimal states, and individual choice as a means of ensuring economic and social well being.” (Larner, 2009 p. 374)
Larner’s definition of neoliberalism is to be understood as a political ideology made to describe market policies, made by a government to achieve economic growth and social wellbeing through open borders, free trade, individual choice, deregulation and privatization. The term ‘Neoliberalism’ was first introduced during the 1970s to explain political policies, where the purpose was to pursue economic growth and social well-being with the markets as the distributor, whereas before the shift to a neoliberal viewpoint, it was the state that provided the goods and services. These settings would create possibilities for individuals and strengthen the competition. Another perspective that neoliberalism added was the creation of a minimal state. The classical school of economists’ position on government intervention is somewhat similar to the neoliberal thought that the government intervention equals failure, as it would annul the effect of these implementations. The difference is that neoliberalism recognises that you could not let the market be left alone, because it is not self-regulating, which is why they deemed regulations needed, but only the possible minimum of state intervention, which is called a minimal state (Larner, 2009).

4.1.2: Globalization’s role in neoliberal economics

Neoliberalism created a shift in the market economy and led to more open borders, in terms of trade and investments. The wide adoption of the neoliberalist ideology created an environment for globalization to thrive, which is called “Neoliberal Globalization” (Larner, 2009). Furthermore, the open borders, free trade and a more globalized market are also opening up the barriers for transnational companies. It is these barriers that allow companies to increase their profit by expanding their output and market share (Murray, 2009).
4.1.3: Globalization’s role in the contemporary economic system

Globalization and neoliberalism have been key components in the development of contemporary society. Technological advancements has enabled us to connect, travel, and communicate more efficiently on a global scale. As such Globalisation has also economically and politically significant. The following quote explains the benefits of globalization in our economic era,

“Globalisation is not new, but the pace of integration of national economies and markets has increased substantially in recent years. The free movement of capital and labour, the shift of manufacturing bases from high-cost to low-cost locations, the gradual removal of trade barriers, technological and telecommunication developments, and the ever-increasing importance of managing risks and developing, protecting and exploiting intellectual property, have had an important impact on the way cross-border activities take place. Globalisation has boosted trade and increased foreign direct investment in many countries. Hence it supports growth, creates jobs, fosters innovation, and has lifted millions out of poverty.” (OECD, 2013, p. 7)

However if we look beyond the beneficial factors of globalization, we see that even globalization has its flaws. Many scholars, governments and international organization such; OECD, officially recognize globalization to be one of the main roots to tax avoidance, “globalization has, however, also had the negative effects of opening new ways by which companies and individuals can minimize and avoid taxes and in which countries can exploit these new opportunities by developing tax policies aimed primarily at diverting financial and other geographically mobile capital.” (OECD,1998; 19)

It is mainly due to globalization that tax havens exist, “In that sense tax havens are at the very heart of globalization, or at least at the heart of the specific type of globalization that we have witnessed since the 1980s.” (Palan, Murphy and Chavagneux, 2010).

Globalization has enabled MNEs to operate in multiple countries and to invent several tax avoidance methods, allowing them to shift profits between their different corporate entities, by exploiting loopholes in ‘global legislation’ for instance bilateral and multilateral agreements on taxation between countries (Sikka & Willmott, 2010).

One of the main methods through which BEPS is possible, is transfer pricing. Transfer pricing is the price set for goods and services when it is sold between different divisions of the same enterprise e.g. when a sister company sells goods to its parent company, the price of those goods is the transfer price (Investopedia 2004) An enterprise is able to exploit tax with the use of this method. If division A of a
company is located in a “non-tax haven” and division B is located in a tax haven, then division B can charge division A very high prices for its good and hence since division B is located in a tax haven, it will have to pay a very little tax rate for its profits made (Investopedia, 2004).

Another aspect to this which the German Minister of Finance Wolfgang Schaube (2014) states that “Tax legislation has not kept pace with the progression of such economic developments. Most tax allocation principles that apply today date back to a time when doing business internationally primarily meant transporting goods across a border to a neighbouring country. Legislation and rules that were formulated in the primary decades of the 20th century are no longer appropriate for today’s international integration of economic processes and corporate structure. They need to be adapted to the economic reality of digital services.” (Britton & Makkonen 2014, p. 1)

The quote shows that the efforts to combat tax avoidance must be updated to reflect the changing nature of the economic system caused by globalization. The low risk of penance involved with exploiting such loopholes has resulted in a widespread of application of such methods (Larner, 2009), based on a profit-maximizing, neoliberalist mind-set.
4.2: Global relevance of tax avoidance

Tax avoidance in its essence is really about distribution of wealth and because of that, it becomes a political and social issue. Contemporary globalisation, in which tax havens have been a key component, facilitates tax avoidance (Hampton & Sikka, 2005). The magnitude of these schemes are quite overwhelming.

Transfer pricing is one of the most common methods of tax avoidance and is arguably “the most important international tax issue facing MNEs” (as cited in Sikka & Willmott, 2010). Some financial experts argue that “transfer pricing is used by virtually every multinational MNEs to shift profits at will around the globe” (as cited in Sikka & Willmott, 2010).

Based on these arguments transfer pricing becomes very suitable to understand the magnitude of tax avoidance and its relevance in global economy. Furthermore, by the beginning of the 21st century “51 of the largest 100 economies in the world” were companies and not nations (Sikka & Willmott, 2010, p. 345). The following quote including figures based on the same time frame, puts the resources these companies have in perspective:

"The 100 largest MNEs controlled assets of $3400 billion, of which 40% were located outside their home countries. The 200 top MNEs accounted for 28% of the world economic activity. The top 500 transnational MNEs controlled 70% of the worldwide trade, 80% of the foreign investments, 30% of the global GDP, one-third of all manufacturing exports, 75% of all commodities trade and 80% of the trade in management and technical services; just 20 controlled the coffee trade, 6 of them held 70% of wheat trade and just 1 controlled 98% of the production of packed tea; 80% of the entire production of world grain was distributed by just two companies (Cargill and Archer Daniel Midland); 97% of all patents are held by nationals of OECD countries almost 90% of these are held by global MNEs (Tripathi, 2000; Korten, 2001; UNFAO, 2003; Anderson et al., 2005)” (as cited Sikka & Willmott, 2010)

These figures clearly demonstrate the vast power such MNEs hold in form of resources, which makes them more difficult to deal with, especially for developing countries, which cannot necessarily deal with the labour intensity required to check the practices they are facing, making them extra vulnerable (ibid.). This power such MNEs hold is arguably also embedded in the fact that nation-states compete against each other, in order to attract investments for their domestic economy. This creates circumstances, in which the MNEs can utilize this competition to their advantage. Exactly this
competition is what enables tax havens to exercise their sovereign powers to provide financial 
environments, where the taxation is little or nothing and where secrecy can be provided (ibid.)

Nearly half of the world trade is channelled through tax havens, despite the fact that these locations 
only account for 3% of the world’s GDP (Hampton & Sikka, 2005). Furthermore, certain tax havens also 
known as microstates, such as US Virgin Islands, Cayman Islands and The British Virgin Islands, only 
account for around 1.2% of the world population, but still more than 25% of American MNEs assets 
and net profits are held in such locations and that is just American based enterprises. Key figures 
suggest that around US$ 7 trillion passes through tax havens each year, and assets held in such 
locations are estimated to be around US$11 trillion, corresponding to more than a third of the world’s 
GDP. In addition around 200,000 new companies are established in microstate tax havens each year, 
and the total amount for companies present in such locations are estimated to be more than 3 million. 
Just one address in Cayman Islands has 18,857 companies registered, and in The British Virgin Islands 
the company to population ratio is 3389 per 100 citizens (Sikka & Willmott, 2010). Clearly there is no 
disputing the popularity of and extent, to which tax havens are utilized by major MNEs.

The magnitude of these schemes have consequences for the societies, which are deprived from 
taxable profits which are shifted to tax havens. In 2011, Google managed to channel 80% of their 
profits through Bermuda, thus allowing them to pay an overall tax rate of 3.2% on overseas profits, 
although most of it was generated in European countries, with high taxes. The executive chairman of 
Google even went so far as to claim how proud they were of their tax arrangements, and stated “It’s 
called capitalism” (Armitstead, 2012). In comparison the average worldwide corporate income tax rate 
is at 22.6% (Tax Foundation, 2014). Examples of the consequences of tax avoidance are not scarce. 
For instance Papua New Guinea was estimated to have lost tax revenues between $9 million and $17 
million in 1999 just within their forestry business - figures which exceeds education and healthcare 
budgets by far. More recent figures even suggest the numbers to be around $100 million due to 
transfer pricing policies amongst international actors in the business, which in turn deprives the 
country of funds crucial to economic advancement (Sikka & Willmott, 2010).

Some NGOs claim that tax avoidance is directly linked to poverty and essentially an assault on 
democracy. In addition, tax avoidance becomes a barrier for advancement of countries, and creates 
social circumstances, which could have been avoided and best explained as negative externalities 
created by tax avoidance. Thus tax avoidance reduces the ability of the state to provide for its citizens, 
and in turn may result in shifting the burden onto the rest of society to compensate for lost tax
revenues through higher taxes on consumption goods, wages etc., which arguably “undermines the social legitimacy of the state” (Sikka & Willmott, 2010, pp. 352).

Tax avoidance facilitated by tax havens, has made it increasingly difficult for governments to collect adequate taxes to fund “public goods or redistribute wealth,” which has created international efforts to combat this problem (Hampton & Sikka, 2005).

On one hand, multinational companies avoid taxes as they would avoid any other cost and in that sense tax is simply the cost of doing business. In that sense, one can argue that they are simply rational economic actors ensuring that their business runs as smooth as possible. On the other hand avoiding corporate taxes is a matter of multinational enterprises enjoying the features of the society in which they operate, but without paying for those features through taxes on profits. These features are amongst others, legal systems, infrastructures and social factors, which support the ability of companies to generate profits (Sikka & Willmott, 2010).

Instead of repaying society and contributing to the advancement and sustainability of it, it seeks to shift taxable income away from those states and into the hands of shareholders. Thus using aggressive tax avoidance techniques arguably becomes problematic in regards to MNEs claiming to act as socially responsible. Claiming to be socially responsible when core accounting processes are established exactly to shift tax payments from society to its shareholders is clearly contradicting (Sikka & Willmott, 2010). This is exactly why it becomes not only a political problem, but also a moral one.

We believe that there is a social cost embedded in tax avoidance as it limits societies’ ability to advance and sustain public goods and instead shifts capital away from society, into the hands of the already rich and greatly contributes to inequality of wealth distribution and thus creates negative externalities.
4.3 The G20 BEPS Action Plan

The G20 Base Erosion and Profit Shifting Action Plan is a strategic policy document devised by the OECD, in July 2013. The Action Plan was devised on behalf of the G20 countries asking the OECD on advice regarding tax avoidance on BEPS methods. The Action Plan is a step in the large project that the OECD in cooperation with the G20 countries is comprised to combat BEPS. The Action Plan consists of strategically designed ways to combat BEPS, “The utilization of tax structures that either exploit inconsistencies in different jurisdictions’ tax system to avoid tax or shift profits to low-tax jurisdictions in which little real activity is conducted.” (Burmester, K & Smiley, 2. 2013)

The aim of the general Action Plan, is to prohibit MNEs that have been able to reduce their tax burden through BEPS methods. Before the Action Plan was developed, an OECD report named “Addressing Base Erosion and Profit Shifting,” was devised by the OECD, which was later commissioned by the G20 countries. The report did so the G20 countries and OECD later called for the Action Plan. The report addresses six main “pressure areas” that should be combated by the Action Plan (Burmester, K & Smiley, 2. 2013):

1) “International mismatches in entity and instrument characterization including hybrid mismatch arrangements and arbitrage.”

2) “Application of treaty concepts to profits derived from the delivery of digital goods and services.”

3) “The tax treatment of related party debt-financing, captive insurance, and other inter-group financial transactions.”

4) “Transfer pricing, in particular in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents.”

5) “The effectiveness of anti-avoidance measures, in particular GAARs, CFC regimes, thin capitalization rules, and rules to prevent treaty abuse.”

6) “The availability of harmful preferential regimes.”
These issues were then later addressed in the Action Plan. The Action Plan was mainly developed to combat the above-mentioned 6 issues. There are 15 points to the Action Plan, “The actions recommended by the 15-point Action Plan generally involve the development of suggested revisions to member countries’ domestic tax laws and changes to the OECD Transfer Pricing Guidelines and Model Tax Treaty.” (Burmester, K & Smiley, 2. 2013). Together with the Action Plan, the OECD have also provided a timeline with an estimation of the completion of each action and estimate that all actions will be completed by the end of 2015.

Each action in the 15-point Action Plan, will be summarized and explained in the following paragraphs.

**Action 1:** The digital economy has raised some tax challenges, and this action plans to address those challenges. The action plans to analyse the business models and the key features of the digital economy. This economy does not create BEPS challenges, however it does aggravate existing problems with the tax regulations. Through the digital economy a company is able to sell goods and services in another market in another country, without being physically present in the country. The reason for this action is that domestic and international laws regarding double taxation, were developed in the 1920s by the League of Nations, and have not been upgraded since and are therefore not coherent with today’s globalized era. (Burmester, K & Smiley, 2. 2013)

**Action 2 - 5:** Actions 2 to 5 are established to fix the loopholes in the interaction of countries domestic tax regulations. These mismatches are called hybrid mismatches, “Hybrid mismatches are cross-border arrangements that take advantage of differences in the tax treatment of financial instruments, asset transfers, and entities to achieve ‘double non-taxation’ or long term deferral outcomes which may not have been intended by either countries.” (OECD, 2015) These actions are focused on these hybrid mismatches due to MNEs are able to exploit these differences and hence reduce their tax burden.

**Action 6 - 10:** Actions 6 to 10 mainly target the existing treaty system. They are shaped to primarily fix the flaws in the OECD Model Treaty and Transfer Pricing Guidelines, including a few changes made to domestic tax regulation when it concerns treaty abuse. These actions mainly concern the flaw of transfer pricing, that allow MNEs to shift their profits to low tax jurisdictions, tax havens (Burmester, K & Smiley, 2. 2013).
Action 11 - 14: The following three actions, action 11 to 14, plan on improving transparency when trying to obtain information on tax planning structures of MNEs. At the moment, audits are the primary methods of obtaining this information, however the OECD feels audits lack on providing this information in short time. These actions deal with the procedure of data collection made by tax authorities, and plans on improving them, while Action plans on improving the transparency between cross-border conflict agenda (Burmester, K & Smiley, 2. 2013).

Action 15: The final action calls for the development of a “multilateral system.” Instead of having a treaty-to-treaty basis for each of the action plans mentioned above, the final action calls for a multilateral system in which the modifications and updates of the action plan can be achieved (Burmester, K & Smiley, 2. 2013).

This is the basic goals and summarization of the G20 BEPS Action Plan, which will be further analysed in Chapter 5, where each action’s aim will be put in perspective.
5: Analysis

5.1: Can tax avoidance be identified as a social cost, and if so can social cost theory justify the G20 action plan?

The first section of the analysis will explain the importance of tax for the sovereignty of governments. The social cost of tax avoidance will be put in perspective based on the function of tax revenue to supply public goods to society. This social cost can be identified as a negative externality of production which causes a market failure. According to theory there are a number of methods of government intervention that can be applied in order to correct market failure. These methods will be evaluated with respect to the issue of tax avoidance.

5.1.1: The importance of tax

Taxation plays an instrumental role for a government in order to manage its responsibilities, and the very foundation of democracy requires a government to collect taxes. The state structure in which western society lives in today, relies heavily on the government to enforce its laws, to assure citizens their rights (Sikka and Willmott, 2010). Law and order, ownership of private property, religious freedom etc. are all basic rights which can be found in constitutions all around the world, and can be traced all the way back to the founders of modern democracy such as Montesquieu and Locke (Uzgalis, 2014). Taxation is instrumental for a government to practically enforce the laws, and thus enable citizens to exercise their rights, by the simple reason that enforcing capital is needed.

The early proponents, mentioned above, of democracy were often of the belief that the laws should be kept at a minimum in order to ensure as much personal freedom, as possible and it follows that if the laws were kept at a minimum, the amount of taxation needed to enforce them, would also be kept at a minimum. Generally, it was argued that government intervention or regulation should be kept at a minimum (Uzgalis, 2014).

However, the form of society, in which most of the western world lives in today is not only responsible of basic rights but far more. Society has taken a form in which the government has stepped in to include many more rights such as healthcare, education, financial aid to people in need and more (Andrew Hogg et al., 2008). And as mentioned above, the more a government is responsible for, the
more taxes it needs to enforce the laws. It follows that taxes often rise proportional to a rise in responsibilities a government must stand for.

From the discussion above, it is clear why taxation plays such an important role for the society in which we live in today. This is supported by the opening line in chapter 2 of the G20 BEPS Action Plan, which states: “Taxation is at the core of countries’ sovereignty(…)” (OECD 2013, p 9). The sovereignty of a state is what enables a country to set the laws it wants. In theory that means, if a government of a sovereign state wish to be responsible for all parts of its citizens lives, and impose 100% tax to cover the costs, it has the right to do so. This is of course not a reality, but what is a reality, however is the fact that governments in western society do stand for a lot of responsibilities, and impose a tax which they deem appropriate. It is fair to say, that taxation is indisputably a very important element for the government structure of western society, as it is a base for many rights to practically exist and thus state sovereignty (Palan et al., 2009). It can be argued that tax avoidance therefore stands as a direct opposite of the aspects mentioned above.

5.1.2: The social cost of tax avoidance

As mentioned in the theory section, a company’s private cost of production is the cost of manufacturing and selling their product including the tax that they are required to pay. However when a company avoids the intended tax they reduce the private cost of production, as they pay a lower tax. Additionally this analysis argues that the social cost of production will increase as private cost decreases through tax avoidance. This is because the tax that a company is intended to pay in the country in which they operate is not paid, which reduces the revenue that the country’s government receives through taxation.

As shown in the section above, governments rely on tax revenue to fulfil their tasks to enforce the rights of its citizens. This means that as tax avoidance reduces the resources that a government needs to fulfil its tasks, it is not able to do so to the same extent. The government is responsible for providing society with a number of public goods, including healthcare, education and welfare, which are a necessity for the citizens’ quality of life. The government will set the tax rate to reflect the level of services that the democratic structure dictates they must provide (Sikka and Willmott, 2010). Tax avoidance therefore means that the government receives less tax revenue than expected, causing a reduction in the quality and quantity of the services they provide, that ultimately must be paid for by the citizens whose quality of life it reduces (Cox, 2009). This is the marginal social cost of tax avoidance,
which the companies involved, aiming to maximize profit, do not consider when operating in the market, making it a negative externality of production since their actions have a negative effect on others (Cowen, 1993).

This argument is supported by the G20 action plan that states “Individual taxpayers are harmed. When tax rules permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers in that jurisdiction bear a greater share of the burden” (OECD 2013, p. 8)

Therefore, this project aims to present the argument that corporate tax avoidance causes a negative externality because the social cost of their operations is greater than the private costs of the MNEs at hand. We will do this by identifying the negative externalities of tax avoidance and showing how they cause a market failure, using empirical data and examples to support our argument. This will emphasize the rational behaviour of companies, which causes the negative externalities of tax avoidance.

5.1.3: Tax avoidance in developing economies - The Christian Aid Report

The Christian Aid Report of 2008 was published in the early phases of the financial crisis of 2008, and sought to address the problems of lost tax revenue and the consequences of the losses. It uses different cases from developing countries to argue its case and backs up its statements with empirical data (Hogg, 2008). The report is often cited by other authors whose work we have used, such as Sharman (2006) and Palan et al. (2009), making it relevant to us.

The main argument of the report is very radical in the way it links activities of tax dodging to negative problems in developing countries. It estimates the annual lost tax revenue in developing countries is a staggering 160 billion US dollars: “If for example, the same proportion of tax revenues were spent on healthcare in these countries as has been since 2000, then the lives of 350,000 children under the age of five would be saved every year – including 250,000 babies” (Hogg, 2008 p. 2).

The argument of the quote above is based on the importance of tax to a government. If nations of the developing world were not plagued by tax avoidance, they would have a certain amount, (the estimate is 160 billion US dollars) which could have been used on public goods (Hogg, 2008). This is exactly what makes the report special as it is linking real life problems to tax dodging. It illustrates that when
multinational corporations practice tax avoidance, it creates negative externalities because governments lose tax revenue, which otherwise could have been used to finance public goods. In this case they argue that the money could have been used on health care, possibly saving thousands of lives. The report features cases of tax avoidance in Tanzania and India, which will be used for the market failure analysis.

This project uses two cases from the Christian Aid report in order to associate social cost with tax avoidance. The cases will create the foundation, which we will use for our market failure analysis.

**The case of Tanzania**

Tanzania is one of the richest African countries in natural resources. One of its main industries is the mining of gold and valuable gemstone with mines opening on an annual basis since 1998, making Tanzania the second biggest exporter of gold in Africa. With more than 500 million dollars in exports in 2007 in gold alone, one would expect the mining industry to have extremely positive effects in the form of tax revenue. However, it is one of the world’s poorest countries with more than 20 million people living for less than a dollar a day, some 140,000 HIV related deaths per year and more than 40% of the population labelled as malnourished (Hogg, 2008). Arguably, the condition of the country’s citizens stands in clear contrast to the wealth generated.

The answer to the question lies within the combination of tax avoidance and the “race to the bottom,” which force governments to legislate in favour of MNEs to attract them. A report called “A Golden Opportunity?” have empirically proven that Tanzania lost more than 400 million US dollars over 7 years, due to the factors mentioned above. Money which otherwise could have been used on public goods could have improved the lives of thousands of people (Hogg, 2008). The essence of the situation is depicted well by Mbaraka Islam: “Back in the late 1980s I thought Tanzania would be in heaven like Botswana and South Africa, with tarmac roads, and good education and health systems. But now nothing has changed and we are still begging.” (Hogg, 2008 pp. 11-12).

The report “A golden opportunity: How Tanzania is failing to benefit from gold mining” which the Tanzanian case is based on, identifies the methods used by the mining companies to avoid paying taxes. Over a course of 7 years, the mining companies had declared losses of a total of 1045 billion US dollars. By declaring losses, and thus reducing their profits, there is no profit base on which they can be taxed. By deferring their income through investment, to a point where they do not generate profit,
they are not liable to taxation. In combination with secrecy provisions, regarding what the companies have to make officially available, it has proved a hard problem to deal with (Curtis & Lissu, 2008).

This project argues that the heart of the problem is tax avoidance and in order to compete for investment, Tanzania is forced by the ‘race to the bottom’ to legislate in favour of multinational MNEs. In combination of these elements, MNEs deprive Tanzania of its wealth with only little spill-over effect. This project believe that the case of Tanzania shows the overshadowing endeavour for profit is dictating the actions (tax avoidance) of MNEs.

The case of India

Poverty levels in India are some of the highest in the world with one in three of the poorest people in the world live in India. The rapid growth of the Indian economy could help the issue of poverty, however it is believed that the benefits are primarily seen by the middle and upper classes, while the poor citizens are getting poorer (Hogg, 2008).

This is partially caused by a significant amount of tax avoidance that occurs in India, through the island of Mauritius. The Double Taxation Avoidance Act (DTAA) between India and Mauritius allows companies based in Mauritius to avoid taxation of capital gains in India, resulting in MNEs based in Mauritius to avoid between 10% and 40% of their capital gains tax, corresponding to a loss of £500 million according to Indian tax officials. This means that the resources which could have provided public goods for the lower class, instead ends up in the hands of the middle and upper classes (ibid.). The scale of the issue is supported by the fact that nearly half of all foreign direct investment (FDI) to India is routed through Mauritius (Zarabi, 2008).

This type of tax avoidance can be identified as treaty abuse. “A finance ministry official said the key change to the treaty being pushed by India is to move from a ‘residence-based system of taxation’ to a ‘source-based’ system, meaning investors from Mauritius would need more than a proforma registered office in the island to qualify for tax breaks” (ibid). The companies involved abuse the DTAA in order to avoid paying capital gains tax in India, as the act says they may pay this tax in Mauritius, simply by establishing Mauritius tax residency. However as capital gains is non-taxable in Mauritius they avoid paying this tax altogether (ibid).

This treaty abuse has been addressed by India through several attempts to amend the DTAA, however none of these attempts have been successful. An Indian finance ministry official has stated that “the
country [India] lost the opportunity to amend or even abrogate the treaty in 1992-93, when Mauritius made capital gains non-taxable. Now it seems difficult as any unilateral move on our behalf will have consequences (on the already volatile stock market).” (Zarabi, 2008)

Similar to the case of Tanzania, India faces significant social problems, leaving the poorest with a low quality of life and lacking rights. This issue is addressed by the government through the provision of public goods and an attempt to secure rights, however is hindered by the reduction of tax revenue caused by tax avoidance.

5.1.4 Tax avoidance in developed countries - The case of US MNEs

As so far in our analysis, we have established some examples of tax avoidance creating negative externalities in developing economies. We wish to broaden the scope to also look at a developed country to identify, how tax avoidance also can create negative externalities in such countries. We have chosen to look at the US and the efforts of the Obama administration to push forth a national healthcare system, which clearly indicates an effort to overcome certain social issues caused by the current lack of health care.

The Obama administration has estimated the cost of Obamacare, if it were to be implemented in the US. The estimate net cost, as of March 2015, lies on $1.207 trillion over the period 2016 - 2025 (Obamacare Facts, 2015). Which means the per year cost would lie at $134.1 billion.

The US is believed to be deprived of $100 billion in tax revenue as a result of profit shifting by tax avoidance and tax evasion techniques (Kredo, A., 2015), however these estimates vary and one specific study estimates that ‘profit shifting’ alone is in the range of $55 billion to $133 billion in 2013 (Gravelle, 2015). Working with a rather high level of abstraction, hypothetically if those funds were allocated towards funding the healthcare plan, it would be able to fund approximately 75 % annually of the net cost of Obama Healthcare Plan over the period 2016 - 2025. The burden, or at least 75% of it could the hypothetically be sponsored by the state through existing tax rates, rather than new taxes or an increase in domestic taxes in general, shifting the burden to other taxpayers.

We realize that this rather high level of abstraction can create certain concerns of legitimacy of our claims and requires more detailed arguments, however we feel that the examples above provide hypothetical ideas, which converges with the argument that tax avoidance does create negative
externalities projected in a ‘what could have been’ paradigm and thus creates a market failure. Within our current framework, we can then link tax avoidance to social costs in this case exemplified by a health program, which theoretically could primarily be funded by lost tax revenue facilitated by tax havens and tax avoidance in general.

We establish an overview of some methods utilized by US corporations, by looking at evidence on how two of America’s largest MNEs avoid paying taxes; Google Inc. and Apple Inc.

Both companies operate with intangible properties such as intellectual property in form of patents and rights of use, also including computer software and income generated from the digital economy with the use of sources such as the internet.

**Non-double taxation and the example of the ‘Double Irish, Dutch sandwich’**

Non-double taxation refers to situations in which a company in multi or bilateral arrangement, where it utilizes the laws of those jurisdictions to avoid paying taxes. One method identified is known as the ‘Double Irish, Dutch sandwich’, essentially a multilateral example, which Google has been utilizing. This method is a tax avoidance method in which a MNE exploit tax laws in order to operate a production apparatus in a high-tax jurisdiction and at the same time shift their profits from that to a non-tax (or low-tax) jurisdiction.

This strategy involves, firstly, establishing an Irish holding company, which for instance acquires ownership of a patent or the rights to a product (an intangible assets of the MNE). This company then has a sales subsidiary which has the purpose of selling products (in this case advertisements - the main source of income for Google) linked to that patent or rights of use in Europe. Between those two companies is then a Dutch subsidiary, which only has the function of claiming the royalties from the sales subsidiary (as the holding company owns the right to those products sold) and transferring that back to the Irish holding company owning the patent or rights to. The Irish “holding company” would have base in a preferential regime (tax haven), with a low tax rate and where it claims “company management”, to avoid corporate tax in the countries where sales have been generated and even avoid paying the relatively low Irish tax. Ireland has however established efforts towards putting an end to the rule, which enables a company to be “incorporated in Ireland” and having tax base in another country. Ireland’s low corporate tax rate however is still a very low tax compared to other countries (Gravelle, 2015).
Transfer pricing

Transfer pricing is a method which enables companies to reallocate profits from a high-tax jurisdiction and to a low-one. They do this by “maximizing expenses in the former and income in the latter” (Sikka & Willmott, 2010 p. 345).

We draw on this quote to illustrate the complexities globalization has enabled (Sikka & Willmott, 2010, p. 345), “An automobile manufacturer can design car parts in countries A and B, have them manufactured in countries C and D, assembled in E and F, hold trademarks and patents in G and H and assign global marketing rights to countries J and K.” (Sikka & Willmott, 2010 p. 345)

There are several ways of using transfer pricing but the essence of it is to shift profits to other parts of the company either by mispricing products in intra company transactions (Sikka & Willmott, 2010) thus shifting profits from high-tax to low-tax jurisdictions. The method is especially effective in regards to intangibles for instance intellectual property, as they are difficult to assess using the ‘arm’s length principle’ (Gravelle, 2015). Apple is known to utilize this method (Ting, 2014) and so is Google (Drucker, 2010)

‘Check-the-Box, Hybrid Entities and Hybrid Instruments’

This refers to how MNEs can misuse definitions of entities in their corporation to their advantage by labelling subsidiaries of their MNEs as specific entities in some jurisdictions an other entities in other jurisdictions. The features and schemes of facilitated by these hybrid entities, instruments and check-the-box regulations are rather difficult to explain, so we draw on the following quote to explain it (Gravelle, 2015):

“For example, a U.S. parent’s subsidiary in a low-tax country can lend to its subsidiary in a high-tax country, with the interest deductible because the high-tax country recognizes the firm as a separate MNE. Normally, interest received by the subsidiary in the low-tax country would be considered passive or tainted income subject to current U.S. tax under Subpart F. However, under check-the-box rules, the high-tax corporation can elect to be disregarded as a separate entity. Thus, from the perspective of the United States, there would be no interest income paid because the two are the same entity. Check-the-box and similar hybrid entity operations also can be used to avoid other types of Subpart F income, for example from contract manufacturing arrangements.” (Gravelle, 2015, pp. 14)
As specific US regulation is not relevant to this project, we do not explain it further, however we feel it is important to briefly explain how the use of hybrid entities creates opportunities of tax avoidance on a global scale. Furthermore utilization of such entities are known to be a core part of many US corporations tax planning (Gravelle, 2015).

**Summary of key arguments of sections 5.1.3 and 5.1.4**

This project finds the arguments of the cases useful as they show tax avoidance from a new perspective; the focus is not on the actual lost revenue but the effects of the lost revenue and in this case, the effects are affecting the lives of thousands of people. Backing up the arguments of the cases with empirical data, they clearly show the social cost as a consequence of tax avoidance.

As this discussion has shown, the process of tax avoidance denies states a revenue that is fundamental to the role that government plays in society. This reduces their ability to provide the services they are required to, in order to achieve a certain level of rights and stability necessary for the society which it represents.

**5.1.5: Theoretical explanation of market failure**

The cases explained in the previous section have shown the harmful effects of tax avoidance on the citizens of countries in which the phenomenon occurs. As the discussion has shown these harmful effects represent a social cost, that the firms causing them do not pay for as they are rational individuals seeking to maximize profits. Instead, this cost is paid by society that must adapt to the loss of quality and quantity of public goods, which ultimately leads to a reduction of the quality of life of the average citizen, or in extreme cases as shown above, the loss of life (Pindyck & Rubinfeld, 2012).

This is the negative externalities of production of companies exercising tax avoidance. This means that the companies at hand are producing at a higher output than what the ‘invisible hand’ would dictate, if the true cost, the social cost, was taken into account by the producers. This results in an inefficient allocation of resources because companies save large amounts of money through a reduction in taxes, that should be allocated to the society from which they receive their revenue, causing an overproduction of products that ultimately harm society (*ibid.*).

When considering the negative externalities of tax avoidance, it is crucial to keep in mind that while the loss of tax revenue has a social cost, the avoidance of taxes itself reduces the private cost faced
by the companies. This results in an extreme case of market failure where the act that causes negative externalities simultaneously makes the companies more competitive in the market, meaning they can produce an even greater quantity of output, than if their private cost had remained static (ibid.).

According to market failure theory, the appropriate response to market failure is through government intervention. However, in the unique case of tax avoidance certain methods of intervention are simply not applicable (ibid.).

The analysis believes that taxation is not a solution to tax avoidance. In certain cases, it is possible to tax companies that cause negative externalities of production in order to push up their private costs, resulting in a lower output. This is not possible when it comes to tax avoidance, since the issue at hand is the fact that these firms do not pay the intended taxes using various loopholes in the taxation system (Frank, 2006).

This does, however, lead to the conclusive point of this analysis. In order to increase private cost of production, similar to taxation, the loopholes used to avoid tax must be closed through regulation, as the other possible solutions of the theory are not applicable. In theory, regulations on tax avoidance have the same effect as a Pigovian tax, as it reduces output by increasing the private cost of production. Simultaneously this approach reduces the social cost, as the negative externalities of production are caused by the avoidance of taxes (Pindyck & Rubinfield, 2012).

5.1.6: Conclusion

Our purpose of this section was to identify whether the theory of market failure can explain the concept of tax avoidance in how it has consequences, what those can be, and what the appropriate response according to this theory requires.

By looking at specific cases in developed countries and the general application of tax avoidance schemes in a developed country, we have demonstrated both hypothetical and concrete costs of tax avoidance. Furthermore, we have explained the theory of market failure and identified the appropriate response the problems identified in our case, according to the theory.

The empirical data used in our analysis fits well within this theory and thus far, our conclusion is that market failure theory does explain how tax avoidance creates problems in a society, and dictates a state response to the disequilibrium created by increased social costs and decreased private costs.
5.2: Does the G20 BEPS Action Plan seek to create a basis for regulation on schemes identified in our analysis, thus justifying the market failure theory?

This part of the analysis seeks to identify tax avoiding methods utilized in the cases we present in the first part of the analysis. This part of the analysis will not provide an efficient tool for evaluating the effectiveness of the regulations suggested in the G20 action plan or whether it encounters all aspects of tax avoidance, however it provides a link between the theory of market failure and the examples of our analysis and thus whether these regulations essentially within our theoretical framework is a response to a market failure created by social costs.

5.2.1: Links Between G20 BEPS Action Plan and Cases

We use content analysis to work with ‘thick descriptions’ of the methods applied in the cases of our analysis and use these to code the G20 action plan accordingly to search for links between these descriptions in order to evaluate convergences between our cases and what the action plan aims to achieve.

From our cases, we have identified a number of methods used to avoid taxation. In the case of Tanzania, we found income deferral and secrecy provisions to be the problems causing tax avoidance. In the case of India, we found treaty abuse, treaty disputes and non-double taxation to be the issues causing tax avoidance. Lastly, in the case of USA we found non-double taxation, transfer pricing and misuse of ‘hybrid entities’ to core methods of tax avoidance schemes. The structure of the following section consists of an analysis of each action in the 15-point G20 BEPS Action Plan. We will identify the actions that are relevant to our cases, summarise the purpose of the actions, and hence link them to the relevant cases from the first part of the analysis.
**Action 1:**
Action 1 aims to address the problems associated with tax regulation concerning the digital economy. For instance, a company is able to have digital presence in another country, and due to lack of current international tax rules regarding the digital economy, the company does not have to pay tax in the country where it has digital presence. The action’s goal is to “Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation.” (OECD 2013, pp. 14-15)

**The case of US corporations**
Due to technological advancements, MNEs such as; Google and Apple, whose business consists of (amongst others) digital products, are able to have digital presence in any country that has a digital economy. Apple’s and Google’s utilization of the e.g. the Internet, enables schemes involving tax avoidance based on PE status (discussed further in Action 7), due to the lack of such international rules. Digitalization has also created a vast amount of digital and intangible products which can be difficult to assess, within (amongst other methods), Transfer pricing. Since the international tax rules were developed in the early 20th century, and have not been updated since, means that the regulation has not kept pace with globalization together with the technological advancements, and hence MNEs have exploited the fact that there are not any tax rules regarding the digital economy.

**Action 2: Neutralise the effects of hybrid mismatch arrangements**
Action 2 aims to address the problems associated with hybrid mismatches such as double non-taxation and income declaration. For instance, companies can use subsidiaries to create profit deductions through investing or loaning, without creating a corresponding income inclusion, resulting in an artificial profit loss. The action’s goal is 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” (OECD, 2013 p. 15).

**The case of Tanzania**
As shown in the previous section of the analysis with the case of Tanzania, the mining corporations are tax avoiding by declaring no profits because their income is used on investment and other expenditures (Curtis & Lissu, 2008). Action 2 aims to deal with the problem identified in Tanzania addressing the issue of profit deferral, by developing: “(iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation
under controlled foreign company (CFC) or similar rules);” (OECD, 2013 pp. 15-16). By implementing domestic law, which ensures that corporations are not able to deduct their profit, simply because they spend money on a subsidiary located in a tax haven, action 2 could help solve the problem the Tanzanian government have experienced with the mining corporations.

The case of US corporations
As mentioned in part one of the analysis, misuse of ‘hybrid mismatch arrangements’ are popular in tax planning of major US corporations and thus have an effect on their ability to shift profit and debt between entities in their corporation. Therefore, this action point has potential implications for such practices and can ultimately affect such corporations’ ability to construct tax-planning strategies around misuses of ‘hybrid entities’.

Action 3: Strengthen CFC rules
Action 3 aims to update the current CFC rules. For instance, a company is able to be located in a country without necessarily having to pay the associated tax to the country it is located in. These are referred to as non-resident taxpayers. Controlled Foreign Corporation (CFC) rules are part of an income system, designed with the purpose to reduce artificial deferral of tax by the use of tax havens. The action’s goal is “develop recommendations regarding the design of controlled foreign company rules.” (OECD, 2013 p. 16)

The case of US corporations
This refers directly to the ‘Double Irish, Dutch Sandwich’ described in the previous section. By utilizing such loopholes, it enables corporations to shift profits generated in e.g. Europe to non-taxed jurisdictions, deriving European jurisdictions of their fair share. Strengthening these rules on a global scale would limit such tax planning structures and their effects, thus increasing the tax revenue of states affected.

The case of India
As shown in the previous section of the analysis the companies performing tax avoidance through Mauritius establish tax residency in Mauritius in order to avoid capital gains tax of stock trades in India. “One of the sources of BEPS concerns is the possibility of creating affiliated non-resident taxpayers and routing income of a resident enterprise through the non-resident affiliate” (OECD, 2013 p. 16). Strengthening the CFC rules would limit the companies’ ability to route income through Mauritius in order to avoid the Indian capital gains tax.
**Action 4: Limit base erosion via interest deductions and other financial payments**

*Action 4 aims to develop recommendations on rules regarding the prevention of tax base erosion. It focuses on the use of exempt or deferred income to create a nil profit base, which cannot be taxed. Its main goal states: “Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense(…)” (OECD, 2013 p. 17).*

**The case of Tanzania**

Much like action 2, this action is addressing the problem in Tanzania. By developing ‘best practices’ of how corporations are allowed to defer their income, this action could possibly deal with the problem the Tanzanian government have. “*Rules regarding the deductibility of interest expense therefore should take into account that the related interest income may not be fully taxed or that the underlying debt may be used to inappropriately reduce the earnings base of the issuer or finance deferred or exempt income*” (OECD, 2013 pp. 16-17). If rules on deductibility of expenses in regards to taxation are implemented, the mining corporations would have no incentive to create deferred income in order to avoid taxation.

**Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance**

*Action 5 aims to address the problems associated with the use of harmful tax regimes, tax havens. For instance, companies can use these low or close to non-tax jurisdictions in order to shift profits to their division in a tax haven, and hence not pay any corporate income tax. The action’s goal is to “revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime.” (OECD, 2013 p. 18)*

**The case of US corporations**

As preferential tax regimes are at the heart of both transfer pricing methods and other types of profit shifting involving preferential tax regimes such as the ‘Double Irish, Dutch Sandwich’ model, this action point aims to affect such practices by countering them. Furthermore, seccreties in such preferential tax regimes creates problems in regards to tax administrations assessing financial activities involving these locations. This further complicates efforts of tax administrations to establish estimates of taxes avoided, through practices involving such regimes.
**Action 6: Prevent treaty abuse**

Action 6 aims to develop a model treaty provisions and rules in order to prevent the exploitation of treaty benefits, in harmful situations. For instance, a company can exploit double-taxation treaties in order to achieve double non-taxation, by avoiding taxation in both countries. The action’s goal is to, “Tight treaty anti-abuse clauses coupled with the exercise of taxing rights under domestic laws will contribute to restore source taxation in a number of cases.” (OECD, 2013 p. 18)

**The case of India**

As identified in the previous section of the analysis, Indian companies abuse the DTAA in order to avoid capital gains tax in India, thus achieving double non-taxation. This is done in accordance with the DTAA through the tax haven of Mauritius. Action 6 states “Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.” (OECD 2013, p. 19) These measures could prevent companies in India from abusing the DTAA in order to benefit from it in an unintended manner.

**Action 7: Prevent the artificial avoidance of PE status**

Action 7 aims to redefine ‘permanent establishment’ (PE), so that the term is not exploited in inappropriate circumstances. For instance, the exploitation of the term PE permits contracts where the sales force of a country, sells the goods belonging to an MNE by a local subsidiary. In this sense, the profits from these sales would not be taxed as much as if they were sold by a distributor. Action 7 aims to, “Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS[...].” (OECD 2013, p. 19)

**The case of US corporations**

PE status can be associated with methods mentioned in the first part of our analysis in the specific example of the utilization of the ‘Double Irish, Dutch Sandwich’ by Google.

“The principle of the system now is that companies often pay tax not on the basis of where they do business, but on where they finalise their business deals with customers. With a contract-stamping operation in a low-tax country such as Ireland as its ‘permanent establishment’, a company can channel revenue from its major markets to be taxed at a lower rate.” (Bergin, 2013, pp. 3)
This is exactly what Google does by having a sales corporation functioning in the European market in general, but the deals are essentially being finalized outside of those jurisdictions in which the sales are generated, reducing the overall tax paid profits generated by such transactions.

**Action 8, 9, 10: Assure that transfer pricing outcomes are in line with value creation**

Action 8,9,10 all aim to combat transfer pricing, by developing rules that prevent BEPS by moving intangibles, transferring risks, allocating excessive capital, and the removal of engagement in transactions that would not, or rarely happen, among group members and third parties. For instance, a company could sell a patent to one of its subsidiary at a very high price, or sell its good to one of its divisions at a price, which is excessively above the market value for that good or service. Actions 8,9,10 aim to, “Develop new rules to prevent BEPS by moving intangibles among group members. [...] Develop rules that prevent BEPS by transferring risks among, or allocating excessive capital to, group members. [...] Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely; occur between third parties.” (OECD 2013, p. 20)

**The case of US corporations**

Transfer pricing is as mentioned in the previous section a widely used practice and as quite clearly stated above a central concern of the OECD action plan. The practice enables MNE to reallocate costs and profits between its entities within the corporation and especially problematic in regards to value setting of intangibles such as intellectual property. In general, the action plan seeks to limit such transactions and the utilization of value setting prone to misinterpretation or exploitation. As such, it can be viewed as attempts to regulate directly on one of the core methods identified in the first part of our analysis.

**Action 12: Require taxpayers to disclose their aggressive tax planning arrangements**

Action 12 aims to deal with the secrecy regarding what corporations have to disclose. Corporations does not have to disclose their tax strategies, meaning that tax officials often have a hard time figuring out whether or not they are liable to taxation(OECD 2013). Stating that they wish to “Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures(..)” (OECD 2013, p. 22) this action wants to address transparency.
The case of Tanzania
One of the problems of the mining corporations in Tanzania was the secrecy around their tax strategies. Because the government cannot gain full disclosure of the activities of the mining corporations, it has a harder time figuring out whether or not they are liable to taxation (Curtis & Lissu 2008). Action 12 can help improve on the problems found in the Tanzanian case, since rules on mandatory disclosure regarding tax strategies would enable the government to figure out when a corporation is liable to taxation or not.

Action 14: Make dispute resolution mechanisms more effective
Action 14 aims to improve the mutual agreement procedure (MAP), which is a tool used to help ensure successful treaty dispute resolutions. Such improvements are important to the efforts to counter BEPS, as it can help prevent obstacles to treaty dispute solutions, which may hinder these efforts. These improvements include ensuring the presence of arbitration provisions in all treaties and ensuring access to MAP and arbitration (OECD 2013).

The case of India
As stated in the previous section of the analysis, in the case of India the treaty abuse of the DTAA has been addressed, but has yet to be resolved. Action 14 will attempt to ensure such disputes can be resolved, which will prevent companies from avoiding tax.

5.2.2: Conclusion
We have utilized the method of content analysis as described in our methods section, to establish direct links between the methods utilized in our cases of the first part of our analysis and the concrete action plans specific aims to create basis for regulation on those tax avoidance methods. Based on the cases, we have explained and investigated, we argue that the theory of market failure can justify and explain the reasoning behind the G20 BEPS Action Plan which seeks to create basis for regulations which can close these loopholes. By reducing companies’ possibilities to exploit loopholes in the global taxation system, the potential regulations recommended in the action plan, has the potential to reduce negative externalities, which ultimately will reduce the inefficient allocation of resources, to restore equilibrium in the free market.

We have shown that the G20 Action Plan aims to deal with a lot of problems associated with tax avoidance. By linking the methods of tax avoidance from our cases in the first part of the analysis to specific actions of the Plan, we sought to investigate if the Action Plan could solve the issues of our
cases. We found that the Action Plan does address the methods of tax avoidance from our specific cases.

We concluded in the first section of the analysis that tax avoidance has created market failure and that government intervention was the response to recreate equilibrium. Since we deemed setting a tax on tax avoidance an illogical solution, the other answer was to regulate the rules of the market instead. The G20 Action plan is a regulation which, we argue, tries to restore equilibrium in the market again. By implementing the actions of the Plan we argue that it pushes up the private cost of corporations, as they must pay more tax than previously. Additionally this will reduce social cost, since tax revenue will increase, as MNEs now pay their intended tax, which will be used to fund public goods. This means private cost of production and social cost are once again equal, which in turn will recreate market equilibrium, thereby achieving efficient allocation of resources (Pindyck & Rubinfeld, 2012).
6: Conclusion

We have described the context in which tax avoidance exists and which factors have lead to facilitate tax avoidance in its contemporary form and what the global response is to the problem (the action plan). The project has shown that global tax avoidance and its methods, are possible due to advancements in globalization. Furthermore, we have described why tax avoidance is relevant, the extent of its application and in turn how it affects the state's ability to provide public goods.

The first part of our analysis identifies the social costs of tax avoidance in both developing and developed countries. We then use the theory to explain how these social costs cause market failure and in turn requires an appropriate response dictated by the theory, identified in this case as regulation. A main aspect to the response, as many scholars have identified, is that it requires a global scale response in order to overcome the complexities of the tax system.

The second part of our analysis utilized a multi-method research strategy consisting of a multiple case study and content analysis to apply findings in part one of the analysis to find evidence of convergence between specific tax avoidance methods relevant to our cases and the specific action points of the action plan. We found that there was a high level of convergence between these methods and the regulatory measures the action plan aims to create, thus the legitimacy of the theory of market failure as an explanatory tool was established.

In conclusion, the working questions have enabled us to answer the research question:

“Can market failure theory explain the economic and political issues of tax avoidance and is the G20 BEPS Action Plan a response to the issues identified by the theory?”

We have demonstrated that market failure theory does in fact explain certain economic and political issues of tax avoidance and therefore proves to be a useful theory to explain how problems created by tax avoidance can be understood as social costs, which in turn creates market failure and therefore requires government intervention identified in our analysis as regulation.

By going into detail with some concrete problems identified in the cases in our analysis, we demonstrate how social problems are directly linked to and hindered by loss of government tax revenues as a counter argument to the neoliberal argument that the market is better off being left alone, unless it fails. Market failure theory explains how these social costs create a market failure and therefore justifies government intervention.
Thus, the theory explains the relation between tax avoidance and political efforts to combat it. Although, we cannot decisively determine the effectiveness of the G20 BEPS Action Plan, we have evaluated its economic and political context, and concluded that in accordance with market failure theory, it is an appropriate response to the issues of tax avoidance.
7: Bibliography

- **Hesse-Biber, S. N. and Leavy, P.**, 2011. The Practice of Qualitative Research. 2nd ed. California: SAGE


