

**The Gordian Knot:  
How the United States, the European Union, and  
Organization for Economic Cooperation and Development  
took action against corporate tax avoidance**

The Honors Program  
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## **Table of Contents**

Abstract.....	1
Introduction.....	2
Purpose of this study .....	3
Methodology .....	4
Literature Review .....	5
Preview of Findings.....	9
Contributions to the Field and Limitations .....	10
The United States: All Talk and No Action.....	12
The Legislative Process .....	12
First Emergence of the Fight.....	13
Clinton Administration (1993-2001) .....	14
George W. Bush Administration (2001-2009).....	16
Obama Administration (2009-2017) .....	19
Analysis.....	22
The European Union: Slow and Steady Wins the Race?.....	27
Levels of Authority.....	28
Drive to complete in internal market .....	29
Ensuring the sustainability of the Single Market .....	30
Post 2008 Financial Crisis.....	31
State Aid and the Commissioner of Competition.....	33
Ireland/Apple Case .....	34
Judicial Process .....	36
Analysis.....	38
The OECD: We're All In This Together .....	41
OECD Organizations, Processes and Legal Instruments.....	42
Early efforts by the OECD to Combat Corporate Tax Avoidance: 1998-2006 .....	42
"Name and Shame" Campaign.....	43
The Interregnum: 2006-2012 .....	45
Base Erosion and Profit Shifting Action Plan.....	45
Implementation by the United States and the EU .....	48
Analysis.....	49
Comparative Analysis.....	51
United States Summary of Actions .....	51
European Union Summary of Actions.....	52
OECD Summary of Actions.....	53
Role of Sovereignty .....	54
Political Will .....	55
Legislation vs. Today's Business Environment .....	56
Two Promising and Successful Methods.....	56
Conclusion .....	57
Appendices.....	59
Appendix A – List of OECD Action Items.....	60
References.....	61

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
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**ABSTRACT**

In 2016, the United States had the highest corporate tax rate in the world. Perhaps, the high tax rate could be why American corporations are holding an estimated \$2.5 trillion abroad (Cox 2016). According to a study by the Bureau of Economic Analysis, U.S. firms pay a measly 3% in tax to foreign governments on those profits, rather than the 35% U.S. corporate tax rate. How are these corporations able to legally avoid paying taxes on a large percentage of their profits? Many use various loopholes in the laws to shift profits into other countries or U.S. states referred to as “tax havens.” These tax havens promote low tax rates and favorable economic conditions to increase business activity. Lately, the phenomena of shifting profits to tax havens has been of topic of public interest with the release of the notorious Panama papers, the Luxi Leaks, the European Union suing Apple for supposedly unpaid taxes, and the Pfizer Ireland scandal.

What the public does not realize is that the struggle against tax havens has been going on since the 1960s. Despite countless attempts at controlling or reducing the number of tax havens, U.S. corporations continue to successfully shift billions of dollars in tax revenue overseas each year. But, how? This study will address the following question, how successful have states’ actions been at combatting tax havens? This research question will be answered by analyzing three case studies: the United States (U.S.), the European Union (EU), and the Organization for Economic Co-operation and Development (OCED).

The research shows that the U.S. methods have been unsuccessful. Conversely, The EU and the OECD have made significant progress in the last few years with their action.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

**INTRODUCTION**

There is a building in Delaware that is listed as the official address of over 285,000 companies. In Luxembourg, a former Pricewaterhouse Coopers (PwC) employee is on trial for exposing years of fraud because the whistleblower law only protects against dismissal not prosecution. In 2016, the European Union (EU) ordered Ireland to collect \$13.9 billion dollars in back tax revenue from Apple Corporation. Ironically, the Irish government has stated that it does not actually want the money. What do all three of these scenarios have in common? Tax avoidance.

In 2016, the United States had the highest corporate tax rate in the world. Perhaps, the high tax rate could be why American corporations are holding \$2.5 trillion abroad, an increase of almost 20% in the last two years (Cox 2016). According to a study by the Bureau of Economic Analysis, U.S. firms pay a measly 3% in tax to foreign governments on those profits. Compare that to the 35% that companies would have to pay to the U.S. government if they chose to bring those profits home, and it is easy to see why the average effective tax rate for corporations has gone down from 30% in the 1990's to 20% on average today (Zucman 2015, 107). For some corporations that effective tax rate is even lower. For example, Google enjoyed an effective tax rate of 6% in 2014, Apple a rate of 2.3%, and Starbucks, was lower than 1% (Chew 2016).

How are these corporations able to legally avoid paying taxes on a large percentage of their profits? They use various loopholes in the laws to shift profits into other countries or U.S. states referred to as "tax havens." These tax havens promote low tax rates and favorable economic conditions to increase business activity. In each of the cases mentioned above, U.S. corporations took advantage of one of those loopholes. The phenomena of shifting profits to tax havens has been of topic of public interest lately with the release of the notorious Panama papers, the Luxembourg Leaks, the European Union suing Apple for supposedly unpaid taxes, and the Pfizer Ireland scandal. What the public does not realize is that the struggle against tax havens has been going on since the 1960s.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

I like to think of the problem of corporate tax avoidance as a modern-day Gordian knot. The “Gordian knot” is often used to describe a complex or unsolvable problem. Its origins can be traced back the time of Alexander the Great. Legend says, Gordius, an ancient king of Phrygia tied “several knots all so tightly entangled that it was impossible to see how they were fastened.” The prophecy said that any man who could unravel its elaborate knots was destined to become ruler of all of Asia. After Alexander the Great attempted to untie the knot several times, he stepped back and said, “It makes no difference how they are loosened” and cut the knot in half with his sword.

There is a parallel between the problem Alexander the Great faced when attempting to untie the Gordian Knot, and the problem that states face as they attempt to deal with corporate tax avoidance. The problem states face comes down to this basic question: how does one solve a problem that involves multiple actors, usually in different tax jurisdictions? Taxes have always been a sovereign matter, and when corporations only work in one state that may be sufficient. However, with the rise of multinational corporations and globalized production, it is clear that domestic laws alone cannot solve the problem of corporate tax avoidance. If not, can states cooperate enough to implement a reasonable solution without eroding too much sovereignty, burdening corporations and governments with unreasonable costs of implementation, and increasing the complexity of an already overly-complex system?

**PURPOSE OF THIS STUDY**

This study will address the following question, how successful have states’ actions been at combatting corporate tax avoidance? In order to answer this question, two secondary questions must be addressed. The first is, what actions have states taken to fight corporate tax avoidance? The second is why or why not were these methods successful? Since it is difficult to quantify the tax revenue gained as a result of these methods due to secrecy laws and the very nature of tax avoidance, the definition of success used in this paper will be the elimination of loopholes and laws used by corporations to avoid taxes. If the methods corporations use to avoid taxes are eliminated, one can surmise that the billions in revenue lost will ultimately make it to its rightful owner.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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**METHODOLOGY**

These research questions will be answered by analyzing three case studies: the United States (U.S.), the European Union (EU), and the Organization for Economic Co-operation and Development (OCED). These case studies will include an account of all the significant action against tax havens taken by these states. There will be a heavy focus on action taken in the last 30 years, since any significant progress made by these three main actors began in the 1990s. These case studies will focus on qualitative data, since the definition of success outlined in this paper is based on elimination as a result of legislation or some other political action, not as a measure of revenue gained. A processing tracing approach will be used to catalog the progress by each state. Each case study will conclude with an analysis of how effective those methods were, and ultimately, a comparative analysis of all three states will be performed.

Since there are so many variables within the topic of tax havens it is important to make a few distinctions. The terms tax avoidance and tax evasion are often used interchangeably but they are markedly different. Tax avoidance is the legal minimizing of taxes by taking advantage of all deductions, restructuring options, and other tax plan strategies that are available within the tax code. Tax evasion, on the other hand, is the illegal practice of not paying taxes by intentionally misstating reportable income, refusing to file, or not paying taxes owed. Corporations use tax avoidance to maximize profits and achieve investor goals (Zucman 2015). Avoidance and evasion can be done by corporations and individuals. An individual is more likely to engage in evasion than avoidance because there are more loopholes for corporations to exploit. The focus of this paper is restricted to corporate tax avoidance.

The definition of tax havens used will be the OECD definition since it is the most widely accepted. It has four key indicators, “1. No or only nominal taxes (and offering, or being perceived as offering, a place for non-residents to escape tax in their country of residence); 2. Lack of transparency (such as the absence of beneficial ownership information and bank secrecy); 3. Unwillingness to exchange information with the tax administrations of OECD member countries; and 4. Absence of a requirement that activity be substantial (transactions

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

may be “booked” in the country with no or little real economic activity)” (“Glossary”). By limiting the focus of this paper to corporate tax avoidance in tax havens we can better understand how successful states are, or are not, at combatting them. Now that the purpose and methodology of this study has been established, it is important to look at how this research will fit into the scope of literature already in the field.

## **LITERATURE REVIEW**

Tax havens by their nature are secretive, complicated, and constantly evolving. This can make researching them very attractive for curious minds, but also very difficult to carry out. This may be why many researchers focused on the history of tax havens. Until the 1980s there was little information available. Today we know that tax havens were in existence long before that. European tax havens, the primary focus of paper, have been in existence since at least the World War I. In the early days, scholars seemed frustrated by the lack of information, and as a result, seemed to gravitate towards the same four areas of study. They hoped to define and categorize them, catalog the emergence and history of tax havens, address the uses of them by corporations and individuals, and finally put forth solutions in the form of legislation or analysis.

Indicative of the early literature, is the 1981 report on Tax Havens, entitled *Tax Havens and Their Uses* by Richard Gordon, a member of the IRS Special Council. This report was the first of its kind. It noted distinctive features of a tax havens, such as large banking sectors compared to the total GDP and relatively small populations. In 1998, the OECD released its own paper, *Harmful Tax Competition: An Emerging Global Issue*. This report divided countries into three categories: tax havens, member countries with preferential regimes, and non-member economies. These kinds of reports became a trend in the years following. Scholars and reporters were focused on understanding what this new phenomena was. Rarely did they asked questions on how to defeat them. Instead they focused on questions like what is a tax haven and why do they exist?

The most accepted and most widely used definition was put forth by the OECD, as described above, but other researchers focused on different attributes. For example, Dharmapala’s article

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

entitled, “Which countries become tax havens?” focused solely on determining what makes a country fit the definition of a tax haven. According to Dharmapala, a tax haven is a state with “an open economy, close to major capital exporters, unlikely to be landlocked, likely to be an island, likely to be of British descent, small in natural resources, and have a strong governance” (Dharmapala 2009).

Definitions like the ones provided by Dharmapala and the OECD give us a very clear, but very narrow, definition of a tax haven. In contrast, Palan provides a broader definition. He writes “Modern tax havens... are sovereign states ... that use their sovereign right to write laws in order to attract a certain type of international clientele (Palan 2009). Tax havens must be viewed, therefore, as “a distinct developmental state strategy that could have evolved only in the context of a robust international system of statehood, respectful of the sovereign right of states to write their own laws” (Palan 2009). What’s interesting about this definition is his emphasis on modern times. Palan’s point is that as tax havens are simply a byproduct of modern tax systems. He goes on to note that most countries, even the United States, fit the mold of a tax haven. According to Palan, the state must offer a Preferential Tax Regime (PTR) and have a highly mobile financial environment which describes most of the developed countries in the world (Palan 2010). Defining a tax haven in the context of different research questions allowed scholars to understand what a tax haven was but then prompted more questions.

The next trend to take hold was categorizing tax havens. Tax havens have many different categories and the way a researcher chooses to categorize a state will affect the way they understand the impact of tax havens as a whole. In his short history, Palan sorted the world’s tax havens into three groups: British Empire based tax havens, European havens, and tax havens in the newer transitional economies of South America and Africa (Palan 2010). The purpose of shorting them like this was to help identify when they emerged and what they were used for. In his article on renegade states, Eden use two different systems. First he categorized havens into four groups: no income tax (Bermuda), low tax (Switzerland), “ring fencing” (Liberia), and special privileges (Luxembourg). He went on to sort them by type as well: production havens (Ireland), headquarter havens (Belgium), sham havens (Caribbean), and



**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

secretary havens (Switzerland) (Eden 2005). His paper attempted to explain how the OECD was able to label tax havens as “renegade states” (Eden 2005). Tax havens can also be sorted into time periods in multiple ways depending on an author’s goal (Palan 2010).

The history of tax havens seemed to go hand and hand with defining and categorizing them. Shaxson frames many of his arguments as a thrilling story rather than a simple historical account. He begins *Treasurer Islands: Uncovering the Damage of Offshore Banking and Tax Havens* by giving his readers a description of the Elf Oil Affair in Gabon Africa. His riveting story explains how his seeming routine journalist trip to Libreville, dropped him right in the middle of a French fraud scandal. He uses the Elf system as a metaphor for tax havens. He explains neither of these systems truly exist anywhere, instead, “they [flourish] in the gaps between jurisdictions” (Shaxson 2012, 6). In a similar manner, Gabriel Zucman uses interesting and engaging history lessons threaded with key statistics to get his message across in his book, *The Hidden Wealth of Nations*. For example, in his first chapter he debunks the myth surrounding the admirable origins of Swiss banking secrecy. Zucman reveals that Swiss banking gained its popularity following WWI in the 1920s, not in the 1930s as most believe. This proves that Swiss banking secrecy was not actually created to allow Jewish people to hide their assets during WWII. In his following chapters, he argues that 8% of household wealth is held offshore, he critiques information exchange, and offers a few of his own solutions to the problem of tax havens (Zucman 2015). Zucman proves that there is tangential information in similar, but not completely related, studies. Zucman’s research questions were focused primarily on individual evasion and hidden wealth on a global scale. That said, there was a significant amount of research that overlapped with my research questions and had I limited my research to my topic alone, I would have missed out on that information. Stories like the ones provided by Shaxson and Zucman, prompted questions by political leaders, citizens, journalists and other states. The broad, almost entertaining, historical accounts of tax havens left people wondering how states and corporations were able to achieve this. This led to in-depth looks at individual states and corporations alike in the search for answers.

Beginning in 2015, state by state secrecy ratings gained popularity. These analyses of individual states are done primarily by activist groups such as the Tax Justice Network (TJN).

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

TJN has developed a list that ranks countries according to their offshore wealth activities and secrecy. Similar black haven lists published by the OECD were used to put political pressure on other states. Unlike those reports, TJNs publishes these to be used as a tool to understand global financial secrecy and tax havens. They are politically neutral and provide short histories and commentary on transparency progress in each country.

The International Consortium of Investigative Journalists (ICIJ) chose to go after corporations instead of states. The ICIJ is a cross-border investigative team of journalists that work on projects that expose the underside of the world. Past projects included anything from organized crime to asbestos companies. The work of these journalists led to in-depth reports on offshore financing and tax havens. The most prominent were the Luxembourg Leaks and the Panama Papers (ICIJ 2014, 2016). These revealed billions of dollars hid in Luxembourg and Panama with the help of accounting firms, such as PwC, for the purpose of tax avoidance. Although on a smaller scale, new outlets in the U.S. frequently report on specific laws and corporations all the time. The methods that Apple, Facebook, and General Motors used to avoid taxes were disclosed in articles by CNN, Forbes, and The Wall Street Journal (Kottasova, 2014; Worstall, 2013; Smith, 2010). This is both a blessing and curse when it comes to information on tax havens. In recent years, there have been over a dozen corporate scandals over effective tax rates that prompted an increase in news articles. This means a wealth of information, but also the possibility that it is biased or incomplete information.

Once scholars defined what tax havens are, how they emerged, and what they are used for people began to try and stop them. Since the secret was out it became easier to estimate how much revenue the U.S. lost each year to tax havens. Citizens for Tax Justice estimated in 2015 the number is between \$90-100 billion (Phillips 2015). Zucman estimates that number could be as high as \$130 billion is lost in U.S. tax revenue each year (Zucman 2015, 107). The nature of tax havens makes calculating the total revenue lost very difficult. Most estimates are based off of the decrease in taxes paid by corporations, the total assets held by corporations and those reported in the U.S., and estimates of sales in foreign jurisdictions. Even without an exact number, the impact of tax avoidance is staggering.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

Armed with definitions, categories, and estimates of damage done, researchers turned to analyzing what states have done to combat tax havens. For example, the concept of taxes in the EU is particularly interesting to scholars since it has such a unique structure. Christiana Panayi has written multiple books on the subject of Corporate Tax and the EU. These works focus on advanced corporate tax issues as a whole not just tax avoidance. Panayi focuses on evaluating the methods that the EU has used to combat tax havens such as the Code of Conduct Group on Business Taxation, the Tax Transparency Package and the Action Plan. She points out some of the major flaws in the current EU Action Plan such as the lack of accountability with multilateral measures, prevalence of bilateral treaties, and the refusal to define the role of source and residence in international tax competition.

One of the most comprehensive looks at the methods that states have used against tax havens is, *Havens in a Storm: The Struggle for Global Tax Regulation* by J.C. Sharman (2006). Sharman catalogs the methods used by the U.S., the EU, and the OECD between 1990 and 2005. His work focuses mainly on the OECD with the U.S. and EU relevant only because of the large role they play in its development. Ultimately, Sharman concluded that the OECD was unsuccessful in their efforts. He used three definitions of success, the first two were outlined by the OECD in their 1998 and 2002 reports. Sharman proves that the objectives they laid out to end preferential tax regimes were not met. He also argues that even if objectives were never set, there was not significant enough progress made to call their campaign a success. For Sharman, tax havens came out on top of this fight.

This thesis has similar objectives. Sharman and I share similar research questions and methodologies, but our time frames and key players differ. My thesis looks to build on the work of the researchers I have referenced here by providing updated information, multiple perspectives, and another definition of success that focuses on legislation rather than tax revenue gained as a result of action taken against corporate tax avoidance.

### **PREVIEW OF FINDINGS**

The subject of corporate tax avoidance prompts many reactions. On one side, there are supporters who would argue that by shifting profits corporations are only fulfilling their

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

responsibility to shareholders to maximize profits. Conversely, some would argue that taxes are one's patriotic duty. If citizens are held accountable for their full tax liability why are corporations not held to the same standard? Regardless of which side is morally correct, governments have made it their mission in the past few years to limit corporate tax avoidance.

The U.S. has favored unilateral action since Clintons Administration in the 1990's. This has included actions such as a corporate tax holiday and attempting to close loopholes.

Conversely, the EU has been a key player in the international arena, leading by example through its support of OECD multilateral initiatives and its unilateral action under the Competition Commissioner. Despite its slow progress, the OECD has been influential in the fight against tax havens. The most significant action is its Base Erosion and Profit Shifting Action Plan that was published in 2015 (BEPS). These cases all depict different methods in an attempt to combat the same problem. The two most promising efforts are those used by the EU Competition Commissioner, who attempts to "cut" corporate tax avoidance, and the OECD, which attempts to "unravel" corporate tax avoidance with its BEPS Action Plan.

**CONTRIBUTIONS TO THE FIELD AND LIMITATIONS**

Whether states' successfully "cut" corporate tax avoidance, or "unravel" it, the results will have major implications for the political system and the economy. It is important for the general public to understand where their countries' funding is coming from and even more important for investors to understand what methods corporations are using to maximize profits. Corporations themselves will need to become comfortable with the new laws as well, which indicates that there will be a growing need for tax professionals in the near future. We may know more about tax havens now than the initial U.S. and OECD reports in the 1980s and 1990s, but there is still much to be learned. As governments create policies that will combat tax avoidance, corporations will be preparing their own strategies to recover lost profits. They may find addition loopholes to take advantage of, or they may find a new way to maximize profits in this newly globalized world. Regardless, research is the key to preparing for the future.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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There are two potential limitations with my study. The first is the conflicting viewpoints of literature between accounting, law, and political science. Accounting and law journal articles focus on interpretation and critiques of laws. These are very technical and lack the political context that is needed to analyze the effectiveness of methods used against tax havens. Political science serves the opposite purpose. This kind of research focuses on many possible influences and how they impact the success of each action. The second is that there are huge limitations to the kind of research available. This field is constantly evolving and the more relevant data usually comes in the form of news sources. Since this study is focused on recent action, many of the sources used will not be scholarly, but put forth by investigative journalists, media publications, or government press releases.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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**THE UNITED STATES: ALL TALK AND NO ACTION**

The United States has been a major player in the field of tax havens. American corporations hold an estimated \$2 trillion in U.S.-based multinational profits in offshore accounts (Dickinson 2014). Since most of the firms involved in tax avoidance are American firms, focusing on what the U.S. has done to curb corporate tax avoidance is a good starting point for this study. Until the 1980s, the U.S. government was unaware of the impact that tax havens were having on its tax revenue. Rolling Stone estimates that the United States is currently losing \$90 billion in revenue each year (Dickerson 2014). In the 1980s, the revenue lost was a smaller percentage of profits earned, but even after the government was made aware of the problem, little progress was made to combat the use of tax havens resulting today's high number.

This chapter will answer two primary questions: what methods has the U.S. used to curb corporate tax avoidance and how successful these methods have been? This will be done first by giving a brief overview of the legislative process in relation to taxes and a short summary of the emergence of the fight against tax havens. Then this chapter will discuss the actions taken by the government, categorized by administration beginning with Clinton, followed by President George W. Bush and President Obama. This chapter will end with an analysis of how success the discussed methods were.

**The Legislative Process**

It is important to understand the enactment and enforcement process of tax law in the U.S. in order to understand the methods used to combat corporate tax avoidance. The U.S. Constitution gave Congress the power to levy taxes. Laws in the U.S. are codified by subject. Title 26 of the United States Code (USC) is the Internal Revenue Code (IRC). It provides the foundation for all federal tax authority in the United States. Tax laws are passed by Congress and then interpreted by Treasury regulations and Internal Revenue Service (IRS) rulings. While the IRS serves mainly as a tax collection agency, its responsibilities include enforcing the IRC and providing guidance on implementation of the laws. Congress is the only political body that has the power to impose federal tax law. The President can make recommendations, and ultimately signs a bill into law, but it must first pass in both houses. Congress can also

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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overrule a Presidential veto with a two thirds vote. Understanding this process is essential to understanding how the U.S. has attempted to stop corporate tax avoidance and how corporations and their lobbyists have sought to ensure specific tax advantages are included in the IRC. There have been many proposals that have been brought to the House or the Senate that never made it to the President's desk ("Tax Research").

This chapter will trace the efforts to combat tax havens at the federal level. Interest groups and corporate influences add another layer of complexity to the already complicated intersection of tax and legislation. This is why, for the purposes of this thesis, the U.S. case study will be organized chronologically by administration. Each administration will also reflect the changing policy objectives. By grouping actions like this, it will be easier to find the patterns and trends of U.S. action involving corporate tax avoidance.

First Emergence of the Fight

The modern-day fight against tax havens began in the 1980's for the United States. Richard Gordon, a top tax official, was appointed by the Carter administration to investigate tax avoidance and evasion by U.S. multinational corporations. The Gordon Report was published in 1981 and was the first major U.S. report on tax havens (Gordon 1981). The report noted distinctive characters of tax havens such as disproportionately large banking sectors as a percentage of their overall gross domestic product (GDP). It also offered several recommendations of action for the Treasury. These included: access to information, terminating treaties with tax havens, taxing corporations on their worldwide income, expanding Subpart F rules on Controlled Foreign Corporations (CFCs) and limiting treaty shopping by limiting the benefits of a tax treaty to residents only (Gordon 1981). Some of these recommendations were implemented over the next few years. For example, the government terminated its tax treaties with Caribbean havens, made formal document requests, minimal information reporting requirements, and new transfer pricing regulations for intangibles. Unfortunately, the tactics used by corporations in this area were just adjusted and the tax avoidance prevailed.

In 1984, the U.S. Treasury followed up on the matter by releasing a report on U.S. citizens moving assets to the Caribbean. In 1985, the U.S. Senate Permanent Sub-committee on

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

Investigations concluded that between \$150 million and \$600 million in unreported taxable income was linked to tax havens. This number includes both individuals and corporations, because research at that time did not distinguish between the two. Still, these reports depict the kind of action that the U.S. took during the 1980s. The U.S. was taking small, unilateral actions against tax havens (Palan 2010). These efforts were ultimately ineffective since tax havens were only growing at that time. Overall, the period spanning Regan and George Bush's Administration was a period of research and minimal unilateral action.

Clinton Administration (1993-2001)

Interestingly, the Gordon report pointed out what the government finally admitted in the 1990s.

“The United States alone cannot deal with tax havens. The policy must be an international one...to isolate the abusive tax havens. The United States should take the lead in encouraging tax havens to provide information...however, such steps taken unilaterally would place the United States businesses at a competitive disadvantage as against businesses based in other OECD countries. Accordingly a multilateral approach to deal with tax havens is needed” (Gordon 1981).

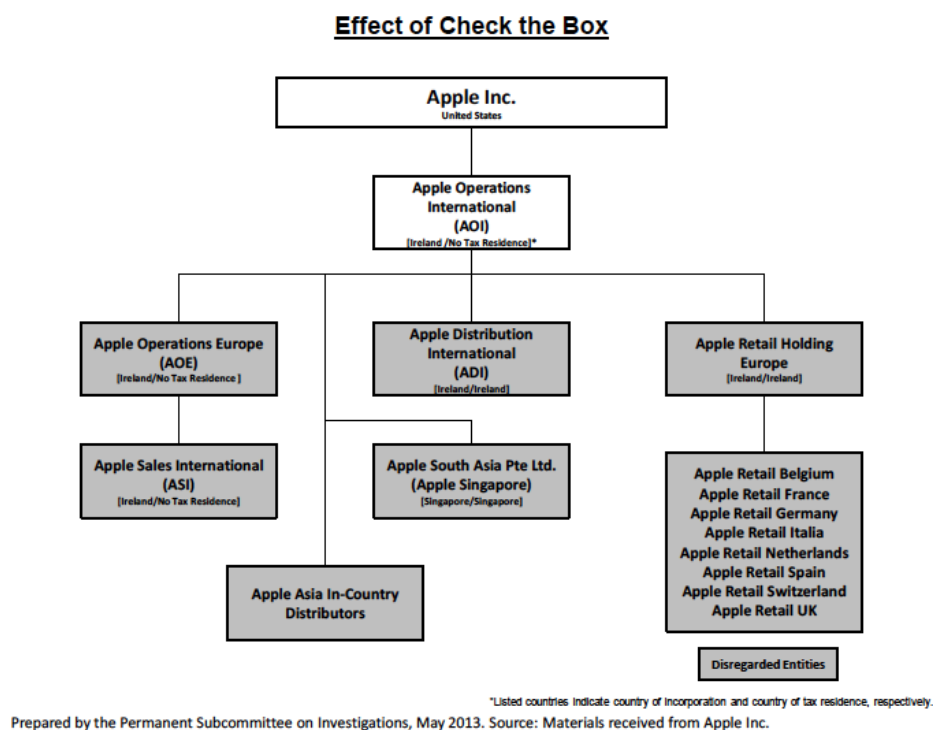
The late 1990s brought the first coordinated international efforts to curb tax haven use. This phase included three main international organizations: the OECD, the Financial Stability Forum (FSF), and Financial Action Task Force (FATF). These three organizations aimed to eliminate money laundering and tax evasion, and improve financial stability, respectively. After its failed attempts at unilateral action, the government accepted that an international problem required a coordinated solution. This may be why the Clinton administration was so supportive of these efforts and positioned the U.S. as an example for FAFT in particular. This phase used the “name and shame” tactic to attempt to stop countries from acting as tax havens. This included a series of “black lists” of uncooperative countries that were released to the public to encourage reform (Palan 2010). Multilateral efforts were really spearheaded by the OECD, with support from the U.S. and the EU, which is why these methods will be expanded upon later in this thesis.



**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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At this point it is important to address one of the methods that corporations use to avoid taxes. There are two main methods that will be discussed in this chapter. The first method is that “check the box” rule which emerged in 1997. The Treasury Department aimed to simplify an overly complicated filing process, called the Kinter test, by allowing corporations to “check the box” on a tax form. This would show that its subsidiaries were “disregarded entities” since the parent would file a consolidated form (Scott 2014). The problem that arose involved multinational corporations. These companies began to set up subsidiaries in tax-favorable jurisdictions, shift profits, and then check the box. By doing this companies were then able to strip earnings from high tax jurisdictions and shift them to low tax jurisdictions. For example, Apple “checked the box” on their Apple Operations International Subsidiary and was able to avoidance \$12.5 in taxes from this loophole alone. One of the subsidiaries in the graphic below is Apple Sales International. This disregarded entity will play a large role in the profit shifting scheme Apple is being sued for in the EU, which will be elaborated on in the next chapter.



*Figure 1 – Apple and Check the Box*

Once the corporation is able to declare its subsidiaries disregarded they are then able to use these subsidiaries to shift profits. The simplest method of doing this is having the U.S. parent

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

make a loan to the disregarded entity. In this case, the U.S. does not recognize the loan or interest payments. Conversely, the disregarded entity can deduct the interest expense on their tax return further reducing taxes owed in the low tax jurisdiction (Scott 2014).

Once the Clinton Treasury realized the damage this loophole could do they tried to backtrack. Clinton administration first tried to eliminate the “check the box” loophole in 1998. Multinational companies, like Coca-Cola and IBM, joined forces with Kenneth Kies, a former director of the Congress Joint Tax Committee member turned lobbyist, to keep the loophole in place. Kies argued that the Treasury was overstepping in trying to take away the loophole (Scott 2014). Other firms such as Monsanto, Morgan Stanley, and Philip Morris pushed their own lobbyists to defend their tax loophole. These firms were able to make enough noise that the Republican controlled Senate Finance Committee passed a bill in 1998 that would stop any changes. Many of the same politicians who were influential in passing the “check the box” loophole went on to work for the very firms who benefited from the rule. For example, William Morris, who was a member of the international tax counsel for Clinton’s Treasury during the time of the loophole passing, ended up at GE a few years later as a member of their global tax division (Dickinson 2014). This is referred to as the “revolving door” of Washington. This relationship between lobbyists, corporations, and the Treasury will continuously play a role in the war on tax havens as the rest of this chapter will point out.

George W. Bush Administration (2001-2009)

In contrast to President Clinton’s intention of passing OECD recommendations into domestic legislation, the George W. Bush Administration brought a new set goals and political opinions. At first, however, it seemed as though the new administration would continue to lend U.S. support to the OECD’s multilateral efforts. In a letter from early 2001, the Treasury Assistant Secretary Mark Weinberg wrote to Senator Don Nickles explaining that there may be “some value in coordinating our efforts with those of countries with similar concerns through multilateral forums like the OECD (Sullivan 2007). At a press conference after the G-7 meeting, Treasury Secretary Paul O’Neill stated: “While I indicated to my colleagues that certain aspects of these efforts are under review by the new Administration, I support the priority placed on transparency and cooperation to facilitate effective tax information

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

exchange” (Sullivan 2007). This statement reaffirmed America’s support of the OECD initiative.

Unfortunately, it did not take long for a lobbying campaign to begin. The Center for Freedom and Prosperity (CFP), a nonprofit organization advocating for jurisdictional tax competition, was a major player in this campaign. The CFP and other firm lobbyists were able to flood the Treasury with letters from Conservatives in Congress. For example, in a letter of support from the Caucus to O’Neil, they said the OECD plan "threatens to undermine the fragile economies of some of our closest neighbors and allies” (Sullivan 2007).

The effect was quick and U.S. support was drawn. In contrast to his statement at the G-7 meeting, O’Neil explained in a statement only 3 months later that the OECD project was “too broad and ...not in line with this Administration’s tax and economic priorities” (Palan 2010, 217). He reiterated that sentiment with his declaration that the U.S. “does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems (Palan 2010, 217). O’Neil went on to explain in a letter to the G-7 Finance Ministers that some “aspects of the OECD initiative, go beyond what is necessary to enforce our respective tax laws. The OECD initiative implicates low-tax regimes that may be designed to encourage foreign investment but that have nothing to do with evasion of any other country's tax law. Countries must be free to adopt tax policies that encourage investment and promote economic growth” (Sullivan 2007). O’Neil put an end to U.S. multilateral support at that time, and we will see later in this thesis whether the U.S. ever rejoins the fight on that level.

Following the end of the first multilateral phase of combating tax havens, the topic was placed on the back burner. There was only one major unilateral attempt by the Bush’s Administration and that was the repatriation holiday. In 2004, Congress tried to bring back foreign profits by granting a repatriation tax holiday. Multinationals could bring their profits home and pay only 5.25% compared to the usual corporate tax rate of 35%. This attempt at combatting tax havens was a part of Bush’s American Jobs Creation Act. In theory, it would increase jobs, research and development spending, and revenue for the Treasury (Dickinson 2014).

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

Unfortunately, this act did not spur investment, jobs or growth. Estimates reach \$3.3 billion in lost revenue that would have been collected over the following 10 years (Peterson 2011). The 15 companies that benefited most from the holiday actually cut over 20,000 jobs over the next 3 years and decreased their research and development spending. Between 60 and 92 cents of every repatriated dollar ended up in the hands of the shareholders, rather than the company directing investing it back in the U.S. economy as the act intended (Dickinson 2014). Some would argue that even if the money first ended up in the pockets of shareholders, they would have done one of two things—invest it or spend it. Both of those options did put the money back in the economy, which in turn, promoted spending and created job.

Conversely, an investigation by the Senate Permanent Subcommittee on Investigations revealed the “10 companies that repatriated the most money after the 2004 tax break have stashed increasing funds offshore every year since the 2004 tax break” which is what the holiday was looking to avoid (Peterson 2011). This survey was released less than a week after Senators John McCain and Kay Hagan proposed another holiday, this time at a rate of 8.75%. Senator Carl Levin, chairman of the subcommittee, was quick to say that “Those who want a new corporate tax break claim it will help rebuild our economy, but the facts are lined up against them” (Peterson 2011). Levin goes on to say, “There is no evidence that the previous repatriation tax giveaway put Americans to work, and substantial evidence that it instead grew executive paychecks, propped up stock prices, and drew more money and jobs off shore” (Peterson 2011). The study also revealed that despite these multinationals bringing back over 90% of their funds to the U.S., most of them have already built that back up in the haven of their choice (Peterson 2011).

Like many actions in regards to tax havens, the holiday was passed with good intentions and unexpected results. Corporations now expect that if they wait long enough there will be another tax holiday. In 2006, corporations held an estimated \$600 billion offshore (Peterson 2011). That number has more than tripled today. This combined with a 2006 legislation that codified the “check the box” rules that emerged in Clinton’s Administration meant that corporations had more than enough opportunity to avoid taxes under Bush’s Administration.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

The next example of a method corporations use to avoid taxes will take us through the end of the Bush Administration and into the Obama Administration. During the Bush Administration, corporations began to aggressively pursue a new method of tax avoidance—corporate inversion. The first corporate inversion was in 1982. By 2003, 31 companies had inverted.<sup>17</sup> of those inversions took place in just three years from 2000-2003 (Olorunnipa 2015). Simply put a corporate inversion is when a U.S. company moves their tax residence overseas to avoid taxes. Generally, this involves four steps.

1. A U.S. company purchases a smaller company in a tax-friendly jurisdiction.
2. The two companies merge
3. The new company renounces its U.S. citizenship.
4. The company becomes a resident of the new jurisdiction.

The sharp increase in corporate inversions in the early 2000s led to an anti-inversion law that was passed in 2004. The American Jobs Creation Act of 2004 restricted inversions to instances where the U.S. company was performing “significant business in its new domiciles and shareholders of the foreign company it buys to do the inversion own at least 20% of the combined firm” (Sloan 2014). This law aimed to end corporate tax inversions for good. It succeeded in slowing inversions down, for there were no inversions in the year the law was passed and only one in the following year.

Obama Administration (2009-2017)

President Obama called for “ending tax breaks for companies that ship jobs overseas” and rebuked our “broken tax system, written by well-connected lobbyists (Dickinson 2014). He promised to “restore fairness and balance to our tax code” (Dickinson 2014). Unfortunately, that seemed to be easier said than done. During his first year in office, President Obama proposed modest reforms to the tax code that included eliminating the check-the-box rule and limiting tax deductions related to offshore profits. These proposals were met with harsh resistance. In a campaign headed by Business Roundtable and the U.S. Chamber of Commerce, almost 200 multinationals joined forces to prevent these proposals from passing (Dickinson, 2014). Ken Kies, who had helped keep this loophole in place in the past, told his clients Microsoft and GM, “Don’t sweat this. This is never going to happen” (Drawbaugh et al. 2013). He was right. Obama’s proposals were never passed. The check-the-box loophole is

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

continually passed into legislation among a package of “tax extenders” that keep both parties happy (Dickinson 2014).

One major deterrent to corporate inversion was that companies that moved offshore were kicked off Standard and Poor’s 500 Index. Between 2008 and 2009, 9 companies were kicked off the index (Sloan 2014). This caused a lot of problems for the S&P 500. Not only were companies furious that they could no longer take advantage of this tax strategy without penalty, but investors were also angry that the S&P was limiting their investment options. When President Obama assumed office, this issue was still playing out on Wall Street. The result was a new definition of what it means to be an U.S. corporation according to S&P. In 2010, S&P decided that to trade on their exchange you must only be a filer with the Securities and Exchange Commission (SEC) (Sloan 2014). By allowing companies to trade on an American stock exchange, while taking advantage of corporate inversion benefits, corporations could have their cake and eat it too.

From 2013-2015 another 38 companies had inverted. This was done despite the additional rules passed by the Treasury Department in 2014. These rules were designed to combat two major issues with this new loophole. The first rule intended to “Prevent inverted companies from accessing a foreign subsidiary’s earnings while deferring U.S. tax through the use of creative loans, which are known as “hopscotch” loans (Action under section 956(e) of the code)” (Patton 2014). Prior to this law, corporations were allowed to shift profits by making a loan to the new foreign parent. Since the new parent is no longer considered a U.S. resident, the loan would happen tax free instead of as a dividend to the parent company which would have been taxed. The new rule eliminates this option by making this exchange with the foreign parent classified as a dividend as well.

The second rule intended to “Prevent inverted companies from restructuring a foreign subsidiary in order to access the subsidiary’s earnings tax-free (Action under section 7701(l) of the tax code)” (Patton 2014). This was designed to combat “de-controlling” strategies used to allow the new foreign parent to access the deferred earnings of the controlled foreign

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

corporation (CFC) without ever paying U.S. tax on them. Companies would do this by having the foreign parent buy enough stock to take away control of the CFC (Patton 2014).

The significance of these rules is not the tax revenue gained as a result, but the need for additional rules two years later. There was another surge in inversions beginning in 2012. By 2014, some high profile companies drew media attention to the problem once again. These companies included Pfizer and Walgreens, both of which ultimately decided to remain in the U.S. as a result of additional rules and controversial publicity. President Obama was not shy about voicing his concern. He explained that “A lot of it is legal, but that’s exactly the problem...these companies get all the rewards of being an American company without fulfilling their responsibility to pay their fair share of taxes” (Obama 2009). President Obama goes further to say that inversions are “insidious loopholes” that allow companies to “game” the system (Olorunnipa 2016).

In 2016, the Treasury Department again took action to limit corporate inversions. This time they aimed to address serial inverters and earnings stripping. The first issue the Treasury addresses is serial inverters. These are corporations that engage in multiple inversions. The new rule changes the formula used to determine whether an inversion is subject to penalties or is blocked by existing tax code rules. The reasoning behind this is that corporations that invert need the new foreign parent to own at least 20% of the combined firm, otherwise they incur penalties and restrictions; for a full inversion with no restrictions, the foreign parent must own more than 40%. By engaging in multiple inversions companies were able to build the size of the foreign firms and eventually complete their inversion. This new rule states that the calculation will disregard any mergers with a U.S. corporation within the last 3 years. This results in a smaller foreign company in relation to the U.S. corporation and will hopefully, eliminate inversions for tax purposes only (Zients 2016).

The second change these new rules make involved earnings stripping. This occurs after an inversion takes place. A foreign parent can lend money to a U.S. subsidiary which has no effect on the consolidated books. The U.S. subsidiary can then deduct interest paid on the loan, effectively shifting profits. The IRS now has more authority to treat these transactions as

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

equity, rather than debt, adding to the tax liability of the corporation. They do this by requiring certain transactions to be characterized as dividend payments (nondeductible) which prevents debt that does not actually finance a new investment from receiving a tax break (Zients 2016).

Despite Obama's public commitment to combat tax havens, very little was actually done to curb corporate tax avoidance. Under his administration, the most noteworthy tax law passed was the 2010 Foreign Accounting Tax Compliance Act (FATCA). FATCA, however, is focused on individuals and evasion rather than tax avoidance by corporations. It requires the automatic exchange of information between foreign banks and the IRS. There has been major criticism surrounding this act because it creates difficulties for ordinary Americans overseas because banks do not want to deal with the new requirements. It also does not require reciprocity from the U.S., invades privacy, and implies that the U.S. holds power of foreign firms. This is unlike anything the U.S. has passed before, so that indicates some progress in trying to combat tax havens, but there are still a lot of problems to work out. In December, 2016 Congress passed the most recent tax package which did not eliminate any of the above loopholes or any of the other more well-known loopholes. These include inversions, carried interest, stock options, derivatives, and the look-through rule (Levin et al. 2016).

Analysis

The United States has always talked a big game. Democrats are quick to blame "the stupid Clinton Treasury" for the check-the-box rule (Dickinson 2014). Journalists are not shy about pointing out all the flaws in the tax repatriation holiday. Even President Obama based a great deal of his campaign on fixing the "broken tax system, written by well-connected lobbyists on behalf of well-heeled interests and individuals" (Obama 2009). After cataloging what has actually been done to stop corporate tax avoidance, it seems the government is all bark and no bite. There are actually only three techniques that the United States has used to combat corporate tax avoidance: supporting multilateral efforts, a tax repatriation holiday, and attempts to close corporate tax loopholes. All three of these methods have been largely ineffective in curbing tax avoidance.



**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

Globalization has made tax avoidance an international problem, one the U.S. keeps trying to solve on its own. Bush and Clinton's administrations were focused somewhat on the multilateral fight. Under Clinton, the U.S. was involved heavily with OECD plans. Under Bush, that support continued for the first part of his administration. After a very successful lobbying campaign against the multilateral efforts, the U.S. pulled out of the multilateral fight. This method was obviously unsuccessful since the United States ended their multilateral efforts, but I think it is more important to focus on the potential for success that the United States lost.

Globalization and technology has made corporate tax avoidance an international problem. The very nature of corporate tax avoidance means that it involves at least two countries. If we are going to end a system as complicated and integrated as tax havens, we need a coordinated international effort. Unfortunately, this is not a strategy the United States is comfortable with. Generally, the United States is supportive of international efforts only when they are provided a significant benefit in return or when they can place the United States in a position of power. Since the number of U.S. multinational corporations that use tax havens is greater than any other nation, one can argue that eliminating them would be unbeneficial. The other side of that argument, of course, is that the government would gain additional tax revenue as a result. Regardless of whether or not the United States believes that it should be ending tax havens, their support of multilateral efforts did not curb tax avoidance. Gordon said it best when he said the "U.S. approach was piecemeal" (Palan 2010, p. 197). Much like the tax code itself, the U.S. was attempting to change a global problem by making small, isolated changes to tax laws rather than leading a coordinated international effort to end corporate tax avoidance.

The first major unilateral effort used against tax havens emerged during George W. Bush's administration. The tax repatriation holiday of 2004 attempted to curb tax avoidance by bringing profits back into the country where they can be taxed. There were two major flaws with this method. The first is that most of the repatriated profits did not spur jobs, growth, or investment. Instead, the profits made the pockets of corporate executives a little bigger. The top beneficiaries of the holiday actually cut jobs over the next few years and decreased their research and development. The second major issue with the tax repatriation holiday is that

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

corporations expected another holiday. The holiday aimed to curb corporate tax avoidance, but in some ways it actually increased it. The study done by the Senate Permanent Subcommittee on Investigations found that the 10 companies that repatriated the most money actually increased the amount of funds kept offshore. This holiday set a precedent, which may be why politicians continue to suggest tax holidays as a solution to tax avoidance despite the overwhelming evidence of their ineffectiveness.

The last technique used by the United States to curb tax avoidance was a series of attempts to close loopholes used by corporations to avoid taxes. The two examples used in this case study were the check-the-box loophole and corporate inversions. All three administrations discussed in this chapter made their own attempt at closing the check-the-box loophole since it was passed in 1997. Likewise, corporate inversion rules have gone through multiple amendments during George W. Bush's and Obama's administrations in an attempt to curb corporate tax avoidance. The problem is, these attempts and amendments are like putting Band-Aids on wounds that requires surgery. Corporations have teams of employees whose sole job is to find preferential tax rules for their clients. If the Treasury or Congress adjusts a loophole without eliminating it completely, corporations will find a way around it as we saw with the second set of inversion rules needed in 2016.

The "check the box" rule costs the U.S. around \$10 billion a year in taxes (Drawbaugh 2013). Congress's Joint Committee on Taxation projected in 2014 that failing to limit corporate inversion would cost the Treasury \$19.5 billion over the following 10 years (Sloan, 2014). With tax revenue losses that high, one has to wonder why Congress been reluctant to issue a full reform?

I think the answer to this question, also gives us an explanation as to why this method has been so ineffective. In his article on the check-the-box loophole, Kevin Drawbaugh comments that many of the politicians who were involved in drafting the loophole went on to work for the companies that now use it—a problem referred to as the "revolving door" culture of lobbying and policymaking in Washington D.C. Similarly, Tim Dickinson, references lobbyist Ken Kies who began his career writing loopholes into law as a politician and now

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

advises multinational corporations like General Electric and Microsoft. This relationship between lobbyists, corporations, and politicians results in a carefully crafted circus act that juggles all three party interests. As discussed, business and special interest groups can be very powerful when they disagree with an action taken by Congress. It can be very limiting for a government who receives funding and support from the very corporations they are trying to increase taxes on. Not only can unhappy corporations can make or break a political career, politicians are meant to represent the interests of the people and there are some very powerful people who favor tax havens.

As a result of the tumultuous relationship just mentioned, a major trend in U.S. tax law has been a series of codes or restrictions passed in response to corporate strategies, but only after serious media attention. Congress has never sought to eliminate the use of tax havens. Instead, it attempts to use legislation to eliminate specific abuses. If the United States wants to be successful at combatting tax havens, they should consider a complete overhaul of the corporate tax codes. Of course, this is unlikely since it would require support from both political parties. If a complete overhaul is not possible, they should consider taking preemptive rather than reactive measures. The check-the-box rules were created with good intentions, but like many of the tax laws, it was shortsighted. Once a tax law is enacted and becomes favorable for corporations, is it very hard to reverse the decision. This is why the best tactic would be to proactively adjust the tax law to prevent corporations from taking advantage of it.

Overall, the major weakness in the United States fight against tax havens is that it does not seem to have an actual strategy to combat corporate tax havens. Instead, they react to corporations which have multiple strategies, when they should be proactively preventing tax avoidance. It appears as though the U.S. does not actually want to solve the problem of corporate tax avoidance. There have been numerous instances where Congress has passed bills that have tax loopholes within them or continued to allow a loophole to exist when it could easily be closed. This leads to other questions about why the United States has been so ineffective in this area. Is it because of the political game played by politicians and lobbyists in Washington D.C.? Or could it be that the U.S. needs Corporate America's support more

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

than they need the billions in tax revenue? Or does the U.S. truly not have a solution to the corporate tax avoidance problem? These are questions that further research in this field of study can answer.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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**THE EUROPEAN UNION: SLOW AND STEADY WINS THE RACE?**

Now that the U.S. action against tax havens has been address, this paper will discuss a more complex political and economic system. Today, the EU is political and economic union of 28, soon to be 27, states with a common market which includes the free movement of people, goods, and capital. Nineteen states use a common currency—the Euro. Its policies span many areas including healthcare, migration, and climate change. Despite its status as a world power today, the EU was not always such a thriving system (“History”).

The EU began as a sectoral economic union—the European Coal and Steel Community. Six states agreed to give up some of their sovereignty, only in the areas of coal and steel, because the benefit of pooling their resources was far greater than the cost. An underlying theme in all European Union (EU) treaties has been the free movement of people, services, and capital. To do this some level of integration was necessary. Despite this, Member States have always believed that sovereign matters should only be given up when the benefits greatly outweigh the costs. This is why the road to integration was a long process full of small victories. The first was the establishment of the European Economic Community in 1957, then after a period of expansion, the 1986 Single European Act spurred the drive for the Single Market which was ultimately established in 1993 (“History”).

In the EU, any progress towards full integration has an impact on a state’s sovereignty so advancements made throughout EU history have been slow and full of compromises—the area of taxation is no different. The problem is that economic integration can never be achieved unless there is some level of harmonization in tax. Specifically, in the areas of indirect taxes, customs, and excise fees. This is why there has been reluctant progress in the area of indirect taxation (e.g., Value Added Tax or VAT). Despite the steady progress made in the area of indirect taxes, any attempt at progress in the area of direct taxation (e.g. corporate income taxes) has been met with resistance from Member States. Member States see harmonization of direct tax as eroding too much of their own sovereignty since it would limit the control each member state has over its own revenue stream and its corresponding budget usage. This makes addressing the problem of corporate taxation even more complex.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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This case study will first describe the methods used by the EU to combat tax havens and assess how successful they have been. This will be done by first establishing the levels of authority in the area of taxation: the Commission, the Commissioner, and the Court of Justice. This case study will then outline action taken by each level and analyze how successful those actions were. The following section of this thesis is heavily influenced by the author's prior papers *Combatting Tax Havens: The Role of the EU and Ireland, Apple and the EU*.

Levels of Authority

There are three ways the EU can take action in the area of taxation: legislation, state aid decisions, and Court of Justice interpretations. Legislation is mainly decided by each country of the EU at the national level. When action at the EU level is needed to facilitate the single market, the European Commission can present proposals for tax legislation or provide recommendations. In all cases the Commission should be following the subsidiarity principle and the proportionality principle. Subsidiarity ensures each matter is being handled at the lowest possible level of authority (i.e. national as opposed to EU) and proportionality means that the proposed initiative does not go beyond what is needed to address the problem. It is also important to note that actions on direct taxation are limited to bringing specific EU country laws more in line with each other. This is done to improve the overall functioning of the EU's internal market. The Commission cannot impose a direct tax (i.e. personal, corporate, or property tax). Any EU tax legislation must be unanimously agreed upon by all EU countries before entering into force which is called the principle of unanimity (Irish Tax Institute 2016, 39). Aside from proposing laws, the Commission can also issue policy statements and recommendations. These are not legally binding, but give best practices for tax matters that EU countries can consider implementing at the national level. The Commission can also issue country-specific recommendation each year. These recommendations focus on making national tax systems fairer and more growth-friendly ("European Commission").

The EU Commission is also responsible for examining whether or not state aid granted by EU countries gives any country an unfair advantage over their competitors and is overseen by the Competition Commission. This includes state aid given as tax deductions or favorable tax rates. The Commission can intervene and force the country to abolish the state aid rule and

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

repay the taxes owed. Since the only significant progress in this area has been made within the last few years, with Margrethe Vestager as Commissioner for Competition, this thesis will look at action in the area of state aid as separate from normal Commission actions (“European Commission”).

Another body with authority in the area of taxation is the Court of Justice. The Court of Justice interprets European Union law and ensures that it is applied correctly. It can be called upon to do this by ruling on a national tax provision to see if it aligns with EU law or by the European Commission referring a case to the Court if it believes an EU country is not in compliance with EU laws as we will see with a Spanish goodwill case later in this chapter (“Court”).

Now that the ways the EU can take action have been established, the following four sections will outline what each level has done and then discuss how successful each level was.

Drive to complete in internal market

In 1996, Competition Commissioner Mario Monti aimed to further the completion of the internal market by proposing a global tax strategy. The Council of Economics and Finance Ministers (ECOFIN) established a ‘High Level Group’ in response to his first Memorandum. After Monti’s second, in October 1996, the Commission published a Communication on harmful tax competition and its limits. Eventually, the result of these actions was a tax package to tackle harmful tax competition including the following measures:

“(a) a Code of Conduct on business taxation (b) a common system of taxation of interest paid to individuals; and (c) a directive, similar to the Parent-Subsidiary Directive, to eliminate withholding taxes on interest and royalty payments between companies in different Member States” (Panayi 2013, 21).

In December 1997, ECOFIN unanimously agreed on the package and shortly thereafter the *Code of Conduct for Business Taxation* was created (Panayi 2013, 22). Member states, although not legally bound, agreed to roll back existing measures that constitute harmful tax competition (“rollback”) and refrain from introducing any other measures in the future (“standstill”). The Code also lays out criteria for a potentially harmful measures which are:

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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- “an effective level of taxation which is significantly lower than the general level of taxation in the country concerned;
- tax benefits reserved for non-residents;
- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
- granting of tax advantages even in the absence of any real economic activity;
- the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD;
- lack of transparency” (Panayi 2013, 75).

The following year, ECOFIN also established the Code of Conduct Group Business Taxation to assess any tax measures that fall within the scope of the Code. In 1999, the Group identified 66 measures with harmful features, 40 of which were in EU Member State countries. The countries had until 2005 to amend the harmful practices and the Group monitored progress (“Harmful”). Today, this group has shifted focus to help with current OECD initiatives like transparency and anti-abuse rules by monitoring.

Ensuring the sustainability of the Single Market

In 2001, the Commission performed a tax study to determine what tax provisions would impact cross-border economic activity in the Single Market. The major highlights of this report focused on the changing landscape of economic activity due to globalization and the recent developments in the Internal Market. The report ended with a few long-term suggestions such as a Home State Taxation strategy, in which a company would calculate all profits in the state that it is headquartered. The significance of this study is that it led to the first discussions on a consolidated corporate tax based. Despite the first draft of the proposal being released in 2007, it was postponed the following year after the Lisbon Treaty was denied. After the 2001 study there was little progress made in this area for almost a decade. Instead, the EU was focused on expansion efforts going from 15 members to 26 by 2011, the lack of an EU constitution, and eventually the worldwide economic crisis. The economic crisis drew attention back to the subject of corporate tax avoidance and spurred additional action. That may be why the *Common Consolidated Corporate Tax Base (CCCTB)* was finally put forth in 2011 (Panayi 2013, 24-27).



**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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Post 2008 Financial Crisis

In March 2012, the European Council, which sets the broad direction of EU policy and is composed of the heads of government of EU states, called on the Commission to “rapidly develop concrete ways to improve the fight against fraud and tax evasion” (Irish Tax Institute 2016, 42). Despite its focus on the more criminal side of things the EU’s policy included action against tax avoidance. Any measures put forth thus far had more to do with facilitating the integration of the Single Market than actually curbing tax avoidance. After the 2008 financial crisis, the focus of most countries shifted to recovery efforts and strengthening the global economy which meant that tax avoidance and evasion needed to be at the top of the list. In December 2012, the European Commission published its *Action Plan to Strengthen the Fight Against Tax Fraud and Tax Evasion*. This plan included over 30 different measures to combat tax fraud and evasion (Irish Tax Institute 2016, 42). This plan was a sign of the EU’s commitment to ending corporate tax avoidance but was ultimately replaced 3 years later with a revised plan.

In June 2015, the European Commission launched its *Action Plan for Fair and Efficient Corporate Taxation*. This plan replaces the original 2012 plan in response to the growing multilateral efforts that will be discussed in the final chapter. This piece of work was comprised of the following five components: a common consolidated corporate tax base (CCCTB), ensuring effective taxation where profits are generated, better tax environments for businesses, tax transparency, and tools for coordination between EU member states. The most important components are related to the CCCTB and the Anti-Tax-Avoidance Package.

The Anti-Tax-Avoidance Package (ATAP) is a combination of objectives from the Organization for Economic Cooperation and Development (OECD) Base Erosion Profit Shifting (BEPS) work, which will be covered in the next chapter, and the leftover aims of the proposed CCCTB. The package itself is composed of multiple initiatives, two of which should be highlighted: the Anti-Tax-Avoidance Directive and Directive on Country by Country Reporting (CbCR). The Anti-Tax-Avoidance Directive aims to ensure compliance with the BEPS plan proposed by the OECD, which is currently a non-binding agreement between member countries. This agreement requires that all member states enact laws that ensure

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

compliance, supplementing the non-binding agreement with domestic laws. This directive also addresses two areas outside the scope of BEPS. These relate to exit taxation rules and general anti-abuse rules (PwC 2016, 2). Under the new CbCR rules, corporations will have to provide certain tax related information on an annual basis for any jurisdiction in which they do business including revenue, profit or loss before tax, tax paid and accrued, and retained earnings (Irish Tax Institute 2016, 67). CbCR will promote transparency between Member States and make avoidance by multinational companies almost impossible (Irish Tax Institute 2016, 43-46).

In October 2016, the European Commission decided to relaunch the CCCTB for a third time. It is really the heart of the Action Plan. It has two primary focuses, a common tax base that will be used to calculate profits in all Member States, and the consolidation of taxable profits so that the total corporate revenue can be divided among states using a formal apportionment process. There are two key differences with this proposal then the first two. This proposal will introduce a mandatory system, as opposed to the previous optional ones. This is an attempt to limit the ability of multinational companies to pursue aggressive tax planning strategies. The new proposal will be implemented phase by phase going from a “common” European tax base to a fully “consolidated” base (Verlinden 2015, 345-346).

For the CCCTB to pass this time around the EU will need a unanimous agreement between all Member States. This seems unlikely, if one considers the perspective of all Member States. For example, Seamus Coffey, a Lecturer in Economics at the University College Cork, was appointed to review the State’s tax code. According to him, “80% of Ireland’s corporation tax is paid by multinationals, this base would clearly be under threat under the EU proposals” (Taylor 2016). He concluded that Ireland could lose up to 50% of its corporate tax base if the CCCTB is implemented (Taylor 2016). In a similar manner, the Danish Minister for Taxation Karsten Lauritzen recently threatened that Denmark would leave the EU if the CCCTB is implemented. A response like this does not bode well for any CCCTB progress (“CCCTB”). That said, most are optimistic that taking smaller steps to implement the OECD action plan will eventually lead to the passing of the CCCTB, but that may not be realistic.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

State Aid and the Commissioner of Competition

The Competition Commissioner is in charge of applying EU competition laws. Her role involves “effectively enforcing competition rules in the areas of antitrust, cartels, mergers and state aid (“Margrethe”). The interesting thing about this position, is that definition of “state aid issues” is debatable. The technical definition of state aid is “any advantage granted by public authorities through state resources on a selective basis to any organizations that could potentially distort competition and trade in the EU” (“state aid”). What is up for interpretation by the Commissioner’s is what is considered to be an advantage. The campaign against multinationals started in 2014 with Joaquín Almunia, the prior Competition Commissioner. He argued that “In the current context of tight public budgets, it is particularly important that large multinationals pay their fair share of taxes. Under the EU’s state aid rules, national authorities cannot take measures allowing certain companies to pay less tax than they should if the tax rules of the Member State were applied in a fair and non-discriminatory way” (“state aid”). This broadened the role of the Commissioner to handle cases in which an EU country is giving preferential tax rulings to companies. This is the first time that tax practices fell under the jurisdiction of the competition enforcer.

Margrethe Vestager took office on November 1, 2014. As the EU Competition Commissioner, she followed in her predecessors’ footsteps and has been leading investigations into whether the tax ruling practices of EU member states constitute illegal state aid. Vestager is the first Competition Commissioner to make tax avoidance by multinational companies a high priority. This may be because the International Consortium of Investigative Journalists (ICIJ) released the “LuxiLeaks” on December 9, 2014, shortly after Vestager took office. This leak revealed around 30 companies which were benefitting from tax advantage and tax avoidance schemes in Luxembourg and started a media storm that most likely contributed to Vestager’s agenda. For example, *The Guardian* wrote an in-depth investigative article after the leaks. One of the videos they released included a Guardian reporter attempting to speak with an Icap employee at the Luxembourg operation of two of its subsidiary’s: Icap Luxembourg Holdings and Sarl and Icap Luxembourg. The video reveals that the same employee, who is paid less than €15,000 a year, is the only employee of the two subsidiaries. Over the intercom the man apologizes for being out of breath since he had just run up the stairs (presumably from the

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

other office). Despite these subsidiaries being listed as million dollar operations, the Icap employee could give very little information and directed the reporter to their public relations office in London without letting the reporter inside (Bowers 2014). There were countless articles and videos released after the leaks, which prompted negative reactions by many.

In June 2014, the European Commission, under the direction of the Competition Commissioner, opened three investigations into Ireland, the Netherlands, and Luxembourg to examine whether or not the corporate taxes paid by Apple, Starbucks, and Fiat Finance and Trade complied EU rules on state aid. The Commission argued that “some companies have received significant tax reductions by way of ‘tax rulings’ issued by national tax authorities” in the form of “comfort letters” (“Commission decides”). While these rulings are normal and necessary in order to clarify certain tax rules, especially with regards to transfer pricing, the problem arises when these “comfort letters” also indicate areas the corporation can take advantage of state aid or confirm tax basis calculations that do not use market values. For the purposes of this thesis, the Ireland/Apple case will be used to illustrate the issues surrounding action of this kind.

Ireland/Apple Case

In August 2016, the Commission's investigation concluded that Ireland granted illegal tax benefits to Apple, which enabled it to pay substantially less tax than other businesses over many years” (“State aid”). As Commissioner of Competition, Vestager declared that “Member States cannot give tax benefits to selected companies” under EU state aid rules. Therefore, the Commission is ordering Ireland to recover the unpaid taxes from Apple for the years 2003 to 2014, which is up to €13 billion, plus interest (“State aid”).

The Commission claims that Apple used two rulings granted in 1991 and 2007, in order to structure their overseas subsidiaries in such a way that gives them the best tax benefit. These two companies, Apple Sales International and Apple Operations Europe, are both incorporated in Ireland and hold rights to sell and manufacture Apple products outside the U.S. Essentially, Apple Sales International would make payments to Apple in the U.S. which serves as a source of income used for research and development of the intellectual property generating revenue overseas. In 2011, the U.S. Senate Public Hearings revealed that Apple

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

had profits of €16 billion, but under these tax rules, only €50 million were taxable resulting in an effective tax rate of 0.05% as opposed to the corporate tax rate of 12.5% that Apple led people to believe they were paying. This effective rate decreased even further in 2014 to 0.005%. The investigation by the Commission also revealed that Apple Operations Europe artificially allocated profits internally to its head office “which [had] no factual or economic justification” (“State Aid”). Since only the Apple Operations Europe branch had “the capacity to generate any income from trading,” this shift violated the “arm's length principle” in regards to transfer pricing (“State Aid”). Due to this cost-sharing strategy, any profits recorded in the head office were not taxed despite the lack of activity or employees at this head office (“State Aid”).

Similar schemes were set up in Luxembourg and the Netherlands. What is important to note about action like this, is the reactions of states and companies. In many ways, these are just as important as the decisions made by the Commission. If a state disagrees with the ruling they can take the decision to the courts, as Ireland did in this case. Ireland’s Finance Minister Michael Noonan “[disagrees] profoundly with the Commission’s decision” (Crisp 2016). He said “an appeal to the European courts was necessary to ‘defend the integrity of our tax system, to provide tax certainty to business and to challenge the encroachment of EU state aid rules into the sovereign member state competence of taxation’” (Crisp 2016). The appeal was filed with the General Court in early November, and a long court process was started between the EU and Ireland. It could take the General Court up to 18 months to make a decision which can then be appealed in the European Court of Justice. During this time, the money Apple supposedly owes Ireland will be held in an escrow account (Crisp 2016).

Apple had a similar response. Tim Cook, the CEO of Apple, published “A Message to the Apple Community in Europe.” In his letter, Cook asserts “The opinion issued on August 30th alleges that Ireland gave Apple a special deal on our taxes. This claim has no basis in fact or in law. We never asked for, nor did we receive, any special deals” (Cook 2016). The rest of his letter comments on the feelings of Ireland and the U.S. while clearly indicating that the EU’s ruling will have detrimental effects on Ireland, a country who has structured a large part of its economic market to attract foreign investment. Cook really highlights the most

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

interesting part of this case when he states, “[Apple] finds [themselves] in the unusual position of being ordered to retroactively pay additional taxes to a government that says [they] don't owe them any more than [they've] already paid” (Cook 2016). In effect Cook says, this move “is effectively proposing to replace Irish tax laws with a view of what the Commission thinks the law should have been [which] would strike a devastating blow to the sovereignty of EU member states over their own tax matters, and to the principle of certainty of law in Europe” (Cook 2016). His thoughts echo the United States Treasury's, which “warned that using state aid rules would mean the executive was turning itself into a ‘supra-national tax authority’” (Crisp 2016).

Even a prior Competition Commissioner questions Vesteger's investigations. Neelie Kroes, who was Competition Commissioner from 2004-2010, argues that State Aid rules should not apply to tax matters. He said, “EU member states have a sovereign right to determine their own tax laws. State aid cannot be used to rewrite those rules, however, the current state aid investigations into tax ruling appear to do exactly that.” Regardless of their opinions, the investigations into Starbucks and Fiat Finance and Trade concluded that preferential treatment was given and both companies were forced to pay the tax owed, amounting to €20-€30 million each (“State Aid”). That said, as the Apple/Ireland case moves through the court system, the definition of “state aid issues” will be called into question which could impact future investigations.

#### Judicial Process

The European Court of Justice (ECJ) interprets all European Union law. In the area of taxation, the ECJ plays two primary roles. The first is ruling on national tax provision disputes to see if the laws in play align with EU law. The second is ruling on cases referred to it by the European Commission if it believes a member state is not in compliance with EU laws (“Court”).

Historically, the ECJ has made cases concerning “overly restrictive domestic abuse rules which hindered the single market” a priority over preventing tax avoidance (Panayi 2015, p. 167). This may be why the ECJ has not ruled on a general abuse principle in the area of direct taxation. In other harmonized areas of taxation, such as VAT tax, there are clearly outlined

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

abuse rules. The ECJ actually agrees that “aiming to minimize one's tax burden is a valid commercial process” (“Anti-abuse”). The catch is that transactions cannot result in the artificial transfer of profits. This is determined on a case by case basis. The ECJ’s guidance on this matter is that “artificial arrangements must be detected via a comparative analysis of form and substance” (“Anti-abuse”). They go on to explain that, in order to “[assess] the substance, verifiable elements should be used such as the location of management structures, physical presence of the establishment and the corresponding commercial risk” (“Anti-abuse”).

This relates to the accounting principle of substance over form in financial reporting. This means that any transaction recording must accurately represent the economic reality of the situation, rather than the legal structure. For example, if Company A opens a subsidiary in Tax Haven B with the intention of using the unique natural resources in that country for business purposes—that is a valid transaction. However, if there is no indication that Company A is moving into this new jurisdiction for a real business purpose, simply to shift profits and lower taxes, Company A would be considered to be abusing the tax laws in the EU.

The other major area that the ECJ oversees is cases related to state aid. This has to do with the principle of subjectivity in defining whether a measure falls into the category of state aid. The EJC has ruled “that in order to meet the selectivity criterion, it is enough to establish that a measure constitutes a derogation from the “regular” tax regime” (EY 2016). This landmark judgement was in a Spanish goodwill case in 2016 involving Santander Bank. The EJC set aside two General Court Judgements which attempted to raise the bar for finding “selectivity” (EY 2016).

This case also outlines the legal process of cases that are sent to the EJC. The case was about a Spanish corporate tax law that allowed undertakings which had acquired shareholdings in foreign companies at 5% or more to deduct the amortized goodwill value from their own taxable income. This same rule did not apply to domestic shareholders. The European Commission opened a formal investigation into the deal with Santander Bank and World Duty

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

Free Group in 2007. The Commission ruled in both cases, the acquisition of shareholders within the EU and acquiring shares outside of the EU amounted to illegal state aid. The decision was appealed in General Court. The General Court reversed the Commission's decision, instead ruling that since the Commission was not able to identify a specific category that the scheme was aimed at, instead it was open to all. This decision was set aside in December 2016 by the Grand Chamber of the EJC. The EJC reiterated that the only relevant criterion to establish selectivity in state aid cases is that the law favors one party over another in the same legal situation. In this case, the ECJ concluded that the Spanish goodwill amortization regime constitutes illegal state aid since it favors Spanish resident companies that make foreign share acquisitions rather than domestic acquisitions (EY 2016).

This case will set a precedent for the European Commission to use State Aid in direct tax matters. As the Apple, Starbucks, and Fiat-Finance cases discussed in the prior section move through the court system, the ECJ will likely refer to this decision.

Analysis

Some would argue that the total tax revenue lost in the EU amounts to 1 trillion dollars. All of which is a result of avoided taxes by multinational corporations (Verlinden 2015, 343). There are three methods that the EU has utilized to combat this avoidance, all of which were described above.

The work of the Commission can be divided into three periods of time, with very different objectives. The first period focused primarily on the drive to complete the single market, while the period following ensured that the single market was sustainable. The major efforts that resulted were the Code of Conduct on Business Taxation and various studies that aimed to determine any tax practices that could potentially harm cross-border economic activity. The major problem with these methods is that they were all nonbinding agreements. The Code of Conduct has no real consequences for countries who signed, but do not practice the Code itself. The harmful tax measures identified in 1999 by the code of Conduct Group on Business Taxation were eliminated, but there was nothing stopping states from using other methods to incentive corporations.



**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

It was during the third period of Commission action that the EU began to see some success. This period was the result of renewed efforts after the economic downturns in 2008. The Commission's major effort was its Action Plan. First published in 2012, and then revised in 2015 in order to align with the international efforts of the OECD and its BEPS Plan. The methods used this period had some success. The EU TIN portal and Tax Transparency Package made progress in the area of information exchange which is crucial to curbing avoidance. I fear that if there is no accountability or consequences, then the plan will be implemented by states and then corporations will invent new ways to all avoidance methods which will provide no more results than the 1990s efforts did.

The major weakness in this period is the lack of consolidation. The EU is unique because its states retain their own sovereignty in the area of taxation, but then compete in the business arena. There is a very fine line between tax abuse practices and healthy economic competition. This problem cannot be solved without a supranational solution. The end goal is ultimately full tax integration, which has traditionally always been protected by state sovereignty. The EU is at a cross roads. They can move forward with integration or continue with patchwork solutions in response to arising problems. If the EU decides not to move forward the cost will continue to be lost tax revenue, but if they do move forward the cost will be the loss of additional sovereignty. The recent proposals, the EU's Action Plan and CCCTB, are multilateral solutions that will be implemented slowly over the next few years.

Since the proposed actions will progress slowly there is a higher chance of success. Historically, incremental steps are the best approach with the EU. That said, Article 15 of the Treaty on the Functioning of the European Union states that "fiscal measures are to be realized through unanimous agreement at the level of the European Council" (Verlinden 2015, 345). The CCCTB has been proposed two times already and has not made any progress. Multiple proposals is not usual for the EU but a questionnaire sent to Member States in 2012 made it clear that only a third of the Member States were actually in favor of the proposal (Verlinden 2015, 345).

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

The next major method that the EU is using to combat tax avoidance is state aid violation cases carried out by the Commissioner of Competition. These cases have gotten a lot of media coverage over the last few years, since Vestager has gone after well-known companies like Starbucks, Fiat Finance, and Apple. In my opinion, this is one of the more effective methods used. Ironically, this is a unilateral action, rather than a multilateral action that one would expect to lead to the most progress. In all three investigations mentioned in this case, the Commission ruled that the respective companies were the recipients of State Aid and that they were required to repay the tax owed. They are also no longer able to use that loophole. Since all three cases have been appealed it might be preemptive to declare this method a success. Conversely, when considering the decision in the Spanish goodwill case mentioned in the EJC section of this case study, it does not seem so presumptuous.

The major progress made by the EJC is that it has begun ruling in State Aid cases. Other action by the ECJ has shied away from direct tax rulings. Since the Spanish goodwill case has a similar topic, many believe that the courts will reference this ruling when handling these future appeal cases. If the court rules in the same way, all three companies will be forced to pay the full taxes owed. It will also set a precedent that allows the Commission to have some power over direct taxes. This could potentially eliminate another aspect of state sovereignty in the long run. Some would argue that according to the EU treaties, any and all matters regarding taxes remain under the jurisdiction of member states. These rulings are contradicting that and have the potential to make a major dent in the opportunities for corporate tax avoidance.

The EU has made significant progress in the area of combating corporate tax avoidance. It seems as though slow and steady truly does win the race. The EU is built on treaties. Progress is slowly passed and then revised. The area of taxation is no different, but it seems to be working. Similarly, the Competition Commissioner is fighting corporate tax avoidance one company at a time. While other countries might see this as an ineffective way to solve a problem, the EU has always operated this way—so why would corporate tax avoidance be any different?

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

**THE OECD: WE'RE ALL IN THIS TOGETHER**

Recent global trends have changed the nature of business. These trends include global expansion, increased technology, the importance of intellectual property (IP), and a greater focus on product innovation and big data. In response business models have been changed to meet these trends such as developing international supply chains, regional headquarters, inventories in local markets, online sales, and centralization of key functions (i.e. procurement, intellectual property, financing) (Irish Tax Institute 2016, 5) The corporate tax systems in place today were largely developed in the aftermath of World War I. At that time, multinational enterprises were mostly industrial companies selling tangible products. Thus the systems put in place were designed to meet the needs of that kind of business. “Today, some 50,000 multinational enterprises and their 450,000 affiliates employ over 200 million people throughout the world” which means the domestically focused tax system do not capture the reality of how production occurs in today’s world (Irish Tax Institute 2016, 4).

As shown in previous chapters, taxes are a sovereign matter. Conversely, tax avoidance is usually achieved on the international level. The question then becomes: can domestic laws alone fix an international problem? States have tried to do this by making small changes and updates to their tax laws. This has resulted in detailed and complex tax codes. The two prior chapters are examples of this phenomena. Unfortunately, the tax systems put in place in the United States and the EU have left room for loopholes in the tax law that are taken advantage of by corporations. Many would argue that this issue will continue as long as their systems are focused solely on their own economic activities rather than an international framework.

The Organization for Economic Cooperation and Development OECD is attempting to fill this need by taking a multilateral approach to the problem of corporate tax avoidance. This chapter will look to answer three questions: what has the OECD done to curb corporate tax avoidance, how successful those actions been, and what role has the U.S. and the EU played in the implementation. This chapter will then proceed as follows: an explanation of the OCED, it processes and legal instruments, an outline of action taken by the OECD, commentary on what the U.S. and EU has done with OECD recommendations, and finally, an analysis of how successful these actions were.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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OECD Organizations, Processes and Legal Instruments

The OECD is an intergovernmental organization that provides a unique forum where the governments of 35 democracies with market economies work with each other, as well as with more than 70 non-member economies to promote economic growth, prosperity, and sustainable development. The OECD explains that its work is based on continued monitoring of significant worldwide events and continual projections of short-term economic developments. Since tax is a major part of the worldwide economy any significant changes can have large impacts on the world's fiscal health which is why taxation issues have been a constant focus of the OECD ("what we do").

When exploring any topic, the OECD Secretariat collects and analyses data which results in discussions on policy by committees made up of member states, observers and the OECD Secretariat. Ultimately, the Council, which consists of one representative from each member country, makes decisions and then governments implement recommendations. The key to this process is peer reviewing. This is the monitoring of a country's progress by its peers, carried out at a committee level. Some discussions can result in agreements, standards or guidelines. Any decisions or recommendations adopted by the Council are usually referred to as OECD Acts. Decisions are legally binding for all Member countries that did not abstain at the time of adoption. They are not international treaties, but Member countries are required to implement decisions. Many of these decisions do result in international treaties that are then legally binding for each state. Recommendations are not legally binding, but there is a high level of expectation that member states will do everything in their power to implement the recommendation, otherwise that country should abstain at the time of adoption ("what we do").

Early efforts by the OECD to Combat Corporate Tax Avoidance: 1998-2006

The first major effort by the OECD in response to corporate tax avoidance was its 1998 report, *Harmful Tax Competition: An Emerging Global Issue* (OECD, 1998). This was drafted in response to a request from the G-7 finance ministers to "develop measures to counter the distorting effects of harmful tax competition" two years prior (OECD, 1998). The push towards action on a multilateral level was the result of three international priorities converging: money laundering, financial stability, and ending the use of tax havens. As noted in the United States Case Study, the U.S. involvement was really a byproduct of their

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

commitment to combatting criminal money laundering. The primary focus of the U.S. was on Financial Action Task Force (FAFT) efforts in which it played a lead role. Clinton's Administration found a link between bank secrecy, tax avoidance, and money laundering which is why the U.S. was supportive of the OECD's efforts. Part of the reason the OECD was able to garner so much support initially was because of the primarily left-of-center governments in power at the time. Once the Bush administration took office policy priorities shifts and the U.S. stepped back from the multilateral fight (Palan 2010, 203-205).

The EU was more worried about the sustainability of their single market. Since the late 1950s and early 1960s it was obvious that tax neutrality would be required for the internal market to work. In 1985, the European Court of Justice ruled that direct tax were to fall under the jurisdiction of member states. That said, the problem of tax avoidance has the potential to destroy the internal market if not handled correctly. This is why the EU looked to support multilateral efforts of the OECD. They hoped that at an international level, the problem of tax avoidance would be handled without encroaching on state sovereignty (Palan 2010, 203-205).

Since the nature of this 1998 report dealt with sovereign matters and topics that most states had strong, but differing opinions on, it was very difficult to compose and presented many views. The final report aimed to do three things: define what harmful tax competition was, argue why it was harmful, and provide a possible solution to the problem. According to the report, harmful tax competition came from two sources, tax havens and preferential tax regimes. The latter was something many OECD Member countries were guilty of themselves. The report stressed that this was a truly global problem that could only be solved with a coordinated solution. The suggested solution was in line with OECD operations. Member states would collaborate on a code of conduct, assess their own laws, submit to a peer review, and remove any problematic areas by 2003 or in special case by 2005, if not they would be included on a blacklist of tax havens (Sharman 2006).

“Name and Shame” Campaign

In 1999, the OECD's new Forum on Harmful Tax Practices began compiling a list of states that were deemed to be tax havens. These states were going to be “named and shamed” and uncooperative countries would suffer consequences of “coordinated defense measures”

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

(Sharman 2006, 15). Forty one countries were identified as tax havens. These countries had one year to make the necessary commitments to change or they would be included on the black list. Prior to the release of the list, 6 of those states did make the necessary commitments and were left off the list. These states include: Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino, all of which are generally still known as tax havens today (Sharman 2006, 46). Two states, Switzerland and Luxembourg, also publicly denounced their involvement and refused to be responsible for any provisions by abstaining. This left 35 states named on the list of tax havens released in June 2000. These states then had an additional year to make the necessary commitments or they would be included on the second list released in 2001 detailing “uncooperative tax havens” (Sharman 2006, 46).

Over the next few years, however, this campaign would slowly fall apart. There were three contributing factors to the end of this phase of multilateral action. The first of which was the loss of U.S. support. The Bush Administration took office in 2001 bringing new policy objectives to Washington. There was a large lobbying campaign, led by the Center for Freedom and Prosperity, which is a nonprofit organization advocating for jurisdictional tax competition. The Treasury Secretary Paul O’Neill, also publicly criticized the U.S.’s support of the OECD initiative saying that it no longer aligned with the political objectives of the Bush Administration. Eventually, enough support was garnered and the Bush Administration withdrew its support. The second contributing factor was the crucial proviso that the Isle of Man was able to include in its 2000 commitment with the OECD. By committing to make changes and outlining a timeline that was deemed to be acceptable to the OECD, a tax haven would be left off the list. In the Isle of Man’s negotiations with the OECD they were able to include a clause that made reforms binding only if all other OECD members agreed to the reform. Finally, the new Joint Working Group on harmful taxation gave equal weight to members and non-members which changed the tone of conversations drastically since this included tax havens. All three of these factors combined significantly slowed progress (Sharman 2006, 16).

The focus of the OECD initiative shifted after September 11, 2001 terror attacks in the United States to focus on information transparency in order to combat terrorism. The goal was to

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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have information exchanged on civil and criminal tax matters. States did agree to this, with the stipulation that they were only bound if every OECD Member country agreed (i.e. Isle Man Clause). Further limiting progress, in 2003 tax havens were able to get the stipulation to read that third-party competitors, or non-member states, must also sign the agreement before it was binding. This effectively halted any significant progress in this area past what they had already began (Sharman 2006, 18). The OECD did publish an update on their progress in the Harmful Tax Practice Project in 2006. According to this update, of the 41 preferential tax regimes that were identified in the 2000 Report, all of them were either abolished, amended, or declared not harmful (“OECD’s Project”).

The Interregnum: 2006-2012

After the first major OECD initiative, the “name and shame” initiative, fell apart there was a period of insignificant activity before the OECD began its major campaign against tax havens in 2012. In the interim, the OECD developed a series of fora and published guidance on various tax related topics that were brought to its attention. Some major fora topics to highlight are the Global Forum on Transparency and Exchange of Information for Tax Purposes and the Forum on Tax Administration. The Global Forum on Transparency and Exchange of Information for Tax Purposes was created in the early 2000s to address risks associated with non-cooperative jurisdictions. It was reformatted in 2009 in order to meet new demands for stronger standards in this area. Today, the Forum includes 139 members that ensure the implementation of international standards on transparency through a peer review process (“Global”). The Forum on Tax Administration (FTA) was created in 2002 and included over 45 countries. Its main goal is to improve tax compliance by creating a forum for Commissioners to identify, discuss and influence global trends in tax around the world. The OECD also passed relevant guidance during this time which included additional Transfer Pricing Guidelines (2010) and Hybrid Mismatch Arrangements (2012), both of which built on prior reports from the FTA. All of this guidance, however, would be superseded by the OECD’s Action Plan (2015) which will be discussed next.

Base Erosion and Profit Shifting Action Plan

The Base Erosion and Profit Shifting (BEPS) Action plan is the latest method used by the OECD to combat tax havens. This is also its major multilateral solution to the problem of

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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combatting tax havens. Erosion refers to the erosion of national tax bases. Profit shifting is one way that corporations make this happen. They do this by using schemes and loopholes to move profits to a lower tax jurisdiction. The G20 leaders' meeting in Los Cabos in June 2012 called for the prevention of base erosion and profit shifting. Part of their motivation was to drive economic growth and recovery after the 2008 financial crisis. The crisis left governments in desperate need of revenue and resulted in increased public awareness of the money that corporations were shifting overseas. The OECD is hoping that the BEPS Action plan would prevent corporations from continuing to shift profits. As a result the finance ministers asked the OECD to report on this issue by their meeting in February 2013. The OECD then performed an in-depth analysis of BEPS issues and identified six pressure areas,

“(1) hybrids and mismatches which generate arbitrage opportunities; (2) the residence-source tax balance, in the context in particular of the digital economy; (3) intragroup financing, with companies in high-tax countries being loaded with debt; (4) transfer pricing issues, such as the treatment of group synergies, location savings; (5) the effectiveness of anti-avoidance rules, which are often watered down because of heavy lobbying and competitive pressure; (6) the existence of preferential regimes (Irish Tax Institute 2016, 27)

The report was well received and the OECD was encouraged to develop an action plan for the G20 meeting in July 2013.

Three key challenges were identified: coherence, substance, and transparency. Coherence of international tax systems seeks to prevent mismatches in tax systems which result in double non-taxation (income that is not taxed anywhere). The second challenge is in regards to matching the economic substance of a transaction with taxable profits. The last challenge is increasing transparency between tax authorities (Irish Tax Institute 2016, 27). In response, 15 specific actions were developed around these three pillars. The final BEPS deliverables were published in October 2015. For a complete listing, please see Appendix A.

The effectiveness of this plan is completely dependent on implementation by sovereign states. Some countries have begun to implement certain measures. For example, all OECD member countries, and some nonmembers, have agreed to begin implementing Country by Country Reporting (CbCr) in 2016. Therein lies is problem though, countries need to implement these



**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

actions into their own domestic tax laws. Some of the Actions listed in the OECD plan will require changes to bilateral treaties which will make this a long and drawn out process between countries. The OECD aimed to rectify this with Action 15 which states,

“Analyze the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution” (OECD Action Plan, 2015).

Essentially, the OECD was looking to simplify the process of amending hundreds of bilateral treaties between states worldwide. The timeline for this measure was fairly quick. A report identifying relevant tax issues was due by September 2014, and the development of the multilateral instrument was due by December 2015.

The 2014 Report, entitled *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties* was approved by the OECD Committee of Fiscal Affairs and supported by the G20 leaders. It analyzed the feasibility of a multilateral instrument and commented on the issues that may arise, but overall concluded that such an instrument was desirable and feasible for a number of reasons. Some of those reasons were: streamlining the process of adapting bilateral treaties, providing developing countries with an opportunity to benefit equally, and increasing consistency. The report did recommend an international conference to develop the instrument. This ad hoc group, which was endorsed at the February 2015 G20 Finance Ministers meeting, would be open to all interested countries (both members and nonmembers) (“Multilateral” 2016). The group’s first meeting was in November 2015, and the adoption of a multilateral instrument took place in November 2016. A formal signing ceremony will take place in June 2017. This instrument will “transpose results from OECD/G20 Base Erosion and Profit Shifting Project (BEPS) into more than 2,000 tax treaties worldwide” (“Countries” 2016). To further aid implementation, the OECD has created an Inclusive Framework. This forum includes over 90 countries who will have a “direct influence in shaping international tax rules to tackle BEPS and ensure a level playing field” (“First” 2016).

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

Other significant progress made in regards to implementation of the BEPS Action Plan is the development of the automatic sharing of country by country information. In January 2016, 31 countries signed the Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of Country-by-Country reports (CbC). Tax administrations where a multinational corporation operates will get aggregate information beginning with 2016 relating to allocation of income and taxes paid. This will give countries a single, global picture on key multinational financial indicators. This will begin in 2017-2018 (“boost” 2016).

Implementation by the United States and the EU

The OECD is running into the opposite problem of the U.S. and the EU. Now that the OECD is solving the international problems, it needs cooperation and political will from the U.S., EU, and other states to implement its recommendations domestically. The U.S. reaction to BEPS has been reserved. In regards to most actions, the U.S. claims that the current laws are in line with BEPS standards in all areas except Action 6, which made the minor changes necessary, and Action 13. The biggest indicator that the U.S. will prove to be supportive of the BEPS project is the legislation passed on June 29, 2016 which will bring its U.S. law in line with Action 13. The Treasury Department released its final regulations that require annual CbC reporting by U.S. entities that are the ultimate parent of a multinational enterprise with annual revenue of \$850 million or more. The IRS will accept and automatically exchange this information beginning in January 2016, but it has not yet signed the Multilateral Competent Authority Agreement (Deloitte 2017).

The EU has been a huge supporter of the OECD efforts since the beginning. Its Anti-Tax Avoidance Package (2016) aims to ensure the consistent application of the BEPS principles across all Member states. The package has four initiatives within it. The first is the Anti-Tax Avoidance Directive which contains five legally binding anti-abuse measures: Controlled foreign company rule, switchover rule, exit taxation, interest limitation, and general anti-abuse rule. The second is the Recommendation on Tax Treaties, which provides members with advice on how to revise tax treaties against abuse. The last two components are an EU Directive on CbC reporting and Communication on External Strategy (i.e. good governance) (European Commission 2016).

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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Analysis

The OECD efforts boil down to two periods of intense action. The first was the “name and shame” campaign in the late 1990s and early 2000s. The second period began in 2012, and is still being implemented. The interesting thing this chapter reveals is the relationship between multilateral action and individual states. For multilateral action to be achieved, not only must there be support for it, but that support must come from the right actors.

There was a demand for multilateral action in the 1990s and the OECD responded with a plan. Unfortunately, the OECD actions were never going to be effective without the support of both the U.S. and tax haven countries. For the “name and shame” campaign to be effective one of two things needed to happen. The first, is that tax haven countries needed to want to change. As we saw though, this was not the case. Six countries we still consider tax havens today “fixed” their economies and laws enough to be left off of the list. Countries that were included in the list took advantage of the “Isle of Man” clause and created a situation that benefitted themselves. They were able to be taken off this list and declared “cooperative” despite the fact that they were not required to implement any action until third-party countries did as well, something that was very unlikely to occur.

The second reason this type of campaign was ineffective because the opposition was so strong. The United States is considered a world power. If it had truly supported the first efforts of the OECD there might have been significant progress at that time. As we saw with their Action Plan in 2012/2015, support from major world powers like the U.S. and the EU (including its tax haven Member states) can result in major progress.

The signing of the multilateral instrument is arguably the most significant accomplishment of the OECD campaign. If all of the countries which tentatively lent their support for this effort actually do sign in June, this will result in the implementation of OECD recommendations in over 100 countries. This will bridge the gap between domestic law and international needs. If it is successful, the OECD estimates that it will result in worldwide increase in tax revenue of 4-10%. Of course, there is always a potential downside. The OECD has decided to use additional laws to try and combat tax havens. What has been proved countless times in this paper, is that corporations excel at finding loopholes. While, implementation at a multilateral

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

level should significantly limit the opportunities for corporate tax avoidance, it will not make it impossible. It is too soon to make definitive conclusions on the OECD Action Plan, but what can be said is that the success of this initiative is entirely dependent on the laws that are implemented domestically since tax is still a sovereign matter.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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**COMPARATIVE ANALYSIS**

The questions I set out to answer in this paper were 1) what have states done to combat tax avoidance and 2) how successful were those methods? I would first like to summarize the actions discussed before elaborating on the broader findings.

United States Summary of Actions

<b>U.S. Action</b>	<b>Year</b>	<b>Intent</b>	<b>Reality</b>	<b>Level of Success</b>	<b>Rational</b>
The Gordon Report	1981	Called upon by the Carter administration to investigate avoidance and evasion by multinational corporations	First investigative report in the U.S. offered some recommendations	Low	Focused on describing and defining tax havens and measuring avoidance. Recommendations were limited and ineffective.
Joined OECD “Name and Shame” Initiative	Late 1990s	To end criminal money laundering	Efforts were aiming to end corporate tax avoidance and the use of tax havens.	Low	Motivations were not aligned at the time. There was not enough political will in the US.
IFRS IRM 4.61.5.3.2	1998	Attempted to end the loophole they had put in place.	Met with huge resistance from corporate lobbyists and business groups.	Low	This loophole is still in place today.
Repatriation Holiday	2004	To increase jobs, raise capital for the Treasury, and spur growth.	Did bring home profits but did not spur growth and investment. Arguable increased tax avoidance.	Low	15 companies that benefitted most cut 20,000 over the next 3 years. Evidence that companies tripled the money they held offshore.
American Jobs Creation Act	2004	Limit impact of corporate inversions.	Shareholders of the foreign company must own at least 20% of the combined firm.	Low	Corporations found ways around this with new loopholes (i.e. step-up inversions)

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

Sec. 956 (e)	2014	Limit impact of corporate inversions.	End hopscotch loans.	Low	Corporations found other methods (i.e. earnings stripping)
Sec. 7701(1)	2014	Limit impact of corporate inversions.	End “de-controlling” strategies	Low	Only limited one part of corporate inversion strategies.
Sec. 163j	2016	Limit impact of corporate inversions.	End earnings stripping	Low	Only limited one part of corporate inversion strategies.
Sec. 7874	2016	Limit impact of corporate inversions.	End serial inversions.	Low	Only limited one part of corporate inversion strategies.

European Union Summary of Actions

<b>EU Action</b>	<b>Year</b>	<b>Intent</b>	<b>Reality</b>	<b>Level of Success</b>	<b>Rational</b>
Code of Conduct on Business Taxation	1997	Tackle harmful tax competition	Not legally binding agreement	Low	Not legally binding agreement
Common Corporate Consolidate Tax Base	2001	Create a uniform tax base for EU countries.	Proposed multiple times with no results. Last proposal was 2016.	Low	No political will. There are tax haven member states.
Action Plan to Strengthen the Fight Against Tax Fraud and Evasion	2012	Combat fraud and evasion.	Included 30 measures. Key goal was transparency.	Low	Superseded by another plan.
Investigations by State Aid Commissioner	2014	Investigated companies such as Fiat-Finance, Apple, and Starbucks	All three were found to have violated State Aid and were charged for back taxes.	High	Ended the loophole and reclaimed the lost tax revenue. Dealing directly with corporations send a message.
Tax transparency package	2015	Automatic exchange of information.	Member states will exchange information on cross-border tax rulings.	Low	Superseded by another plan.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

Anti-tax Avoidance Package		Implementation of BEPS Action Plan	Implementation of BEPS Action Plan	High	There is political will backing the current efforts of the OECD and the multilateral instrument will aid in this implementation.
Goodwill Case	2016	Settle a state aid dispute.	Clearly defined selectivity in regards to state aid.	High	Gave more power to the Competition Commissioner.

OECD Summary of Actions

<b>OECD Action</b>	<b>Year</b>	<b>Intent</b>	<b>Reality</b>	<b>Level of Success</b>	<b>Rational</b>
Harmful Tax Competition: An Emerging Global Issue	1998	Investigative Report	Suggested code of conduct and black haven list as a solution.	N/A	Report
Forum on Harmful Tax Practices	1999, 2000	Identify Tax Haven States and	41 were identified, 35 included on uncooperative list	Low	According to the OECD all of these problematic practices were either abolished or amended as of 2006 but some are still tax havens today. Lack of political will lead to end of this initiative.
Base Erosion and Profit Sharing Action Plan	2012, 2015	Multilateral solution to corporate tax avoidance.	Final Action Plan included 15 Actions to address 3 key challenges: coherence, substance, and transparency.	High	There is a great deal of political will from powerful countries. The multilateral instrument to aid in implementation.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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It is clear in these summary tables that most of the methods discussed were unsuccessful. That said, it is important to note the lessons that were revealed by analyzing those failed attempts. When dealing with an issue as complex and constantly changing as with corporate tax avoidance, the failures are truly just one step closer to success. I think there were three major takeaways: 1) the role of sovereignty, 2) the need for political will and 3) the gap between legislative needs and actual legislation.

Role of Sovereignty

This paper discussed three different actors, each with a different level of sovereignty or authority in play. In the United States, in regards to taxes, laws are passed and enforced domestically, usually at the federal level. Conversely, the EU is a more complex system. What began as an intergovernmental organization has evolved into a supranational system in many areas. That said, member states have retained their sovereignty in areas of controversy such as taxes, foreign policy, and economics. This is why the EU may require a more complex platform to handle issues that arise in these areas than the U.S. might. The OECD combines aspects of the U.S. and the EU. It is an intergovernmental organization, meaning most of its actions are a result of collaboration between states at the multilateral level just like in the EU. Many of these laws do end up as international treaties or implemented in domestic laws, in the same way that the US adopts some state laws at the federal level (i.e. same sex marriage).

There is a direct relationship between the methods used and the level of sovereignty a country has. Overall, the U.S. employed domestic legislation as its method to combat avoidance. All three administrations discussed attempted to close loopholes with legislation. The Bush Administration also tried to use a tax holiday. There was minimal support for multilateral solutions from the US until the most recent OECD Action Plan. This may be a result of the Obama Administration being willing to cooperation on an international level. However, the shift in administration priorities with the 2017 inauguration of President Trump might change the level of support we see in the future. The EU also employed unilateral action through the Competition Commission and her investigation and subsequent sanctions for various corporations. The EU has also been a huge supporter of the OECD multilateral initiatives. As



**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

an intergovernmental organization, the OECD has obviously employed multilateral tactics in its fight against tax havens.

Despite tax policy remaining a sovereign matter, pressure from other countries may result in changing norms. For example, corporations in the U.S. were polled and 86% of them said that they had already begun to moderately or significantly change their approach to corporate tax avoidance due to reputational concerns. The U.S. may still not want to end corporate tax avoidance from a political standpoint, but pressure from the EU and the OECD may force corporations to change their ways despite the fact that the loopholes are still in place domestically in order to meet global norms.

Political Will

Having political will requires enough support from political leaders to implement policy change. There were two major instances of lack of political will discussed in this thesis. The first was in the U.S. chapter. Each time that the government attempted to close a loophole there was a lobbying campaign against any change. In the case of the check-the-box rules, no legislation has ever gained enough support to pass—indicating a lack of political will. Changes in inversion laws were minimal and required constant updates as corporations were able to outsmart the system each time and find other ways around the laws. The relationship between lobbyists, corporations, and the government in the U.S. makes political will one of the strongest influences on whether or not a policy change will go through.

The second instance also involved the U.S. During the first multilateral efforts by the OECD, it was ultimately the lack of political will by influential countries like the U.S. and tax havens counties that led to the end of that phase. It is easy to see during the second wave of action by the OECD that political will is a major influence. The discussions surrounding the BEPS Action Plan included tax havens, the EU, and the U.S. all of which were supportive of these efforts. Action 15 called for collaboration to create a multilateral instrument to implement any required treaty adoptions. It was the point of implementation that things broke down during the first OECD efforts, but the same point during the second campaign only spurred greater cooperation. Development of the instrument took only two years which is a relatively short

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

time frame for this subject, as we have seen throughout these cases. This indicates a great deal of political will during the second phase.

Legislation vs. Today's Business Environment

These case studies also revealed a deep gap between the current legislation and modern day business needs. In the age of globalization, supply chains have gotten longer, multinational companies are commonplace, and intellectual property is more important than ever. Despite this evolution, the laws in place today have not undergone major changes in over 30 years. For example, aside from slight changes made in the tax code, there has been no major overhaul in the United States since the 1986 tax reform. This leaves loopholes that corporations have taken advantage of. Even worse, in 1961 President Kennedy spoke these words,

“Recently more and more enterprises organized abroad by American firms have arranged their corporate structures aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices [...] in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad” (“Saint-Amans et al. 2016).

It took another 25 years for the United States government to call for an investigative report. Our world is changing and the political system is having a hard time keeping up. Those in power throughout the world need to put their heads together before the problems get any bigger.

Two Promising and Successful Methods

I set out to answer two questions in this paper 1) what have states done to combat tax avoidance and 2) how successful have were those methods. The first question was answered in the three case studies presented above. Not only did these case studies present the action that has been taken against corporate tax avoidance, but they also revealed the challenges associated with business in the globalized world. After looking at these three cases it is easy to see why states have had such a difficult time finding a method that can successful combat corporate tax avoidance. That said, I argue that two methods have the potential to be quite successful. The first is the method used by the EU Competition Commissioner and the second is the OECD BEPS Action Plan.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

I like to think Margrethe Vestager's response to the problem of tax havens is similar to Alexander the Great's reaction to the Gordian knot. Vestager looked at a complex problem, riddled with political games, and decided to "cut" right to the core of the issue—corporations. Instead of attempting to unravel the political mess that is state aid laws and corporate tax avoidance issues, Vestager took matters into her own hands. She opened multiple investigations and was able to sanction those corporations. As a result, she sent a message to corporations: methods of corporate tax avoidance will no longer be accepted in the EU. It is too early to tell how successful this method will be in the long-term but initial success is promising. The three investigations mentioned in this case, Starbucks, Fiat-Finance, and Apple have all been closed and each company was found to have violated state aid laws and was charged a penalty. All three cases are now in appeal, but as the Spanish goodwill case indicates, the courts will likely uphold Vestager's decision.

Alternatively, the OECD is attempting to "unravel" the knot. They plan to use a multifaceted, multilateral Action Plan to combat corporate tax avoidance. By adjusting domestic laws around the world, the OECD hopes to eliminate the opportunities for corporations to avoid taxes. Logically, this solution makes the most sense for this problem. Now, with proper support and enough political will, this solution has the potential to have the widest impact, especially since over 100 countries are already in support.

Conclusion

Having looked at the action taken by the U.S., the EU and the OECD over the last 30 years it is easy to see why the problem of corporate tax avoidance is still a global challenge. The Tax Justice Network estimates that the U.S. loses \$189 billion a year to corporate tax avoidance (Stupples 2017). Unless there is research and legislative adjustments, this modern-day Gordian Knot will never be solved. Even after three case studies, I cannot say for certain whether the problem of corporate tax avoidance can be cut with unilateral domestic action or untied with multilateral action, but the recent efforts by the EU and the OECD are promising. With political will on their side, the EU and the OECD may actually be successful. That said, corporations are powerful organizations backed by unparalleled intelligence and untaxed wealth. The plans that are in motion can easily be derailed as we saw time and time again

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

---

throughout these case studies. The political climate is primed for change at the moment, the world should act soon or risk the loss of support once again.

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

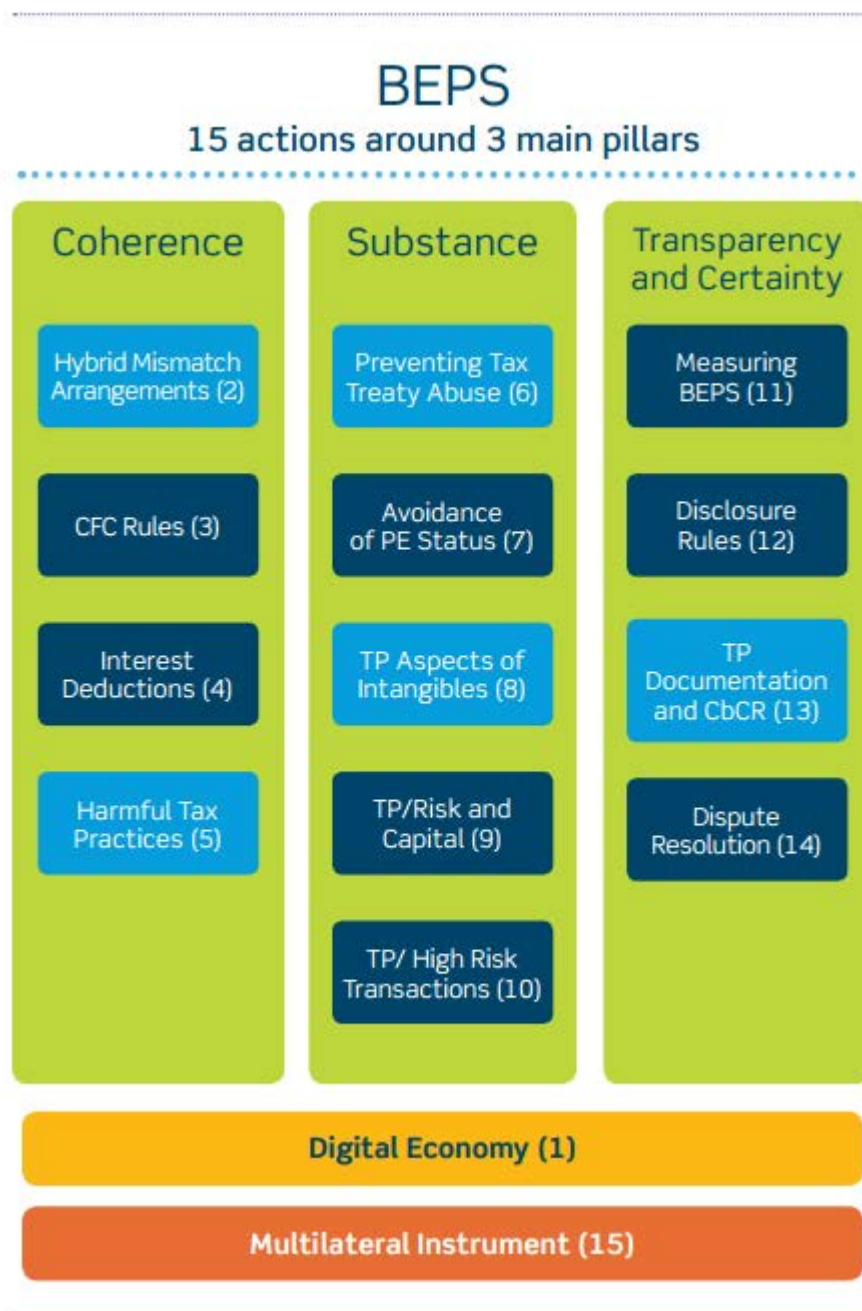
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**APPENDICIES**

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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Appendix A – List of OECD Action Items



*Adopted from the Irish Tax Institute 2016*

**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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**The Gordian Knot: How the United States, the European Union, and Organization for Economic Cooperation and Development took action against corporate tax avoidance**  
*Senior Capstone Project for (Katlyn Twomey)*

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