

Avoiding Tax in Times of Austerity

Energias de Portugal (EDP) and the Role of the Netherlands in Tax Avoidance in Europe



Rodrigo Fernandez, Katrin McGauran & Jesse Frederik

Colophon

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Abbreviations

APA	Advance pricing agreement
ATR	Advance tax ruling
BEPS	Base erosion and profit shifting
SFI	Special Financial Institution
BIT	Bilateral Investment Treaty
CBS	Central Bureau of Statistics
DNB	De Nederlandsche Bank (Dutch Central Bank)
IMF	International Monetary Fund
MNC	Multinational Corporation
OECD	Organisation for Economic Co-operation and Development

1. Introduction

Since the financial crisis the economy of the European Union is under heavy pressure. The unemployment rate and contraction of the economy in countries such as Portugal, Spain, Italy, Greece and Ireland are unprecedented since the Second World War. The crisis is now in its fifth year and drew heavily on the social contract between employees, employers and the government. The welfare state is retrenched and cuts in public spending continue.

While governments substantially cut back on public resources, the Netherlands, along with other tax havens, creates many opportunities for multinational corporations (MNCs) to avoid taxes. The European Commission (EC) estimates the annual loss of tax revenue through tax fraud, illegal tax evasion and tax amounts to € 1000 billion per year.¹ This amount corresponds to € 2000 per EU resident and is more than the combined annual spending on health care. € 150 billion of this so-called 'tax gap' is generated by tax avoidance. This amount in turn is equivalent to the total annual expenditure of the EU.²

This asymmetry, whereby citizens, workers and small and medium-sized enterprises pay the bill for the crisis and large companies transfer their profits to tax havens, has led to (the call for) political action. Protests against cuts are increasing and parliaments are beginning to oppose austerity measures imposed by the EU. Also in the Netherlands, more critical questions are asked, especially about the role of the Netherlands as an international hub in tax avoidance.

In 2012, the role of the Netherlands in European tax avoidance attracted a lot of public attention and anger. This was caused by the news that Jerónimo Martins - owner of Portugal's largest supermarket chain - sold its shares to the company's Dutch subsidiary. According to experts, this was for tax reasons.³ The present study contributes to the debate by examining the role of the Netherlands in reducing tax payments of Portuguese MNCs in Portugal, based on bilateral investment flows and the business case of EDP.

After a brief explanation of the methodology used, the paper analyses to which extent investment flows from Portugal to the Netherlands can be attributed to tax planning. It also describes the opportunities provided by the Netherlands to international companies to avoid taxes. For detailed information on the Dutch tax system we refer to previous publications.⁴ This paper also includes a business case that shows that Portuguese companies routed their tax planning through the Netherlands, even before the crisis and with an active contribution from the Dutch state. Finally we

¹ Richard Murphy, 'Closing the European Tax Gap. A report for Group of the Progressive Alliance of Socialists & Democrats in the European Parliament'. February 2012,

http://www.socialistsanddemocrats.eu/gpes/media3/documents/3842_EN_richard_murphy_eu_tax_gap_en_120229.pdf

² European Commission website, 'Budget 2013 in figures', http://ec.europa.eu/budget/figures/2013/2013_en.cfm

³ 'Holanda tem regime de SGPS "muito favorável" – fiscalista', Agência de Notícias de Portugal, 3 January 2012, <http://www.rtp.pt/noticias/index.php?article=515090&tm=6&layout=121&visual=49>.

⁴ SOMO, The Netherlands. A tax haven?, November 2006, http://somo.nl/publications-en/Publication_1397. The global problem of tax havens: The case of the Netherlands, January 2007, http://somo.nl/publications-nl/Publication_3464-nl. See also the update of this publication from May 2008, http://somo.nl/publications-nl/Publication_3463-nl; Tax haven and development partner. Incoherence in Dutch government policies?, June 2007 http://somo.nl/publications-en/Publication_2088

describe the possibilities for political intervention and recommendations on how the Dutch government can close the fiscal gap.

Lack of transparency is an important barrier to identifying tax avoidance and the role played therein by conduit countries such as the Netherlands. Considering that crucial financial information is not publicly available, and companies themselves do not provide sufficiently detailed information in response to queries regarding their tax planning structures, the conclusions of tax-related company research, including this report, are sometimes hypothetical. Lack of transparency is therefore one of the main recommendations of this report: more financial transparency is necessary to effectively tackle tax avoidance and the resulting tax base erosion by companies. Furthermore, it is important that deals that the tax authorities make with companies, such as EDP's Advance Pricing Agreement described in this report, are regularly scrutinised by the Dutch authorities and parliament for potential double non-taxation.

Methodology

For the study on investment flows between the Netherlands and Portugal, we use data from the IMF and the Organisation for Economic Co-operation and Development (OECD) on foreign direct investment. For the outline of Special Financial Institutions (SFIs) in the Netherlands, we use data from the Dutch Central Bank ('De Nederlandsche Bank', DNB) and the Central Bureau of Statistics (CBS).

The business case of Energias de Portugal (EDP) is based on information from the 2008 to 2012 financial statements of the company. Own calculations were made to estimate the interest rates that EDP's Dutch holding company levies on loans it provides to Spanish and Portuguese subsidiaries. These estimates were submitted to the company itself and to a tax expert for revision. Their comments were included in the business case. Furthermore, we analysed agreements between the company and the Dutch tax authorities, made between 2007 and mid-2012.

SOMO follows a standard review procedure whereby before publication companies in question are given the opportunity to respond. A draft version of the research findings were presented to EDP, with the opportunity to react, to indicate factual inaccuracies and to provide additional information. EDP commented extensively on the findings, these comments were included in the business case.

2. Portugal in crisis - tax avoidance via the Netherlands

The crisis has struck hard in Portugal. In December 2012, unemployment rose to 16.5 percent of the workforce and hovered around 17 percent at the end of July, well above the EU average of 10.5 percent; youth unemployment amounts to more than 40 percent.⁵ Also in this Mediterranean country, the government raised taxes on the middle-class and cut spending as a condition of the troika. On Sunday 3 March 2013 demonstrations took place in more than twenty Portuguese cities, which mobilised between 1 and 1.5 million people. This represents massive popular protest, given that Portugal has around 10 million inhabitants. The country suffers from the cutbacks and the economy is in a seemingly endless crisis, with an expected growth rate of no more than 1 percent in the coming years.⁶ After more mass mobilisations and two general strikes in May and June against the austerity measures, the finance minister Vitor Gaspar resigned, intensifying the country's political crisis.⁷ Portugal recently increased its income tax to generate more public revenue. Greece took similar measures at the beginning of the Greek crisis: a tax increase was used to cover the deficit, a burden which is largely carried by the poor and middle class income groups. The Portuguese draft budget for 2013, however, also provides for an increase in withholding taxes on outbound taxable income, a measure that targets internationally operating companies. Since 2012, Portugal has stepped up efforts to counter double non-taxation by international profit shifting (Law 55-A/2012). It does so by increasing the tax rate from 30 to 35 percent on income of non-resident entities that enjoy a privileged tax regime in their country of residence. Also transparency, in particular the disclosure of the ultimate beneficial owner of an income, is high on Portugal's agenda. Law 55-A/2012 provides for the same tax increase on investment income of non-residents, paid to or made available to bank accounts of one or more holders, when the identity of the ultimate beneficial owner is not disclosed.⁸ Companies, however, have ample opportunities to avoid tax increases with 'tax planning' measures, with the help of the Netherlands.

According to the Portuguese Central Bank, foreign direct investment in 2011, during the crisis, grew by 134 percent.⁹ Questions in the European Parliament in January 2012 suggest that this phenomenon is the result of large-scale fiscal planning by Portuguese companies.¹⁰ Given that the Netherlands is the biggest investor in Portugal (see chapter 3), this harmful erosion of the tax base is attributed to Dutch mailbox companies. The Soares dos Santos family, which sold 56.4 percent of its shares in the

⁵ Eurostat news release, 19/2013, 'December 2012: Euro area unemployment rate at 11.7%', 1.2.2013, http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-01022013-BP/EN/3-01022013-BP-EN.PDF.

⁶ 'Portugal's Architect of Austerity Resigns After Nationwide Protests', 4.7.2013, http://therealnews.com/t2/index.php?option=com_content&task=view&id=31&Itemid=74&jumival=10399

⁷ 'Portugal's finance minister resigns', The Guardian, 1.7.2013, <http://www.guardian.co.uk/business/2013/jul/01/portugal-finance-minister-resigns>.

⁸ See Deloitte, 'Portugal Tax Alert', 16.11.2012, http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dtl_tax_alert_Portugal_161112.pdf.

⁹ 'Portuguese 'letterbox companies' in the Netherlands', Parliamentary Questions by Rui Tavares (Verts/ALE) and Bas Eickhout (Verts/ALE), 25 January 2012, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2012-000499+0+DOC+XML+V0//EN>.

¹⁰ 'Portuguese 'letterbox companies' in the Netherlands', Parliamentary Questions by Rui Tavares (Verts/ALE) and Bas Eickhout (Verts/ALE), 25 January 2012, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2012-000499+0+DOC+XML+V0//EN>.

Jerónimo Martins business to one of its Dutch subsidiaries¹¹ was explicitly mentioned. The company owns, among other things, the supermarket chains Biedronka (Poland), Pingo Doce and Recheio (Portugal) and works together with Unilever producing consumer goods.¹² According to the Portuguese daily newspaper Público, nineteen of the twenty largest Portuguese listed companies founded letterbox companies in the Netherlands in 2011 for the purpose of tax planning.¹³

Table 1: Some Portuguese listed companies with a holding company in the Netherlands¹⁴

Company	Turnover	Dutch holdings and/or investment institutions
Galp Energia Sgps SA (oil and gas)	€ 18,508,000,768	Galp Energia Portugal Holdings BV
EDP - Energias De Portugal SA (energy)	€ 16,339,865,856	EDP Finance BV
Jerónimo Martins (distribution, production)	€ 10,875,798,784	Sociedade Francisco Manuel dos Santos BV
Portugal Telecom SGPS SA (telecommunication)	€ 6,597,799,936	Portugal Telecom International Finance BV
Sonae (distribution, real estate)	€ 5,378,024,320	Sonae Investments BV
Banco Comercial Portugues (bank)	€ 4,793,511,040	BCP Investment BV
Mota Engil Sgps SA (construction)	€ 2,243,167,616	Mota-Engil Finance BV
Cimpor-Cimentos De Portugal (cement)	€ 2,008,156,992	Cimpor Financial Operations BV
Semapa-Sociedade De Investimento (paper)	€ 1,952,568,352	Seinpar Investments BV
Portucel SA (paper)	€ 1,501,618,816	[1]
Sonaecom SGPS SA (telecommunication, media)	€ 825,6000,000	Sonaetelecom BV

[1] Pedro Queiroz Pereira owns more than 75 percent of the pulp and paper industrial company Portucel via Semapa. Seinpar Investments BV is wholly owned by Semapa.¹⁵

The figures in this report show (see graphs 2 and 3) that the Netherlands is the biggest investor in Portugal and in turn receives the largest part of Portugal's foreign direct investment. These capital flows are largely connected with activities of Netherlands-based mailbox companies, categorised as Special Financial Institutions (SFIs) by DNB. These are therefore investments that are channelled through the Netherlands to make use of the Dutch fiscal regime.

In this paper, the case of Portuguese energy company Energias de Portugal shows that - while the crisis has exacerbated the problem - the Netherlands served as a tax haven for Portuguese companies even before the crisis. Moreover, the case shows that the Dutch government plays an active role in this process. By investing through the Netherlands, earnings and expenses can be manipulated, and tax payments in the country where economic activities take place can be reduced. Moreover, the Dutch tax authorities can give guarantees for this tax planning in the form of tax rulings that are not public and that are not automatically exchanged with tax authorities elsewhere. The fact that nineteen of the twenty largest Portuguese listed companies have financial holding companies in the Netherlands points out that tax planning via the Netherlands takes place routinely. As a result, the Portuguese state can rely less on the strongest shoulders in times of austerity.

¹¹ Sociedade Francisco Manuel dos Santos BV.

¹² Jerónimo Martins Annual Report 2012, <http://www.jeronimomartins.pt/media/509135/annualreportjeronimomartins2012.pdf>.

¹³ 'Portuguese 'letterbox companies' in the Netherlands', Parliamentary Questions by Rui Tavares (Verts/ALE) and Bas Eickhout (Verts/ALE), 25 January 2012, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2012-000499+0+DOC+XML+V0//EN>.

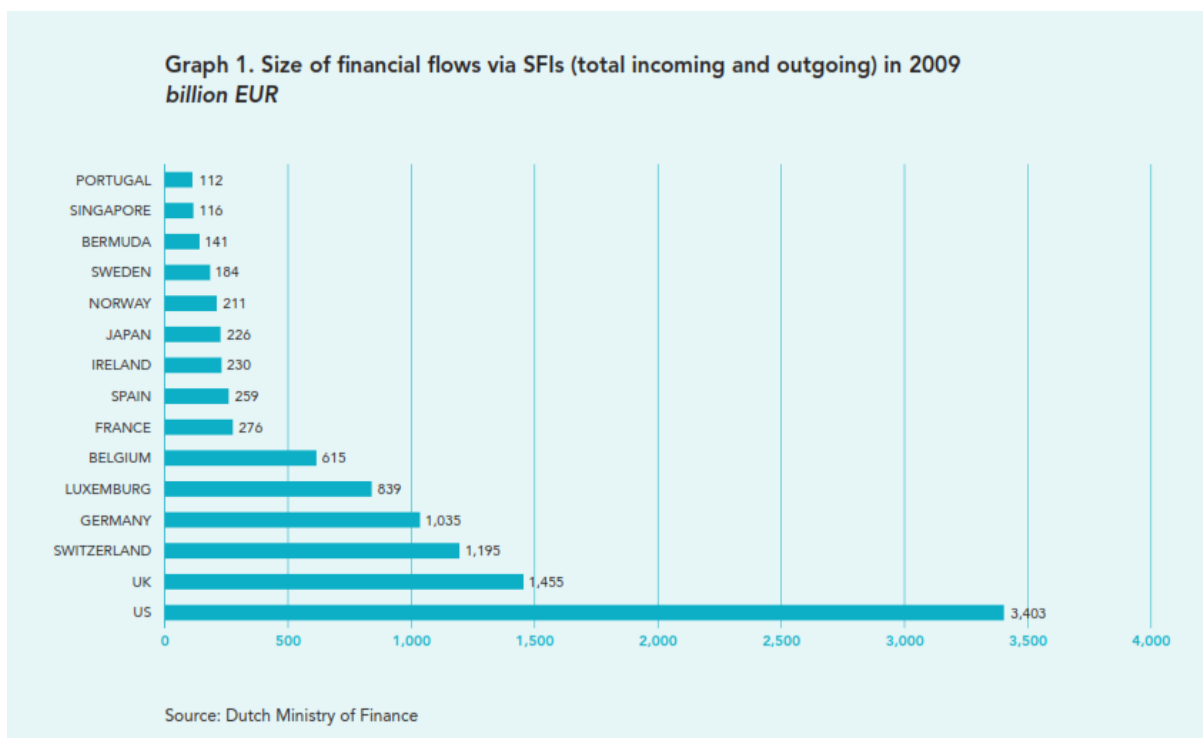
¹⁴ Sources: Bloomberg, Dutch Chamber of Commerce. A number of companies have set up more than one Dutch financial holding company or other Dutch BVs (Ltds) for investments.

¹⁵ Blandina Costa, 'Business: Portuguese companies move abroad seeking better conditions', Portugal Daily View, 4 December 2012, <http://www.portugaldailyview.com/01-economy/business-portuguese-companies-move-abroad-seeking-better-conditions>.

3. Investments between the Netherlands and Portugal

3.1 Investment flows between the Netherlands and Portugal

The total accounts receivable owed to SFIs - established in the Netherlands - by Greece, Italy, Portugal and Spain grew from € 178 billion to € 304 billion (+ 71 percent) between 2006 and 2011.¹⁶ The debts owed by Dutch SFIs to these countries grew in this period from € 72 billion to € 163 billion (125 percent).¹⁷ This is in stark contrast to the developments of the receivables and debts by Dutch SFIs to Germany, for instance, where the increase in debt was 73 percent in this period and the increase in receivables, 13 percent. Graph 1 shows that in 2009, according to figures of DNB, Portugal was the fifteenth country in volume of financial flows routed via SFIs.¹⁸



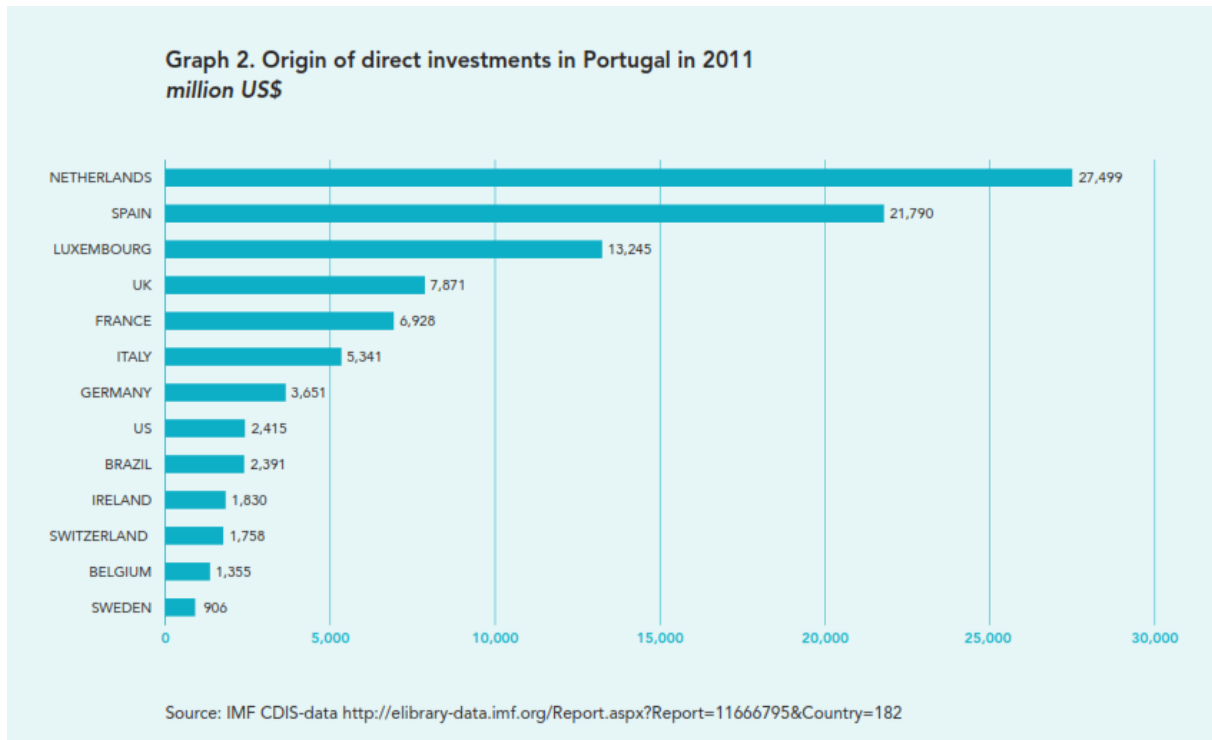
Looking at direct investments that enter and leave Portugal, it is striking that the Netherlands is the main destination for Portugal. Graph 1 is based on investment flows and graphs 2 and 3 on investment stocks. Flows are measured annually and stocks are investments that are built up over

¹⁶ DNB, Table 1: 'Vorderingen en schulden van BFI's op het buitenland', http://www.dnb.nl/binaries/Tabellen_tcm46-284530.pdf.

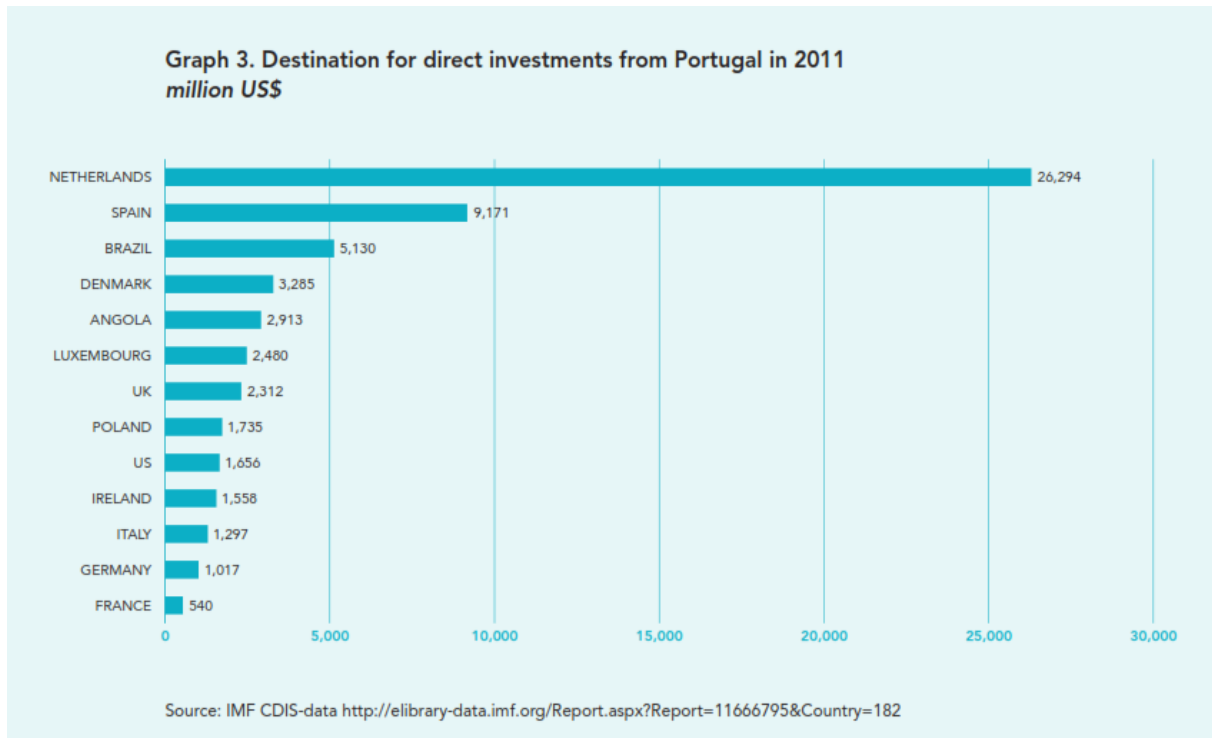
¹⁷ Ibid.

¹⁸ Ministry of Finance, Directorate international tax matters, "Beantwoording Kamervragen van de heer Braakhuis op 30 mei 2011: <http://www.rijksoverheid.nl/bestanden/documenten-en-publicaties/kamerstukken/2011/05/30/beantwoording-kamervragen-over-geldstromen/beantwoording-kamervragen-over-geldstromen.pdf>.

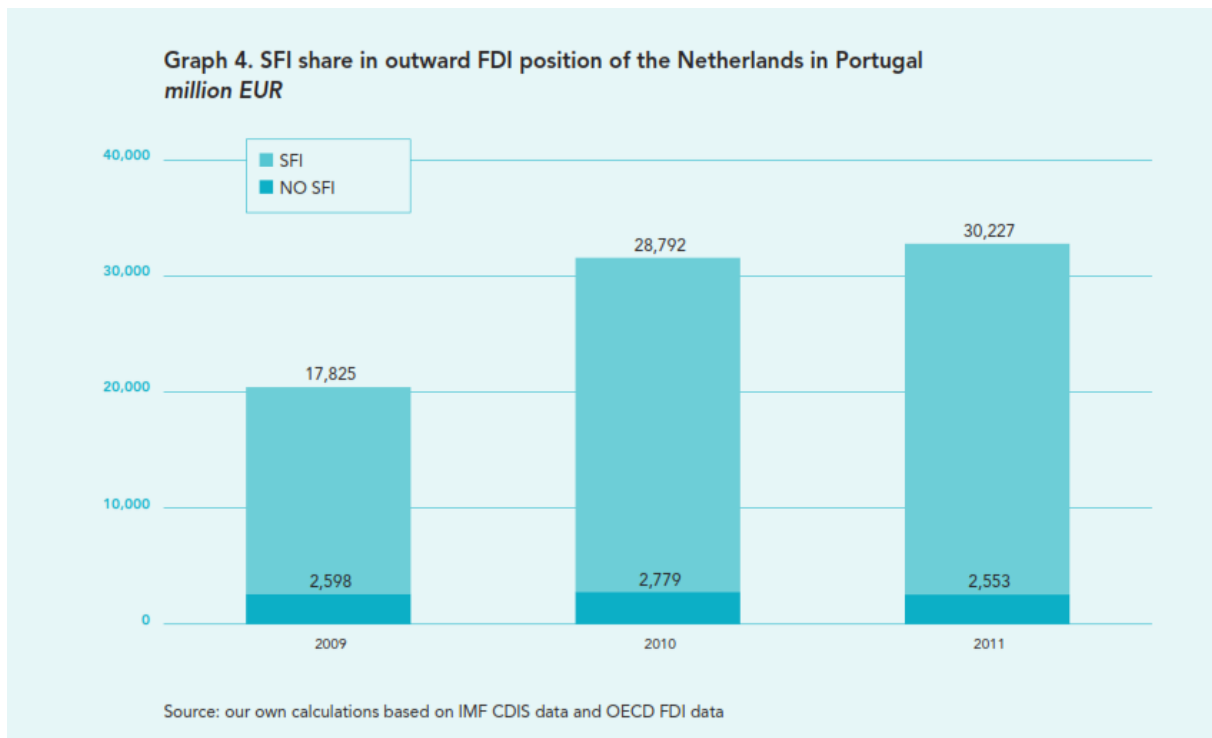
time. Another difference between these data sets is that graph 1 only shows investments by SFIs, while graphs 2 and 3 show all investments, including SFIs. Graph 2 shows that in 2011, 25 percent of all investments from abroad to Portugal came from the Netherlands. In 2009, Spain was the largest investor in Portugal with 21 percent (US\$ 24,129 million). The Netherlands held the second place of total foreign investment with 19 percent (US\$ 21,462 million). During the European financial crisis (Euro crisis), investments from Spain remained the same while investments from the Netherlands rose by US\$ 6 billion, as shown in graph 2.



Graph 3 shows that the Netherlands attracts most of Portugal's FDI. In 2011, the Netherlands received 38 percent of all Portuguese investments. This is more than the following five countries with the largest investments from Portugal together, namely, Spain, Brazil, Denmark, Angola and Luxembourg. In 2009 also, the Netherlands was the largest receiver of Portuguese investments. Then, the Netherlands received 26 percent (US\$ 17,651 million). Also in the case of outward investments we can see that the flows to the Netherlands increased during the Euro crisis.



The graphs above are based on IMF data. The OECD also keeps figures on bilateral direct investment. However, the OECD filters the financial flows that run through SFIs. If we subtract these figures from the IMF data, the SFI portion of total direct investment remains. Unfortunately, this can only be done for outward investments from the Netherlands. The result is shown in the graph below. It is striking that the figures for outward investment for the Netherlands (graph2) are higher than the figures in the same IMF dataset for inbound investments in Portugal (graph 3). The difference is caused because different national statistical offices are responsible for supplying data. The figures held by the Netherlands about inbound and outbound investments are not the same as Portugal indicates. However, the comparison between the IMF and OECD data sets allow us to draw conclusions with regard to the proportion of direct bilateral investment vis a vis investment that is routed via SFIs. The most important aspect of graph 4, therefore, is not to show the exact investment flows through SFIs but the ratio between investments of SFIs and non-SFIs.



Most investments from the Netherlands to Portugal are thus routed through SFIs. We can assume that investments from Portugal to the Netherlands are routed through SFIs as well. The Netherlands therefore serves as a financial conduit. Portuguese companies invest in Portugal and other countries via the Netherlands. To assess the importance of Portugal's role in Dutch SFI investment flows, we can see that 0.9 percent of all investments of SFIs in the Netherlands went to Portugal in 2011 (graph 4). Considering Portugal is a relatively small economy and the Netherlands is one of the world's biggest investors due to its conduit SFI structures, this is a substantial percentage.

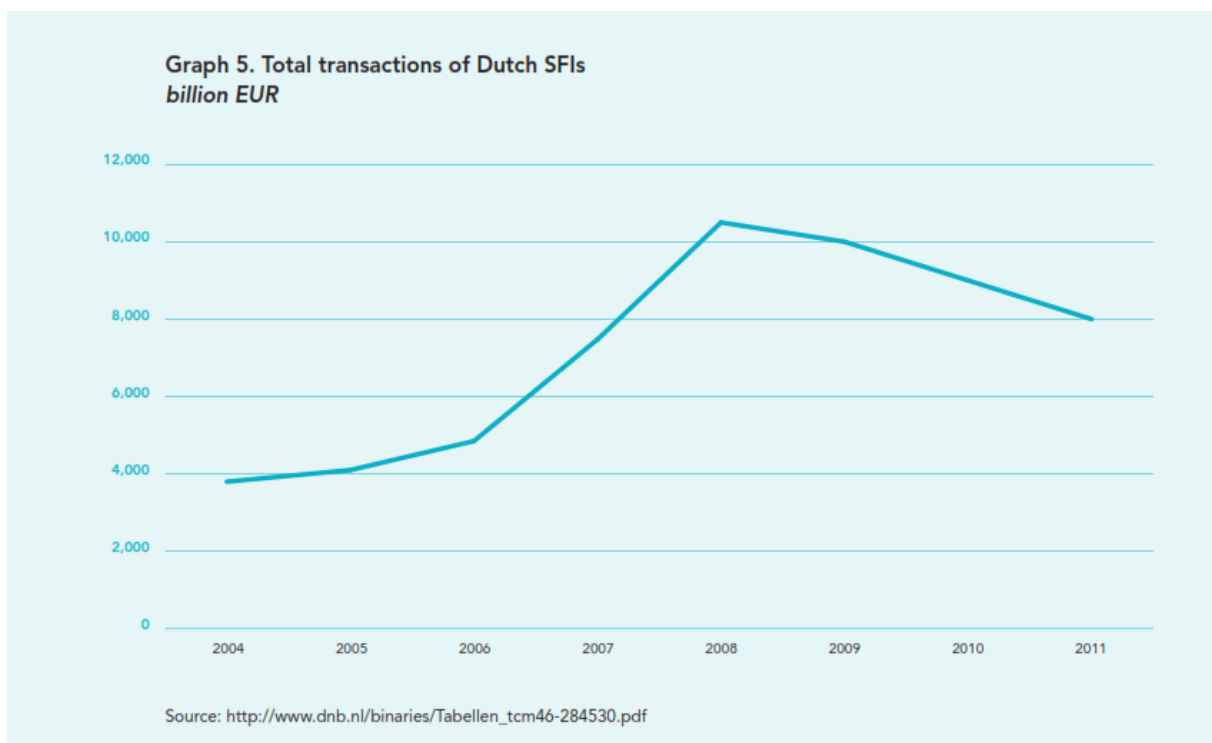
Based on CBS data we know how much profit was made by the SFIs established in the Netherlands. In 2011, this was € 26 billion interest income and € 70 billion dividends from investments. In total: a € 96 billion profit.¹⁹ If we assume for convenience that every euro invested yields the same profit, this means that Dutch SFIs with a Portuguese origin made profits worth € 865 million in the Netherlands. If we apply this method to calculate the last three years, we get an amount of € 2.5 billion. This amount is the portion of profit made by SFIs in the Netherlands, which is proportional to the stock of outbound investments by SFIs from the Netherlands to Portugal. This amount is not the avoided tax in Portugal, but rather is an indication of profit shifting, which is a precondition for avoiding taxes. It is important to see that many tax avoidance techniques are not necessarily captured by these figures. The main technique which is not included is 'transfers (mis)pricing' that is the manipulation of prices on intra-group transactions so that profit falls within a tax-favourable jurisdiction. It is also important to note that in certain tax planning constructions, profit in the Netherlands is kept low. This especially applies to group financing operations, such as the ones described in the following study on EDP, whereby a Dutch entity is used to route funding from the capital market or other group firms to finance group subsidiaries in operating countries.

¹⁹ CBS Statline, <http://statline.cbs.nl/statweb>.

In conclusion, it can be said that the Netherlands has a special relationship with Portugal. The Netherlands is the country where most investments come from and go to. These investments flow for the greater part through SFIs. The Netherlands is thus used as a financial conduit country. The scale of investment flows and profits made by SFIs in Netherlands are a rough indication of the extent to which MNCs from Portugal use the Netherlands to reduce their tax burden.

3.2 The Netherlands: a tax haven

The Netherlands is the EU's biggest tax haven if we measure inbound and outbound investments attributable to SFIs, as these investments have no relationship with the Dutch economy. These are empty shells, with no economic activities in the Netherlands. It is estimated that there are currently 23,500 letterbox companies in the Netherlands. This figure also includes conduit entities that are not classified as SFIs by DNB. The number of SFIs as defined by DNB was estimated at 11,500 in 2010.²⁰ Graph 5 below shows how strongly the investment flows, which run through SFIs, increased until 2008 and then decreased by more than € 2,500 billion.²¹ Despite this sharp decrease, total flows in 2011 were more than thirteen times larger than the GDP of the Netherlands in the same year. This shows that the size of the Netherlands as a financial transit country is truly enormous.



The Netherlands is not alone in facilitating tax avoidance. It operates in a broad network which involves on the one hand major financial centres such as London and New York and on the other

²⁰ De Nederlandsche Bank, 'Statistical Bulletin December 2010', http://www.dnb.nl/en/binaries/Statistical%20Bulletin%20DNB%20%20December%202010_tcm47-246952.pdf.

²¹ Figures from DNB, Table 1: 'Vorderingen en schulden van BFI's op het buitenland', http://www.dnb.nl/binaries/Tabellen_tcm46-284530.pdf.

hand mini-states and islands in the Channel and the Caribbean.²² The latter group mainly provides opportunities to park capital because of very low taxes and little transparency. These are the terminals of the network of tax havens. According to estimates by JP Morgan, companies have tucked away US\$ 1,700 billion in such tax havens.²³

The Netherlands is not the final destination of capital gains and assets, but a financial transit port of capital.²⁴ Just as the port of Rotterdam imports many goods in order to export them, so-called re-exports, a large amount of capital flows into the Netherlands to flow through or out again. The value of the transactions in graph 1 and 2 is composed of capital inflow and outflow. The Netherlands is a country where companies can legally avoid tax which would otherwise be taxed in other countries.

The main features of the Netherlands as a tax haven are the extensive network of bilateral tax and investment treaties, participation exemption,²⁵ the possibility to make prior arrangements on transfer pricing with the tax authorities (Advance Tax Rulings (ATR) and Advance Pricing Agreements (APA)) and the existence of a well-developed trust sector. There is also no withholding tax on outgoing royalties, interest and, in many cases, dividends. Another element is the political stability of the Netherlands and its solid reputation as a financial centre. In this study about *Energias de Portugal*, the issues of withholding tax on interest payments in conjunction with European law and unilateral APAs is particularly striking. An APA is an agreement on an appropriate 'transfer pricing' methodology for a series of transactions over a certain period, which determines the profit (spread) of a company attributed to the Netherlands.

Profit shifting with transfer pricing

Transfer pricing are the prices sister companies charge for transactions, including interest payments for group loans. These prices largely determine where the profit falls within the group. They can create tax advantages if there are differences between the corporate taxes applied by the countries where the sister companies are located. International rules such as the OECD Model Tax Convention, its Commentaries and corresponding Transfer Pricing Guidelines state that intra-group transactions should take place under the same conditions as transactions between independent third parties. In the Netherlands this principle was set out on 1 January 2002 in Article 8b of the Corporate Tax Act.²⁶

²² A good description of the global network of tax havens can be found in: Ronen Palan et al (2010). Tax Havens: How globalization really works. Cornell University Press.

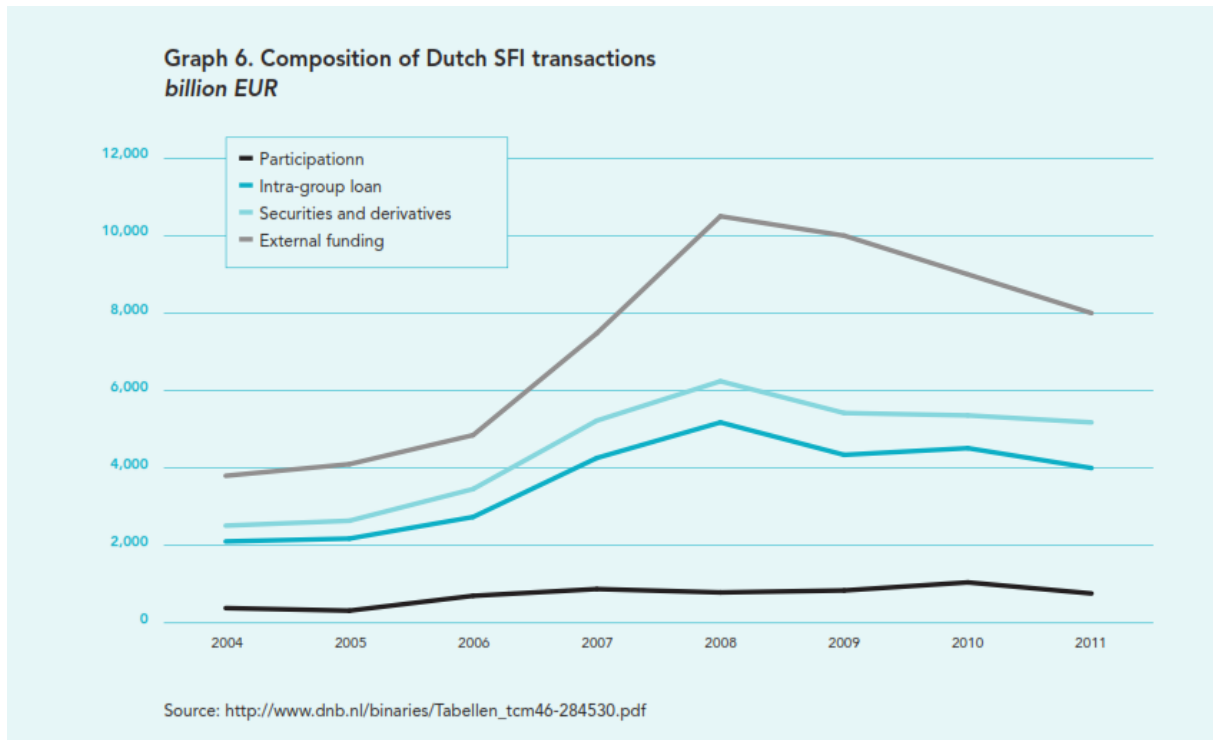
²³ This study is quoted in: OECD (2013). Addressing Base Erosion and Profit Shifting. OECD Publishing. <http://www.oecd.org/ctp/BEPSENG.pdf>.

²⁴ SOMO, The Netherlands. A tax haven?, November 2006, http://somo.nl/publications-en/Publication_1397.

²⁵ Whereby income from dividends from a qualifying participation in the multinational group are exempt from corporate income tax in the Netherlands.

²⁶ See, amongst others, PricewaterhouseCoopers 'Transfer pricing en intragroep financiële transacties', undated, <http://www.pwc.nl/nl/spotlight/assets/documents/9.transferpricing.pdf>.

Graph 6 below shows that on-lending within the own group is particularly important in the total transactions of Dutch SFIs. The total transactions of SFIs in the field of corporate loans amounted in 2011 to € 3,327 billion. The total transactions (incoming and outgoing investment flows) in the field of attracting external capital and internal on-lending within the group amounted to € 4,500 billion in 2009 and € 2,800 billion in 2011. This shows that the activities of *Energias de Portugal* in the Netherlands are not an isolated incident but systematic.



4. Energias de Portugal (EDP)

4.1 Introduction

Energias de Portugal, with a turnover of more than € 14 billion, is the largest Portuguese electricity and gas company. Until recently, the Portuguese state was partly owner of the company, but in December 2011 it sold its stake of 21.35 percent to the Chinese state-owned company Three Gorges. The privatisation was completed in February 2013 with the sale of the remaining state-owned shares of 4.14 percent.²⁷ The company operates in thirteen countries in Europe, North America and Brazil, but still generates its largest turnover in Europe.

Like virtually every company of its size, EDP issues debt to finance its expenditure. EDP established a Dutch subsidiary for this purpose. At the end of 2012, 74 percent of all debt of the group was borrowed through a Dutch subsidiary (EDP Finance BV).²⁸ EDP Finance BV lends this money on to Spanish and North American subsidiaries and the Portuguese parent company.

4.2 Mailbox companies: empty shells without 'substance'

EDP Finance BV can be classified as an empty mailbox company since the company is not materially present in the Netherlands (i.e. it has no 'substance'). The formal directors are 'trust' staff who receive no significant remuneration (€ 5800 in 2008). In a response, EDP Finance BV states that the concentration of total group loans by the Dutch subsidiary gives non-tax-related benefits, such as benefits of scale and costs related to raising funds separately for each subsidiary. However, materially speaking, the Dutch entity does not fulfil these functions, which makes it seem that the Ltd is only registered in the Netherlands to make use of tax benefits in the Netherlands. Activities (collecting and passing on money from the market, risk management and all decisions) are entirely executed by the head office in Lisbon, as confirmed in several passages in the commercial annual accounts.²⁹ Apart from the trust direction, the Dutch subsidiary has no employees.

The Dutch entity has concluded a service agreement with the Portuguese parent company (EDP - Energias de Portugal S.A.) to carry out the work, with an annual fee paid by EDP Finance BV to its parent.³⁰ Moreover, there is a 'keep-well' agreement with the Portuguese parent. Under this agreement, the headquarters in Lisbon promise to make available funds to meet its Dutch subsidiary's payments obligations.³¹

²⁷ EDP's response to the draft version of the research findings, 25 March 2013.

²⁸ EDP's response to the draft version of the research findings, 25 March 2013.

²⁹ "EDP – Energias de Portugal S.A. is responsible for providing financial management services such as negotiating and contracting funding and derivatives instruments, providing treasury management services, coordinating the rating attribution and updating process and generally supporting the relationship with the banking system."; "... the Financial Department of EDP – Energias de Portugal, S.A. manages EDP Finance BV's exchange rate risk exposure resulting from foreign currency loans/borrowings, seeking to mitigate the impact of exchange rate fluctuations on the financial costs of the Company.. "; " .. by arranging , managing and maintaining (door EDP S.A.) all debt portfolios of the Company, based on the total amount of existing debt to manage ..", EDP Finance BV Annual Report 2011, p13-18.

³⁰ EDP Finance BV Annual Report 2011, p18.

³¹ "In case the Company shall have insufficient funds or other liquid assets to meet its payment obligations (including in respect of any Debt Obligations) at any time, EDP - Energias de Portugal S.A. shall make available to the Company funds sufficient

4.3 Tax benefits in the Netherlands

The lack of EDP's material activities in the Netherlands and the fact that in 2007 the company settled an advantageous APA with the Dutch tax authorities, indicate that EDP routes its loans through the Netherlands for fiscal reasons. Some of these (potential) tax benefits are outlined below. The tax authorities require companies to keep a spread between interest income and interest expenditure resulting from financing operations, so that there is at least a taxable profit in the Netherlands. A deal can be made with the tax authorities about the size of these obligatory profits, in a so-called Advance Pricing Agreement (APA) or Advance Tax Ruling (ATR).

APAs and other fiscal benefits provided in Dutch legislation, such as the participation exemption, are only beneficial to internationally operating companies because the Netherlands does not levy withholding taxes on outgoing payments (in the case of dividends the statutory 15% WHT can easily be circumvented³²). Because of the lack of withholding taxes on interest, EDP does not pay tax on its loans. Its Spanish and Portuguese related companies, which have to pay interest to the Dutch financing subsidiary EDP Finance BV, also pay little or no interest taxes because of the so-called EU Interest and Royalties Directive (see figure 1).³³ Since 2006, the fiscal advantage due to lack of withholding taxes on outgoing interest payments for international group financing is also available to corporations in Portugal. Although Portugal has a statutory withholding tax on outbound interest payments of 25 percent (and 35 percent if it is paid to tax havens)³⁴, a 2006 exemption to this rule applies for interest payments on public and private bonds.³⁵ As of 2006, EDP therefore has the same advantages with an incorporated financing subsidiary in Portugal. However, the Dutch subsidiary was incorporated in October 1999, and the Netherlands still offers special deals on transfer prices. This deal with the Dutch revenue authority is discussed below.

4.3.1 Advance Pricing Agreement led to double non-taxation

According to the EDP's annual accounts, the company settled an APA in 2007. This led to double non-taxation for a large part of EDP Finance BV's interest income profits (the APA was cancelled, however, at the end of 2012 with retroactive effect). The APA specified a very small spread, that is, the minimum taxable income allocated to the Netherlands, as an 'arms-length return on equity plus a spread of 0.03 percent on on-lent funds, minus operational cost.³⁶

to enable the Company to meet such payment obligations in full as they fall due. However, the keep-well agreement is not a guarantee [...]", EDP Finance BV Annual Report 2011, p15.

³² The rate for inter-company dividends (for foreign shareholders) is often reduced, in many cases even to nil percent, due to application of tax treaties or the implementation laws based on the EU Parent Subsidiary Directive (2003/123/EC). No Dutch dividend withholding tax is levied for qualifying Dutch Cooperations (Coöperaties) and there is an indirect tax credit for re-distributed dividends. Finally, a branch structure can also lead to no withholding tax on dividends. See also 'Dutch withholding taxes on outbound payments' at http://tax-consultants-international.com/read/Dutch_withholding_taxes#2.

³³ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. This EU law ensures that companies based in the European Union are not subject to interest tax if they pay them to sister companies within the EU. However, the Netherlands does not have this limitation and payment of interest charges to tax havens can be deducted from the profits.

³⁴ Deloitte (2013) Portugal Highlights 2013. http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/2013/dttl_tax_highlight_2013_Portugal.pdf.

³⁵ The exemption is laid down in 'Regime Especial de Tributação dos Rendimentos de Valores Mobiliários Representativos de Dívida', Decreto-Lei 193/2005, 7 November, <http://www.dre.pt/cgi/dr1s.exe?t=dr&cap=1-1200&doc=20053128%20&v02=&v01=2&v03=1900-01-01&v04=3000-12-21&v05=&v06=&v07=&v08=&v09=&v10=&v11=%27Decreto-Lei%27&v12=&v13=&v14=&v15=&sort=0&submit=Pesquisar>.

³⁶ EDP Finance BV Annual Report 2008, p20.

At the beginning of 2010 the Dutch subsidiary had an equity of € 23 million, while it had lent on more than € 10 billion. As a result of the APA, EDP Finance BV had a tax burden of less than € 1 million in 2010, although the company had a net interest income of € 63 million (after deduction of operational costs and expenses). According to the Tax Justice Network this illustrates that unilateral APAs can lead to almost complete double non-taxation of group interest payments, because the payments are tax deductible in one Member State, but largely excluded from the tax base in another Member State. This double non-taxation is facilitated by lack of legislation and of information exchange on a unilateral agreement with the tax authorities in another country.³⁷

The following table presents key figures from annual reports (2008 to June 2012) of EDP Finance BV before the APA was cancelled with retroactive effect. These figures show that between 2008 and June 2012, EDP made more than € 140 million profits in interest income in the Netherlands, while the company only paid € 5 million in corporate income tax, which amounts to an average tax rate of 5.36% over five years.

Table 2: Tax rate EDP Finance BV³⁸ before the cancellation of the APA at the end of 2012

€ x1000	Profit before taxes	Taxes paid	Effective tax rate
2008	7.075	465	6.57%
2009	7.743	645	8.33%
2010	62.757	873	1.39%
2011	43.021	2.210	5.14%
2012(interim report) ³⁹	21.740	1.167	5.37%
Average tax rate over 5 years			5.36%

An average corporate tax rate of 5.36 percentis remarkable, because the statutory corporate income tax rate in the Netherlands is 25 percent. In its annual accounts EDP Finance BV explains this difference by "an Advanced Pricing Agreement settled with the Dutch tax authorities, which establishes the taxable turnover under certain assumptions and requirements".⁴⁰

However, according to Dutch law, an APA determining a 'transfer pricing' method that is beneficial for the company can keep the spread (i.e. the profit that is allocated to the jurisdiction) low in the Netherlands, but not reduce the income tax rate paid on those profits. EDP would have to pay a regular corporate tax rate on the earnings in the Netherlands - after deducting interest expenses. Consulted tax specialists do not know how to interpret the brief explanation in the financial statements of EDP Finance BV. "Dutch tax authorities cannot offer anything in advance to anyone by way of agreement that deviates from law and jurisprudence, and they never do that," says a tax expert who was a member of the ruling team of the tax authorities which negotiates APAs, among other things.

³⁷ EDP case in 'Summary report of the responses received on the public consultation on factual examples and possible ways to tackle double non-taxation cases', European Commission, TAXUD D1 D(2012), 5 July 2012, http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/double_non_tax/summary_report.pdf

³⁸ Figures from the Annual Report of EDP Finance BV 2009-2012.

³⁹ These figures are taken from the interim 2012 Annual Report of 30 June 2012, before the APA was withdrawn and the tax payments corrected.

⁴⁰ "EDP Finance settled a advanced pricing agreement with the Dutch Tax authorities that determines the taxable amount of the company under certain requirements and assumptions. This APA explains the difference between the Dutch statutory tax rate of 25% and the effective tax rate in the table above." Annual Report EDP Finance BV 2011, p18.

The problem of APAs in this case is not that a prior pricing agreement leads to a lower taxable spread in the Netherlands. After all, the Dutch company does not do anything to earn this profit and all risks are borne elsewhere, in this case, in Portugal. However, it is a problem that the Netherlands apparently makes agreements with companies which leads to the situation that the profits are not taxed elsewhere and thus to double non-taxation. The fact that there is an APA that strongly minimises the tax base in the Netherlands is explicitly mentioned in EDP's annual accounts. Of course, the profit which is not taxed in one jurisdiction as a result of an APA, should be taxed elsewhere (presumably in Portugal), because an agreement with the Dutch revenue authority should not lead to an international tax gap.

We can only speculate about the reasons why the Portuguese tax authorities did not raise the question of tax base erosion with the Dutch tax authorities. It may be that the Portuguese tax authorities were not aware of this APA (until its publication in June 2012) or that Portugal saw no reason and/or possibility to tax the profits that were commercially allocated but not taxed in the Netherlands in Portugal. There may also be a qualification difference in the legislation or its implementation, as a result of which those profits are not treated as taxable in Portugal.

Possible functional analysis of EDP Finance BV in establishing an accurate transfer price

The determination of an appropriate transfer price is always preceded by a functional analysis. This analysis seeks to identify and compare the economically significant activities and responsibilities undertaken by the independent and associated enterprises for the group. Given the information provided in EDP Finance BV's annual accounts, the Dutch tax authority could have reasoned as follows in this case: EDP Finance BV itself does not carry out (or not entirely) an active group financing role (such as actively seeking the most favourable financing opportunities on the capital markets and lend on these funds); this takes place at the company's head office in Portugal. The headquarters also make up deficits. Although it does not provide formal guarantees to this effect, it can be assumed that moneylenders only lend when they know that the headquarters actually make up deficits.

This functional analysis could imply that certain parts of the profits, although commercially reported in the Netherlands, should not be attributed fiscally to the Dutch subsidiary but to the head office Energias de Portugal, S.A.. This could relate to certain loans, and/or certain benefits from derivatives, because their economic importance lies solely and directly in the S.A. The following quote indicates that this reasoning may have played a role in settling this APA: *"EDP Finance settled an advanced pricing agreement with the Dutch Tax authorities that determines the taxable amount of the company under certain requirements and assumptions"*.

4.3.2 Withdrawal of the APA in 2012 - retroactively

Interestingly, the Dutch tax authorities and the company cancelled the above-mentioned APA at the end of 2012 with retroactive effect. EDP's annual account and replies to SOMO's queries were insufficiently detailed to ascertain the precise reason for this cancellation. However, it is noteworthy that this action was taken after the publication of the APA of EDP in an EC consultation document on double non-taxation in July 2012⁴¹, in a contribution by the Eurodad network, to which the Tax Justice Network is affiliated. The APA was negatively mentioned in the consultation document as being the cause of the double non-taxation of the company's interest income. Although the specific reasons to cancel the APA are not specified in the 2012 financial statement, the latter informs that the corporate tax paid was indeed lower than the statutory tax rate, and that this is now corrected:

⁴¹ Case of EDP in 'Summary report of the responses received on the public consultation on factual examples and possible ways to tackle double non-taxation cases', European Commission, TAXUD D1 D(2012), 5 July 2012, http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/double_non_tax/summary_report.pdf.

“As a result of the discussions held with the Dutch Tax Authorities, it was agreed and concluded that the APA was no longer applicable as of the year 2010. Therefore, the effective corporate tax rate of EDP Finance BV in 2011 and 2012 corresponds to the Dutch statutory tax rate of 25%”.⁴²

In its response to the findings on the low effective tax rate before the cancellation of the APA, EDP replied⁴³: “As a result of the development of EDP Finance BV’s activities, the company and the Dutch tax authorities had been discussing whether the APA remained still applicable.”

Table 3: Effective tax burden EDP Finance BV after cancellation of the APA⁴⁴

Information extracted from the Annual Reports of EDP Finance BV						
€ x1000	Accounting pre-tax profit	Yearly tax recorded in the accounts			Effective tax rate	
		Income tax expense [A]	Additional tax provision for the year [B]	Total tax payable provision [A]+[B]=[C]	Income tax expense (based on [A])	Total tax payable provision (based on [C])
2008 (*)	7.075	465	1.776	2.241	6,6%	31,7%
2009 (*)	7.743	645	1.400	2.045	8,3%	26,4%
2010 (*)	62.757	873	19.701	20.574	1,4%	32,8%
2011 (*)	43.021	2210	11.789	13.999	5,1%	32,5%
2012 (**)	14.388	3609	0	3.609	25,1%	25,1%
Total	134.984	7.802	34.666	42.468	6,0%	31,5%

(*) As per the respective Statutory Annual Report

(**) As per the 2012 Annual Report of EDP Finance BV

⁴² EDP Finance BV Annual Report 2012, p18, <http://www.edp.pt/en/Investidores/publicacoes/relatorioecontas/2012/Annual%20Report%202012/EDP%20Finance%20BV%20Report%202012.pdf>.

⁴³ EDP’s response to the draft version of the research findings, 19 April 2013.

⁴⁴ EDP’s response to the draft version of the research findings, 25 March 2013. Note: According to SOMO’s reading of EDP Finance BV’s annual report 2011, the tax provision of that year is 11.380 and not, as specified here, 11.789. Furthermore, SOMO’s calculations on the basis of the figures provided by EDP in this table result in a mean effective tax rate of 5.8% rather than 6%, as specified in this table. Questions with regard to this difference could not be clarified in time for the publication of this report. Any reply by EDP, however, will be published on SOMO’s website.

The table shows that in 2012, due to the cancellation of the Dutch APA, EDP Finance BV uses its full tax provision built over a number of years (see table 4) to increase its tax payments over several years retrospectively, by € 34.7 million in total. This leads to a higher effective tax rate, according to this table, even higher than the Dutch statutory tax rate, on the profits in the Netherlands. According to EDP, tax payments for 2008 and 2009 also increased retroactively, even though the APA is still applicable in those years.

Table 4: EDP Finance BV's tax provision and use 2008-2012⁴⁵

€ x1000	Provision made	Provision reversed	Provision used	Provision end of year
2008				2.856
2009	1.400	-1.080		3.176
2010	19.701	-1.776		21.101
2011	11.380			32.481
2012	0	-1.400	-31.081	0

When asked why the tax provisions were made in the first place, EDP informed SOMO that “as a result of the development of EDP Finance BV's activities, the company and the Dutch tax authorities had been discussing whether the APA remained still applicable. In anticipation of the outcome of this discussion, EDP Finance BV recorded a tax provision in the relevant fiscal years. This is a standard procedure which is required under the applicable accounting principles.”⁴⁶ Given that the provision increased from € 1.4 million in 2009 to € 19.7 million in 2010, it appears the Dutch authorities and EDP were discussing the applicability of the APA at least from 2010 onwards.

The APA and its cancellation are remarkable. Firstly, raises the question whether the Netherlands settled APAs with more companies that lead to double non-taxation or a substantial tax loss in other countries. Secondly, it is important to know whether the withdrawal of the APA was only beneficial for the Dutch treasury, or also for Portugal.

4.3.3 Tax benefits by 'transfer pricing' of interest payments?

Rough calculations of interest payments based on EDP's annual accounts indicate that EDP's intra-group interest charges to its Spanish and Portuguese subsidiaries are fiscally beneficial.

The following calculations assume that outstanding loans to subsidiaries at the end of the year are somewhat related to interest payments received during the year. It is not possible to calculate the exact interest rate, because interest payments in one year do not directly relate to outstanding loans at the end of a year. The outstanding amount of the loans to each subsidiary of the group changes during the year (in the course of the year loans expire and others are contracted) and the total amount shown includes loans with different maturities and currencies that are not mentioned in the annual report. According to EDP, this information is not public.⁴⁷ The difference between outstanding loans received and interest paid by Spanish and Portuguese companies to the Dutch financing subsidiary over a number of years is so great that it can only be explained by a significant difference in interest rates charged to these subsidiaries.

⁴⁵ Figures taken from EDP Finance BV's Annual Reports 2008-2012.

⁴⁶ EDP 's response to the draft version of the research findings, 19 April 2013.

⁴⁷ EDP 's response to the draft version of the research findings, 25 March 2013.

As tables 5 and 6 below show, with the methodological limitations mentioned above, loans of EDP Finance to Spanish companies seem to have higher interest rates than those of the Portuguese parent company.⁴⁸

Table 5: Loans, interest income and estimates of interest rates in 2011 (EDP Finance BV)

Sister Companies	Loans ⁴⁹	Income ⁵⁰	Interest (estimate) ⁵¹
EDP Renoveis (Spain)	€ 2,986,433	€ 152,017	5.09%
EDP Sucursal en España (Spain)	€ 3,288,505	€ 173,978	5.29%
HC Energia (Spain)	€ 1,921,236	€ 137,738	7.17%
Millenium Energy S.L. (Spain)	€ 213,551	€ 2,752	1.29%
EDP Energias de Portugal (Portugal)	€ 5,207,187	€ 78,792	1.51%
Other	€ 211,045	€ 3,365	1.59%
Total / average	€ 13,827,957	€ 548,642	3.66%
Portuguese mother company	€ 5,207,187	€ 78,792	1.51%
Spanish subsidiaries (average)	€ 8,409,725	€ 466,485	5.55%

Table 6: Spanish and Portuguese interest rates (estimate) 2010-2012

	2010	2011	2012
Portuguese parent company	1.16%	1.51%	0.69%
Spanish sister companies	5.05%	5.55%	5.66%

4.3.4 Arm's length principle

There is no evidence in the financial statements that EDP Finance BV makes use of transfer mispricing to reduce the tax burden within the group (see box). EDP states⁵² that all its interest rates are based on the arm's length principle of the OECD, which states that prices within a group should reflect the market prices charged between unrelated companies.

⁴⁸ Calculations based on figures from the Annual Report of EDP Finance BV, 2011.

⁴⁹ EDP Finance BV, Annual Report 2011, p.19 (Loans to group entities).

⁵⁰ EDP Finance BV, Annual Report 2011, p.25 (Income from transactions with sister companies).

⁵¹ Own calculation. It should be noted that it is not possible to calculate the exact interest rate, because interest payments in one year do not directly relate to loans outstanding at the end of a year. However, the difference between outstanding loans and interest paid between Spanish and Portuguese companies over a number of years remains high, so a difference in interest rates is obvious.

⁵² EDP's response to the draft version of the research findings, 25 March 2013.

EDP: transfer pricing according to the OECD Guidelines

In response to the stated interest rate difference, EDP let SOMO know.⁵³

“In accordance with international transfer pricing best practices, EDP Finance BV determines the interest rates charged on loans made to corporations of the EDP Group solely on the basis of the comparable market interest rate that would be charged by an independent third party to those same corporations, taking into account factors such as, inter alia, each entity’s credit risk profile (on a stand-alone basis), including the business sector and geographies in which it operates, and the terms and conditions in which the loans are granted, namely the maturity and currency. EDP’s methodology is properly documented in specific transfer pricing reports that are available for review by the tax authorities. As such, the different interest rates charged by EDP Finance BV to different subsidiaries simply reflect those factors and it is irrelevant for that purpose whether the actual withholding tax rate applicable to interest or the local corporate income tax rate is higher or lower in Spain or Portugal. Therefore, neither EDP Finance BV nor its Portuguese and Spanish intra-group borrowers manipulate earnings / expenses for purposes of profit shifting or tax avoidance. All transactions entered into between these companies are arm’s length priced, strictly in accordance with the transfer pricing rules applicable as per the OECD Transfer Pricing Guidelines.”

A number of factors determine the level of interest rates, such as the risk of non-repayment of a loan (credit risk), the length and terms of loans, inflation compensation and service costs. It is possible that a higher risk provision of Spanish loans, for instance, led to a higher interest rate for Spanish companies. However, EDP Finance BV itself states that the credit risk arising from loans granted to EDP groups companies is mitigated by the control that the Portuguese parent has over the management of these companies.⁵⁴

One possible reason for the low interest rate applying to the Portuguese parent compared to its Spanish subsidiaries could be that the loans from EDP Finance BV to the Portuguese parent company run no longer than one year, whilst loans to the Spanish subsidiaries are largely long-term. According to the arm’s length principle, short-term loans can have lower interest rates. However, the financial statements do not explain why these loans are contracted every year. The short-term loans appear to be renewed every year, by which they gain a long-term character. In 2012 for example, EDP Finance BV provided a short-term loan to the Portuguese parent company of € 6.9 billion and in 2011, a short-term loan of € 5.2 billion. EDP did not provide further clarification on the short-term nature of these loans.

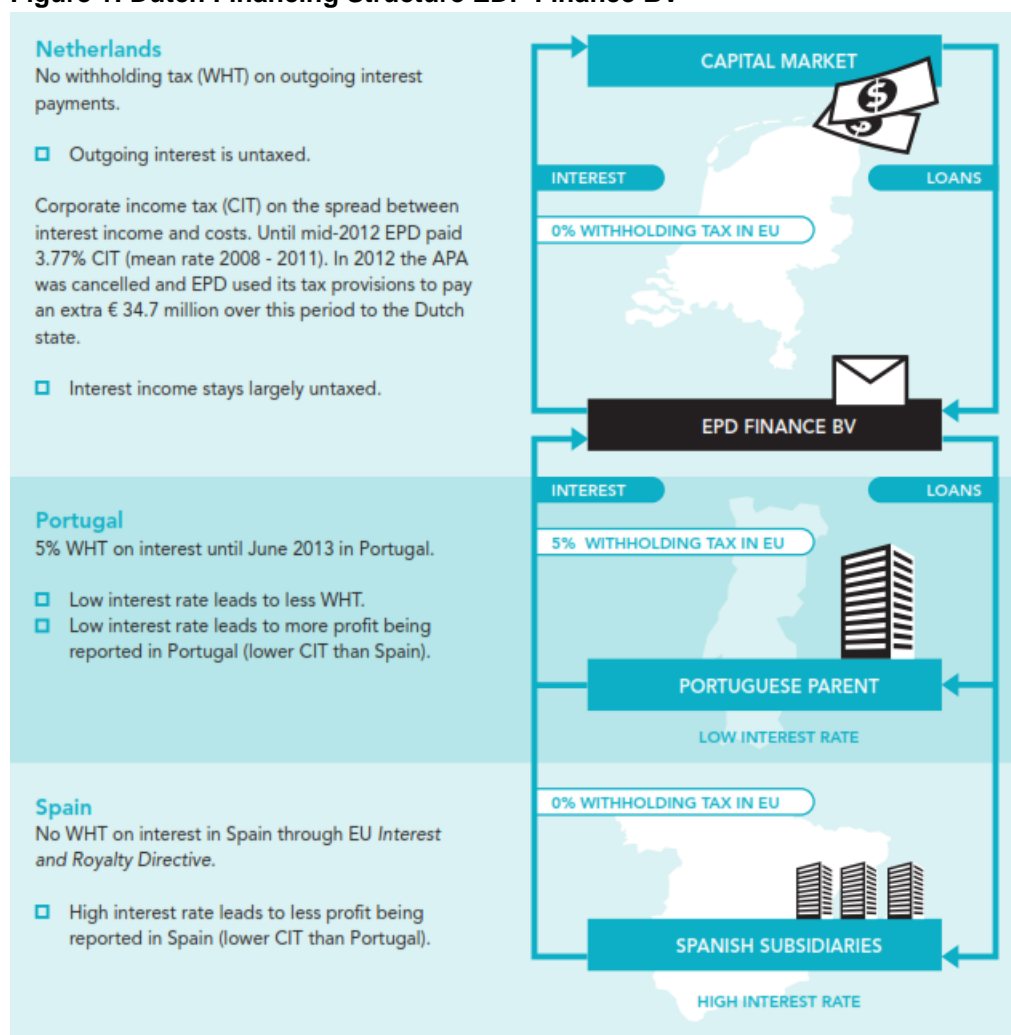
It should be noted that the complexity of defining transfer pricing offers many opportunities to manipulate prices. Based on information from the financial statements it cannot be concluded that EDP Finance manipulates its interest rates. It can only be observed that at present, the intra-group interest payments are fiscally beneficial to the company. Firstly, Portugal has a lower corporate tax than Spain, making it favourable to report more profit in Portugal rather than Spain. Secondly, until June 2013, Portugal was allowed to charge 5 percent withholding tax on outgoing interest payments under a transition period before the EU Interest and Royalties Directive comes fully into force in Portugal. Until June 2013 it was therefore advantageous to limit Portuguese interest payments to the Netherlands to a minimum.⁵⁵

⁵³ EDP’s response to the draft version of the research findings, 25 March 2013.

⁵⁴ EDP Finance BV Annual Report 2012, p16.

⁵⁵ Deloitte Tax Highlights Portugal, http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/2012/dttl_tax_highlight_2012_Portugal.pdf.

Figure 1: Dutch Financing Structure EDP Finance BV



4.4 Conclusions

Until mid-2012, EDP enjoyed several tax benefits by investing through the Netherlands, while no recognisable commercial and business activities in the Dutch financing entity seem to exist. EDP says that the rationale for locating its group financing subsidiary in the Netherlands is the centralisation and therefore efficiency of these financing activities.⁵⁶ However, all activities regarding these financing activities are carried out by the Portuguese parent company. This raises the question why the parent company does not fulfil these functions legally as well, centralised in Portugal.

The difference in interest rates charged by the Dutch financing subsidiary to the Portuguese and Spanish group entities are fiscally advantageous for EDP because of the higher corporate income tax rate in Portugal and the 5% withholding tax that the country could levy until June 2013 under the EU transition period. From the financial statements, however, it cannot be determined whether EDP Finance BV aimed at avoiding withholding taxes or whether that advantage was also pursued through

⁵⁶ EDP argues that “EDP Finance BV plays a key role in the financing function of EDP Group, allowing concentration in one company of the financing raised in the market, which has benefits through economies of scale and avoiding structural subordination vs. the alternative of raising funds directly at each subsidiary.” Company response from 25 March 2013.

improper transfer pricing. It can only be concluded that the allocation of profit of the company between Portugal and Spain appears to be advantageous.

Finally, it can be concluded that as long as the APA was in force, most of the commercial profits of EDP Finance BV were almost completely untaxed. This advantage, however, was reversed in 2012, to the advantage of the Dutch tax authorities – and not the Portuguese state - by the cancellation of the APA. In 2012, EDP Finance BV used the entire tax provision it had made in preceding years to pay tax retroactively on its past interest income according to the statutory tax rate in the Netherlands. This amounted to a total of € 34.7 million.

5. Conclusion: opportunities for political intervention

Since the internationalisation of business, tax avoidance has been a structural problem that harms public interests. This paper shows that the largest Portuguese companies avoid taxes by using the Netherlands as a conduit for group financing activities, while in April 2013 Portugal announced cuts of € 1.2 billion, including a reduction in the public sector of € 600 million.⁵⁷ In recent decades, attempts to achieve a structural reform of the international tax system were blocked in the EU and at the international level because major EU Member States, including the Netherlands and other OECD countries, have an interest in maintaining the current system.

However, the political landscape is changing. Through public campaigning of, amongst others, the Tax Justice Network, but also since the financial crisis began in 2007, a number of opportunities have opened up for political intervention and change. These can be used to implement structural reforms, provided that the social pressure in favour of a more equitable economic redistribution persists.

5.1 Plans for EU reforms

In 2012, there was a clear shift in the positions of the EU, the OECD, the G20 and the Financial Stability Board (FSB) with respect to countries that enable tax avoidance and evasion and apply slack rules. The EC has started to decrease the 'tax gap'. Firstly, by addressing the illegal part, fraud and tax evasion, and secondly, by putting legal tax avoidance on the agenda and by addressing undesirable 'aggressive tax planning' techniques by companies. The Commission has recently published an Action Plan⁵⁸ and two recommendations⁵⁹, in which, on the one hand, it proposes to adapt EU rules and, on the other hand, it calls on the Member States to take action themselves. For example, Member States are called upon to link the use of mailbox companies to real economic activities, the so-called 'substance' requirement.

"Member states are encouraged to introduce the following clause in their national legislation: An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance"

European Commission Recommendation on aggressive tax planning 2012⁶⁰

Fighting tax evasion and tax fraud was one of the two main themes at the European Council meeting on 22 May 2013. "It's high time to step up the fight against tax fraud and tax evasion. We have seen headline after headline highlight loopholes in tax systems, fuelling indignation - and rightly so. At a

⁵⁷ NRC Handelsblad, April 14, 2013.

⁵⁸ European Commission, An Action Plan to strengthen the fight against tax fraud and tax evasion, Brussels, 6.12.2012, COM(2012) 722 final, http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf

⁵⁹ See the Commission website Fight against tax fraud and tax evasion for background information and the recommendations mentioned: 'Fight against tax fraud and tax evasion', http://ec.europa.eu/taxation_customs/taxation/tax_fraud_evasion/index_en.htm

⁶⁰ European Commission Recommendation on aggressive tax planning, Brussels, 6.12.2012, C(2012) 8806 final, http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/c_2012_8806_en.pdf

time of fiscal pressure and social tensions, fighting this is a matter of fairness and credibility," Herman Van Rompuy, President of the European Council, said after the meeting.⁶¹

Although the political demand for reform within the EU is getting stronger, the policy process of the EU is not yet far enough to see whether the strong language will result in action. Since the EU is part of a growing group of international organisations that want to curb tax avoidance, however, there is a realistic chance for the new initiatives to be successful in the long term.

5.2 International actions against tax avoidance: the OECD, the G20 and the USA

In 2012, the G20 also announced an international action plan against tax avoidance, in which the OECD plays a central role. In February 2013, the OECD presented the ground-breaking report *Base Erosion and Profit Shifting*, which shows that the Netherlands is a financial hub that plays a central role in profit shifting by large corporations.⁶² The report makes particular mention of the large investment flows that run through the Netherlands. The OECD consequently calls for jointly taking steps to closing this gap in the international tax system.

In the US there is an ongoing debate on the costs of tax avoidance by US companies. A study of the Congress in 2012 considers the Netherlands, along with countries such as Switzerland, Bermuda, Ireland and Luxembourg, as a 'tax haven'.⁶³ A striking feature of this group of countries is that 43 percent of the profits of US companies are reported here, while only 4 percent of employment is located in these countries. This discrepancy is explained by the fact that companies artificially move profits to these tax havens from the locations where economic activities take place.

The Obama team has also been active in countering tax avoidance. In 2014 the *Foreign Account Tax Compliance Act* (FATCA) will become effective. This law requires US citizens and companies abroad to be transparent about their assets and profits. It is expected that this law will shed light on the way US companies hide their profits from the Inland Revenue Service.

5.3 Political debate in the Netherlands

Until recently, there has been no majority in Dutch parliament in favour of taking concrete measures against the role of the Netherlands as a tax haven. The discussion has been dominated by the idea that SFIs can grow into real businesses and thus contribute to Dutch economy over time. However, there are no studies showing that SFIs in the Netherlands - or in other tax havens such as Luxembourg and Ireland –are incorporated in these countries for reasons other than tax-related ones. The recent report by the *Stichting Economisch Onderzoek* (SEO) also concluded that there is no hard evidence that mailbox companies develop into real businesses.⁶⁴ The majority of parliament still appears to view the Dutch fiscal regime as a legitimate means to compete with other countries. The Ministry of Finance emphasises the benefits the system generates for the Netherlands and downplays the costs it generates in foreign countries. The benefits for the Netherlands consist of about 1 billion tax income per year and employment for 3,500 people.

⁶¹ European Council press release, 22.5.2013, EU leaders agree to step up the fight against tax fraud, <http://www.european-council.europa.eu/home-page/highlights/eu-leaders-agree-to-step-up-the-fight-against-tax-fraud?lang=en>

⁶² See OECD Base Erosion and Profit Shifting project: <http://www.oecd.org/tax/beps.htm>

⁶³ Mark P. Keightley, 'An Analysis of Where American Companies Report Profits: Indications of Profit Shifting, Congressional Research Service, 7-5700, R42927, January 2013, http://qzprod.files.wordpress.com/2013/02/crs_-_an-analysis-of-where-companies-report-profits-indications-of-profit-sharing.pdf

⁶⁴ SEO, June 2013, 'Uit de schaduw van het bankwezen', p.120.

However, the costs of tax avoidance are many times higher than the revenues the avoidance industry generates in the Netherlands. Foreign countries are also starting to make a stand against this base erosion and proposed measures at EU and G20 level are becoming more concrete. This study intends to inform the general public in Portugal and elsewhere about the harmful effects of the Netherlands as a tax haven, so as to increase this pressure. The pressure on the Dutch government has been growing in recent years and recently led to a reaction of the Minister of Development Cooperation and State Secretary of Finance in which they announced a few national measures. Although it is a positive step that the Netherlands acknowledges its crucial role in international tax avoidance schemes, the measures will not be sufficient to combat tax evasion. Therefore, the recommendations in the following paragraph should be implemented as well.

5.4 Recommendations

An end to tax avoidance cannot be achieved by one country alone if other countries maintain unilateral harmful tax regimes. Given that the Netherlands is the most important conduit country for tax avoidance of Portuguese companies, the Dutch government must take measures to eliminate tax avoidance and evasion through its tax regime in order not to exacerbate the European debt crisis. In particular, the Netherlands can take the following measures, which are also recommended by the EC:

Substance requirements and anti-abuse provisions

To prevent its double taxation treaties to be used for profit shifting, the Netherlands should introduce/improve the following measures:

- Effective 'substance' requirements, so that only companies carrying out material economic activities in the Netherlands can use the benefits of lower withholding taxes on passive income in tax treaties. These requirements should use economic criteria, such as number of employees, sales or material production.
- Anti-abuse provisions in tax treaties: The Dutch government has committed to offering anti-abuse provisions in 23 tax treaties with developing countries. When negotiating a new treaty, the Dutch government will, together with the developing country concerned, evaluate which anti-abuse provision is necessary. In addition to these recent commitments, the Netherlands should also take an active role in the negotiation process if a treaty partner indicates that a treaty is abused, and actively support the partner with fiscal expertise in the formulation of more effective anti-abuse clauses. Moreover, the Dutch government should research the effectiveness of different anti-abuse provisions, so that it can make informed and evidence-based decisions on the adoption of anti-abuse provisions.
- General Anti-Avoidance Rules in national legislation, as recommended by the EC.

Advance Tax Rulings (ATR) and Advance Pricing Agreements (APA)

As the EDP case indicates, APAs allow for double non-taxation. To ensure that income - which is not taxed or taxed less in the Netherlands - is taxed in other countries so as to prevent double non-taxation, the Netherlands could do the following:

- Provide no APA/ATR to empty mailbox companies, based on effective substance requirements (see above). The government recently announced that companies can only apply for APA/ATR when they have a "sufficient connection to the Netherlands".⁶⁵ However,

⁶⁵ Kabinetsreactie op SEO-rapport Overige Financiële Instellingen en IBFD-rapport ontwikkelingslanden, kenmerk IFZ/2013/320 U. Original text: "voldoende band met Nederland".

this connection is measured through substance requirements that are, as stated above, too weak to effectively ensure material economic activity.

- Introduce a test of double non-taxation when issuing an APA.
- Automatically and in all cases – not only when it concerns companies that do not meet the substance requirements – notify the tax authorities of the home country of an APA and its contents.
- Make (interest) payments to tax havens non-deductible for tax purposes, because this leads to double non-taxation.

Transparency

More transparency on tax payments (and other payments to governments) will allow governments to take action against tax avoidance and work as a preventive measure, by making tax avoidance visible, making it less attractive for companies.

- The Netherlands must take an active role in promoting the adoption of country-by-country rules by the EU, and the implementation, monitoring and extension of the reporting obligation (on profits, turnover, number of employees, etc. in each country where the MNC is operational and for each sector).
- It must be known where the profits end up (transparency of ultimate beneficial owners). The Netherlands can achieve more transparency on ultimate beneficial owners within the EU by supporting the review of the EU's anti-money laundering directive. The Netherlands must also adapt its own legislation: in the case of private (unlisted) companies it should be known who the ultimate beneficial owners are if they have a 'total' interest of 5 percent or more.⁶⁶

⁶⁶ Tax Justice Nederland, 'Verdragsparadijs Nederland', 2012, <http://nl.tackletaxhavens.com/nederland-verdragsparadijs/>

Avoiding Tax in Times of Austerity

Energias de Portugal (EDP) and the Role of the Netherlands in Tax Avoidance in Europe

There is growing concern about the negative impact national harmful tax regimes have on the domestic revenue of other countries, especially in the context of the international financial crisis and resulting austerity measures. In the EU, the tax gap resulting from tax evasion and avoidance is estimated at € 1 trillion a year. This paper looks at the role that the Netherlands plays in reducing the tax payments of Portuguese multinational corporations (MNCs) in Portugal.

FDI statistics show that the Netherlands is the largest investor in Portugal and the Netherlands receives most Portuguese investment. These capital flows are largely related to activities of Dutch mailbox companies, which enjoy tax benefits in the Netherlands. This results in the shifting of profits from Portugal to other jurisdictions and an overall reduction of companies' tax payments.

To illustrate how these tax benefits work, the paper analyses the case of Portugal's largest energy company, Energias de Portugal. The case of EDP in particular shows how the Netherlands makes special secret deals (Advance Pricing Agreements or Advance Tax Rulings) with foreign companies that lead to double non-taxation. The paper urges for more transparency and a review of this practice and proposes a number of policy alternatives to end the Dutch harmful tax regime. Political opportunities for tax reform at the OECD and EU level are also identified.



This paper is part of series of publications analysing the impact of Dutch foreign and economic policy on sustainable development and public interests. The series is part of a project entitled 'Private Gain, Public Loss' in which policies aiming to attract foreign business or investment to or through the Netherlands (the so-called 'vestigingsbeleid', or business location policy) is analysed in the framework of development policy and human rights coherence.