ISSN 2582-0311 (Print)
ISSN 2582-0303 (Online)

Volume 6
Issue I

August 2024

# VIPS STUDENT LAW REVIEW

VIVEKANANDA INSTITUTE OF PROFESSIONAL STUDIES - TECHNICAL CAMPUS

Affiliated to GGSIP University, Delhi
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Volume 6, Issue I August, 2024 ISSN 2582-0311 (Print)
ISSN 2582-0303 (Online)

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# TAX AVOIDANCE TECHNIQUES BY MULTINATIONAL COMPANIES

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VIPS Student Law Review
August 2024, Vol. 6, Issue 1, 168-179
ISSN 2582-0311 (Print)
ISSN 2582-0303 (Online)
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https://vslls.vips.edu/vslr/

**ABSTRACT**

*Multinational Enterprises (MNEs) like Apple and Google have increasingly adopted aggressive tax planning strategies to minimize their tax liabilities, utilizing methods such as the "Double Irish with Dutch Sandwich". This approach involves establishing two subsidiaries in Ireland—one as a holding company and the other as an operating entity—while using the Netherlands as a transit point and routing profits through low-tax jurisdictions like Bermuda. These strategies allow MNEs to save substantial amounts of money by exploiting international tax loopholes, often employing foreign shell companies and sophisticated transfer pricing schemes. Such practices have drawn significant government scrutiny and led to the implementation of rules like the Controlling Foreign Corporation (CFC) rule. This research paper examines the legal frameworks, including a comparative analysis of tax avoidance across different countries, to assess the fairness and legality of these techniques. The paper also explores the impact of these practices on government budgets and small companies, which face unfair competition as a result. The conclusion will discuss potential measures for better scrutiny and prevention of such tax avoidance strategies, questioning whether MNEs should be allowed to continue using these methods, given their implications on economic fairness and legality.*

**Keywords:** *Aggressive Tax Planning, Double Irish with Dutch Sandwich, Multinational Enterprises, Controlling Foreign Corporation Rule.*

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# 1. INTRODUCTION

Tax avoidance is a common practice among individuals and businesses that seek to minimize their tax liability within the confines of the law. As tax laws and regulations change, a wide variety of complex tax avoidance strategies are being developed. The objective of this research paper is to give a general overview of the most popular tax avoidance strategies used by people and businesses, as well as the moral and legal ramifications of these actions.

The introduction of the paper will define tax avoidance and set it apart from tax evasion, which is an illegal act. This paper will also cover the aggressive tax planning strategies used by the MNCs, the most popular methods of tax evasion will then be covered, such as transfer pricing, offshore tax havens, and the use of tax loopholes.

The paper will also look at how tax experts, such as accountants and attorneys, facilitate tax avoidance activities. It will examine these professionals' ethical obligations and possible repercussions for both their clients and themselves. The final section of the paper will look at potential solutions to the tax avoidance problem, such as modifying tax laws and regulations, enhancing transparency, and encouraging ethical behaviour among taxpayers and tax professionals. The overall goal of this research paper is to give a thorough overview of tax avoidance strategies and how they affect people, businesses, and society as a whole. Tax avoidance is the process of minimizing tax liabilities while staying within the parameters of Tax Laws and Regulations. It entails the use of legitimate strategies to lower the amount of tax due, including exemptions, credits, and deductions. As long as tax laws and regulations are not breached, tax avoidance is not considered a crime. Tax evasion, on the other hand, is the unlawful act of knowingly underreporting or failing to report income, concealing one's assets, or making up deductions or credits in order to avoid paying taxes. This crime carries a range of punishments, including fines and imprisonment.

# 2. BASIC TAXATION RULES APPLICABLE TO MNCS

Multinational corporations' (MNCs) basic tax regulations are governed by the tax laws of each nation in which they do business. However, there are some general principles and guidelines that MNCs must follow to ensure compliance with tax regulations.

## 2.1 Permanent Establishments (PE)

MNCs that have Permanent Establishments (PE) are required to determine whether they have such an establishment in a given nation. A fixed location where the

MNC conducts business is referred to as a permanent establishment. The presence of a permanent establishment in a country may result in tax liabilities there, including corporate income tax, withholding tax, and value-added tax. (VAT).

### 2.2 Transfer Pricing

When conducting transactions between related entities in different countries, MNCs are required to adhere to transfer pricing regulations. The pricing of goods or services that are transferred between related entities is referred to as transfer pricing. These transactions must be carried out at arm's length, which requires that the cost be the same as it would be, if the parties weren't connected.

### 2.3 Controlled Foreign Corporation (CFC) Rules

MNCs are required to abide by controlled foreign corporation (CFC) rules, which are intended to stop profits from being transferred to low-tax jurisdictions. According to CFC regulations, MNCs must include the profits made by their subsidiaries in low-tax jurisdictions in their taxable income.

### 2.4 Double Taxation Agreements (DTAs)

To avoid paying taxes twice on the same income, multinational corporations (MNCs) must be aware of double taxation agreements (DTAs) between nations. DTAs are agreements between two nations that specify the procedures to be followed when dividing up taxing rights.

### 2.5 Tax Treaties

MNCs are required to abide by tax treaties, which are bilateral pacts between two nations to prevent double taxation and tax evasion. Tax treaties set forth the tax rates that apply to cross-border transactions as well as rules for the division of taxing authority among the nations.

## 3. STATUTES APPLICABLE TO MNCS IN THE INDIAN SUBCONTINENT

The Income Tax Act of 1961, the Goods and Services Tax (GST) Act of 2017, and the Double Taxation Avoidance Agreement (DTAA) between India and the country where the MNC is headquartered are just a few of the tax laws that apply to multinational corporations (MNCs) operating in India. The following are some of the main tax statutes that MNCs in India must abide by:

### 3.1 Income Tax Act, 1961

MNCs operating in India are required to pay corporate income tax on their domestic profits under the Income Tax Act. The corporate income tax rate is currently set at 25% for businesses with an annual turnover of less than INR 400 crores (roughly USD 53 million) and 30% for businesses with a turnover above INR 400 crores, depending on the level of income the MNC earns. MNCs are also subject to withholding tax on payments made to non-residents, such as royalty payments, technical fees, and dividends.[1]

### 3.2 Goods and Services Tax (GST) Act, 2017

A value-added tax known as the GST is levied in India on the supply of goods and services. If an MNC's annual revenue in India exceeds INR 20 lakhs, they are required to register for GST. (About USD 26,500). MNCs are required to charge GST on the supplies of goods and services they make, and they must remit the GST they collect to the government.

### 3.3 Double Taxation Avoidance Agreement (DTAA)

India has DTAA agreements with over 90 nations to avoid double taxing MNCs' income. By enabling MNCs to claim tax credits in their home nations for the taxes they paid in India, the DTAA relieves the burden of double taxation. The DTAA also lays out guidelines for determining India's taxing rights as well as those of the nation where the MNC is headquartered.

### 3.4 Transfer Pricing Regulations

According to India's transfer pricing regulations, multinational corporations (MNCs) must deal with their related parties at arm's length, which means that the prices they charge should be the same, as if the transactions were being carried out between unrelated parties. To show that their dealings with related parties are unrelated, MNCs must maintain transfer pricing documentation.

## 4. AGGRESSIVE TAX PLANNING STRATEGIES USED BY MNCS

Aggressive Tax Planning strategies refer to the use of tax planning techniques that push the boundaries of what is legally permissible to minimize or avoid taxes.[2]

1 "India: Corporate - Taxes on Corporate Income", *PwC: Worldwide Tax Summaries*, Dec. 22, 2022, available at: https://taxsummaries.pwc.com/india/corporate/taxes-on-corporate-income (last visited on March 31, 2023).

2 Lenz H, "Aggressive Tax Avoidance by Managers of Multinational Companies as a Violation of Their Moral Duty to Obey the Law: A Kantian Rationale" 165 *Journal of Business Ethics* 681 (2018).

Multinational companies (MNCs) often engage in aggressive tax planning strategies to minimize their tax liabilities in countries where they operate. Here are some common aggressive tax planning strategies used by MNCs:

Transfer pricing manipulation is one of MNCs' most popular business tactics. This entails determining a price that is not reflective of the market for goods or services that are sold between related entities in various nations, MNCs often do this to transfer profits to affiliates in low-tax jurisdictions and lower their tax obligations in high-tax jurisdictions.[3]

The use of tax havens is another tactic MNCs employ. MNCs may establish subsidiaries or other entities in tax havens, which are nations with low or no tax rates, in order to transfer profits and evade paying taxes in high-tax jurisdictions.[4] Concealment laws may also be offered by tax havens, preventing tax authorities from learning about the MNC's operations. MNCs may also engage in treaty shopping, which involves establishing a subsidiary or entity in a country with which their home country has a favourable tax treaty. The MNC can then use the treaty's advantageous tax provisions to lower their tax obligations in their home country.

Another tactic employed by MNCs is hybrid mismatch arrangements. This involves the use of hybrid entities or instruments that receive various tax treatment depending on the jurisdiction. This may allow the MNC to deduct taxes in one jurisdiction while avoiding paying taxes on the income in another.

Finally, MNCs might employ thin capitalization to reduce their tax obligations. In order for the MNC to be able to deduct the interest payments made on the debt, financing subsidiaries in this way allows for a high debt-to-equity ratio. While some of these techniques may be legal, they can raise ethical and moral concerns. Tax authorities are increasingly taking measures to curb these aggressive tax planning strategies. Big corporations like Apple, Google, and even Facebook plan taxes through an IP based Base Erosion and Profit Shifting-tool popularly known as Double Irish and Dutch Sandwich. BEPS are tax planning strategies that use deductible payments like interest or royalties to "shift" profits from jurisdictions with higher taxes to those with lower taxes or no taxes where there is little to no economic activity. This "erodes" the higher tax jurisdictions' "tax-base"[5]

3 Clausing, K.A., "Tax-motivated transfer pricing and US intrafirm trade prices" *Journal of Public Economics*, 2207-2223 (2003).

4 Hines, J.R./Rice, E.M., "Fiscal Paradise: Foreign Tax Havens and American Business" *The Quarterly Journal of Economics* 149-182 (1994).

5 Dhammika D, "What Do We Know About Base Erosion and Profit Shifting? A Review of the Empirical Literature" University of Chicago Law School, Chicago Unbound (2014), *available at:* https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2385&context=law_and_economics> (last visited on April 2, 2023).

As our economy shifts to become more digital and knowledge-based, the majority of BEPS activity is linked to industries with intellectual property ("IP"), specifically technology (e.g. Apple, Google, Microsoft, Oracle) and life sciences (e.g. Allergan, Medtronic, Pfizer, and Merck & Co.).[6] The largest global BEPS income flows are caused by IP-based BEPS tools, which are referred to as the "raw materials of tax avoidance.".[7] For multinational corporations, intangible assets like patents, designs, trademarks (or brands), and copyrights are desirable because they are typically simple to identify, value, and transfer. This is especially true given that these rights are typically not geographically restricted and are thus highly mobile[8]. As a result, they can be relocated using prepared licensing structures without incurring significant costs. In order to operate so that the income generated by the intangibles in one location is received in another location with a low/no tax regime, many multinational corporations use IP structuring models to separate the ownership, funding, maintenance, and use rights of intangible assets from the actual activities and physical location of intangible assets.

Therefore, there is a substantial role of IP intensive business models in Multinational company's taxation processes. Multinational companies, for this purpose, establish licensing and patent holding companies that meet the needs of offshore locations and is often only used to acquire, exploit, license or sublicense Intellectual Property Rights for their foreign subsidiaries. After that, the profits are passed on from the foreign subsidiary to the offshore patent-owning company where there are little to no taxes levied on royalties received. These profits that are passed on to the patent-owning company is often exempted from tax or is subjected to low tax rate since it is in the jurisdiction of tax haven.[9] Also, these companies facilitate the bigger purpose that is avoiding high withholding taxes that are usually charged on royalties coming from the country from which they are derived[10]. These taxes are can also be reduced by double taxation agreements between the countries.

6 Cobham A, "Progress on Global Profit Shifting: No More Hiding for Jurisdictions That Sell Profit Shifting at the Expense of Others", Tax Justice Network, September 7, 2020, *available at:* <https://www.taxjustice.net/2018/07/24/progress-global-profit-shifting/> (last visited on April 2, 2023.

7 Andrew Blair-Stanek, "Intellectual Property Law Solutions to Tax Avoidance" 62 *UCLA Law Review* (2) (2015).

8 Clemens F, Christoph S, Katharina F, Jost H. Heckemeyer, and Hannah N, "Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform" DP No. 13-078, Centre for European Economic Research.

9 Howlader AA, Jones C, and Temouri Y, "Articles: The Relationship between Mne Tax Haven Use and FDI into Developing Economies Characterized by Capital Flight" 27 Transnational Corporations 1 (2020).

10 Clemens F, Christoph S, Katharina F, Jost H. Heckemeyer, and Hannah N, "Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform" DP No. 13-078, Centre for European Economic Research.

Often times, Countries offer subsidies regarding the expenditures of research and developments (R&D) or on acquiring IP. Taking advantage of this, Multinational enterprises set up R&D facilities in such countries where they find best tax rebate arrangements. As a result, MNEs now have double advantage, as for one, it takes advantage of a desirable research infrastructure and generous R&D tax incentives in one nation and second, it enjoys low tax rates on income derived from exploitation of intangible assets in a different nation.

## 5. BERMUDA AS A TAX HAVEN

The nation's tax laws provide a number of tax advantages, including exemptions from income tax, capital gains tax, and dividend withholding tax, among others.

By utilizing Bermuda's tax treaties with other nations, MNCs can use the island state to reduce their tax obligations. Over 40 nations, including the United States, the United Kingdom, and Canada, have tax treaties with Bermuda, also, this country imposes no taxes on profits, income, dividends, or capital gains, has no limit on the accumulation of profit, and has no requirement to distribute dividends.[11] These agreements give MNCs the chance to lower or completely get rid of taxes on particular forms of income, like interest and dividends.

Frequently, MNEs use Bermuda as a tax haven by forming shell companies or trusts there. The true owners of the company's assets and income are hidden through the implementation of these legal entities (shell companies and trusts), which makes it difficult for the tax authorities to track and tax the company's income.

## 6. NETHERLANDS AS A TRANSIT POINT

MNCs use the Netherlands as a transit point as it has a favourable tax system. It helps multinational corporations (MNCs) reduce their tax liabilities in several ways.

First, being the participation exemption, the Netherlands has a participation exemption, which exempts multinational corporations (MNCs) from paying taxes on profits they make from subsidiaries or other businesses in which they have a sizable stake (i.e., at least 5%). This can significantly lower the MNC's overall tax obligation.[12]

11 "Bermuda: Corporate - Taxes on Corporate Income", *PwC Worldwide Tax Summaries*, Apr. 1, 2024, *available at:* <https://taxsummaries.pwc.com/bermuda/corporate/taxes-on-corporate-income> (last visited on April 2, 2023).

12 "Netherlands: Corporate - Income Determination" *PwC World Tax Summaries*, Jul. 01, 2024, *available at:* <https://taxsummaries.pwc.com/netherlands/corporate/income-determination> (last visited on April 2, 2023).

Tax treaties: To avoid double taxation, the Netherlands has a wide network of tax treaties with other nations. The withholding tax rates on dividends, interest, and royalties are frequently decreased by these treaties' provisions.

Intellectual property (IP) Innovation box: The Netherlands has a policy known as the IP Innovation box that enables multinational corporations (MNCs) to pay a lower rate of tax on income derived from patents, trademarks, and other types of intellectual property.[13] This can be especially helpful for businesses whose IP revenue accounts for a sizable portion of their revenue. In 2010, the Dutch Government decreased the amount of Intellectual Property related taxes, from 10% to 5% which is a huge discount as compared to the average corporate tax levied by the Dutch Government at the rate of 25%.[14]

The Netherlands has a system for tax rulings that enables multinational corporations to obtain in advance certainty regarding the tax ramifications of their anticipated transactions. This can assist MNCs in structuring their business operations to minimize their overall tax liability. Google has also been known to use the BEPS strategy, Double Irish, and Dutch Sandwich to minimize its tax liabilities[15]. Ireland and Netherlands are two countries from where google reaps benefits as these countries charge low taxes. The strategy that Google uses involves creating a subsidiary in Ireland, and this subsidiary is subject to low tax rate of 12.5% and it holds rights to Google's Intellectual Property, and it charges royalties to subsidiaries in other countries for the use of this Intellectual Property.[16]

Then there is Google's second Irish Subsidiary which is also subject to low tax rates but this subsidiary pays royalties for the use of Google's IP instead of charging royalties like the first one. These royalty payments reduce the income to be taxed of the second subsidiary and then can be used to offset profits earned in other countries. The MNE, that is Google, to further reduce its tax liability, uses a Dutch subsidiary and channel funds through it from second Irish subsidiary to the other subsidiaries in tax havens such as Bermuda. This Dutch subsidiary is able to take advantage of tax treaties between the Netherlands and other countries to minimize tax on the funds it channels.

13 "The Taxation of Intellectual Property in Netherlands", *Crystal Worldwide - International Tax Expert*, April 25, 2019, available at: https://crwwgroup.net/en/2015/10/01/the-taxation-of-intellectual-property-in-netherlands/ (last visited on April 2, 2023).

14 "The Taxation of Intellectual Property in Netherlands", Crystal Worldwide, Oct. 1, 2015, available at: https://crwwgroup.net/en/2015/10/01/the-taxation-of-intellectual-property-in-netherlands/#:~:text=The%20Dutch%20Innovation%20Box%20system,tax%2C%20which%20is%2025%25.

5tricks-that-google-used-to-save-3-7-billion-in-taxes/articleshow/62349788.cms?from=mdr> (last visited on April 2, 2023).

16 *Supra* note 492.

Google's tax obligations on profits made outside of the US have been significantly reduced owing to the use of Double Irish with Dutch Sandwich strategy. Google's effective global tax rate in 2016 was 19.3%, according to data provided by the IRS; this was made possible in part by shifting the majority of its international profit to the Bermuda-based entity, with this tax rate, Google would have saved $3.7 billion through that transfer.[17] Similarly, Apple uses this arrangement to minimize its tax liabilities, this Company has set up two subsidiaries in Ireland namely, Apple Operations International (AOI) and Apple Sales International (ASI) where, AOI is a holding company, which own many of Apple's Intellectual Property Rights, while ASI is responsible for selling Apple products in Europe, the Middle East, and Africa.

From 2009 to 2012, Apple generated $74 billion in profits from international sales (excluding the Americas) while paying essentially no taxes to any nation and these sales were attributed to Irish subsidiaries where businesses paid less than 1% in taxes.[18] Under Double Irish and Dutch Sandwich strategy, ASI pays royalties to AOI for the use of Apple's Intellectual Property. AOI is based in Ireland, where the corporate tax rate is low at 12.5%, and therefore pays a relatively low tax rate on the royalties it receives. Apple Operations International (AOI) has earned $30 billion over the past five years without paying any corporate income tax to any country, it has no physical location at any address and has never employed anyone in its thirty years of existence.[19] AOI then use the Dutch subsidiary to channel the royalties to another subsidiary, which is based in Bermuda. By utilizing tax agreements between the Netherlands and other nations, this Dutch subsidiary is able to keep the royalties it receives tax-free. Apple can lower the amount of tax it pays on its international profits by employing this method. According to a report by the US Senate Permanent Subcommittee on Investigations, "Apple used this and other tax avoidance techniques to avoid paying $44 billion in US taxes between 2009 and 2012."[20]

## 7. IMPACTS ON SMALLER COMPANIES

One of the main impacts on the smaller business that cannot use these tactics to lower their tax liabilities is that they may face an uneven playing field as a result of use

17 Alencastre CV, "TP Mazes and the Global Tax for Multinational Companies", *International Tax Review*, June 14, 2022, *available at:* https://www.internationaltaxreview.com/article/2a6abhsoozg3247yw2br4/tp-mazes-and-the-global- tax-for-multinational-companies> (last visited on April 2, 2023).

18 U.S. Senate Permanent Subcommittee on Investigations, Exhibit 1a, pp. 21, 24-25.

19 U.S. Senate Permanent Subcommittee on Investigations, Exhibit 1a, pp. 21-23.

20 *Ibid*.

of these strategies by large multinational companies.[21] Smaller businesses frequently are unable to benefit from complicated tax arrangements because they need a lot of money and expertise to implement them.

Additionally, the adoption of these types of "aggressive" tax planning techniques by the multinational corporations may result in decreased earnings from taxes for the Government. This in turn would facilitate situations where there would be less funding for public services that are crucial for the advancement or longevity of small business. These public services might include infrastructure, education or skill development etc. The Double Irish and Dutch Sandwich may also expose smaller businesses to more competition from bigger multinational corporations that can offer lower prices because of their lower tax obligations. Smaller businesses may find it challenging to compete and survive in the market as a result.

## 8. INTERNATIONAL DISCUSSIONS

The corporate tax rates in the US and UK are high, at 35% and 19%, respectively. DIDS helps MNEs by lowering their tax rates by shifting profits to countries with low taxes. States like the US and the UK experience chaos as a result, which results in significant revenue losses. This is so that the parent company can grant the subsidiary company a license for its intellectual property. Additionally, this subsidiary company was founded in a country that is a tax haven, so it will either pay little or no tax. Since the subsidiary company is located in an offshore jurisdiction that is a tax haven, US tax laws do not apply to that country. As a result, small and individual businesses are subject to a higher rate of corporate tax, which has a negative impact on their growth. The tax avoidance strategy has recently been the focus of debates and discussions across the globe. The issue of multinational corporations evading taxes has been addressed by a number of nations and international organizations, who have also taken steps to forbid the use of these strategies. Here are a few instances:

- Base Erosion and Profit Shifting (BEPS) Project of the OECD: The BEPS Project was started by the Organization for Economic Co-operation and Development (OECD) in 2013 with the intention of stopping multinational corporations from evading taxes.[22] Transfer pricing, intangible assets, and tax treaties are

21 Terstege F, "BEPS", *Tiberghien Economics*, May 24, 2017, *available at:* https://www.tiberghieneconomics.com/beps (last visited on April 2, 2023).

22 BEPS Actions, *available at:* https://www.oecd.org/tax/beps/beps-actions/. (last visited on April 2, 2023)

just a few of the many issues covered in the project's 15- point action plan. The strategy calls for limiting the application of the "double Irish" and "Dutch sandwich" techniques.

- The European Union (EU) adopted the Anti-Tax Avoidance Directive in 2016, which consists of measures to stop multinational corporations from evading taxes. A number of provisions are included in the directive, including prohibitions on the use of the "double Irish" and "Dutch sandwich" strategies.

- TCJA of 2017: The Tax Cuts and Jobs Act, The TCJA made several changes to the tax code in the US, including clauses intended to stop multinational corporations from evading taxes. To discourage the use of the "double Irish" and "Dutch sandwich" strategies, the law includes a new tax on global intangible low-taxed income (GILTI).

- The General Anti-Avoidance Rule (GAAR), which has been adopted by many nations, is intended to stop tax evasion by focusing on transactions that are carried out primarily for taxation.[23] For instance, in India, the "double Irish" and "Dutch sandwich" techniques are prohibited by the GAAR, which was introduced in 2017.

A "grandfathering period" until 2020 is available for businesses that already had such a structure in place. Ireland also amended its regulations regarding the residence of incorporated companies, which had encouraged companies to use the "double Irish" construction.[24] The "Corporation Tax Roadmap," published by the Irish Department of Finance, provides a summary of all recent modifications to Irish corporate tax laws as well as steps taken to counter aggressive tax planning.[25]

## 9. CONCLUSION

Multinational Enterprises have repeatedly taken advantage of the loopholes in Taxation Laws, but these loopholes have not been ignored by the International organizations. This paper sheds light on the tax planning strategies, their impacts, and legislative actions taken against it. Countries all over the world are signing tax treaties to adopt common

23 COUNCIL DIRECTIVE (EU) 2016/1164 of 12 July 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

24 At a Glance: Ireland's tax reforms and the fight against aggressive tax schemes, European Parliament.

25 *Ibid*.

taxation practices. This would aid in tracking of income by tax authorities of offshore shell companies or trusts. With time, more stringent taxation laws would be put in place and these loopholes would positively be non-existent, enabling smaller businesses to flourish and facilitating governments to work at their best potential to provide for these small businesses.