

IOTA Digital Workshop

Combating international tax avoidance and aggressive tax planning through the use of legal entities in tax havens

Group Discussion 2
Assessing real business activity

FEEDBACK FROM GROUP 2

Question 1

Is information included in commercial databases most commonly used by tax administrations i.e. Moody's Orbis/ TP Catalyst, adequate to assess a company's business activity which is located in a jurisdiction with a preferential tax regime?

FEEDBACK FROM GROUP 2

Our first key takeaway was that commercial databases such as Orbis and TP Catalyst are widely used and considered valuable starting points for risk assessment, but participants generally agreed that they are not sufficient on their own to assess whether a company carries out genuine business activities.

Participants noted that these databases can provide useful information on ownership structures, directors, employees, and group relationships. However, the quality of information depends heavily on the transparency rules of the jurisdiction concerned. In many low-tax or offshore jurisdictions, publicly available information is limited, making it difficult to determine the true nature of a company's activities.

As a result, commercial databases are mainly used for initial risk assessment and case selection. Auditors typically need additional evidence such as contracts, invoices, financial statements, banking information, and other documentation to assess economic reality.

Question 2

How does your tax administration identify a company that is located in a “tax haven” if it is used for tax avoidance purposes?

FEEDBACK FROM GROUP 2

A second important finding was that tax administrations do not automatically consider a company to be engaged in tax avoidance simply because it is located in a low-tax jurisdiction. Rather, the jurisdiction is treated as one risk factor among several.

Several countries maintain lists of jurisdictions of interest or jurisdictions with preferential tax regimes, while others rely more heavily on case-by-case analysis. Regardless of the approach, participants emphasized that the key question is understanding the role that the entity plays within the group structure.

The discussion highlighted the importance of examining functions performed, assets held, risks assumed, and the resulting tax benefits generated by the structure. The general view was that risk assessment must go beyond geographical location and focus on the economic reality of the arrangement.

Question 3

Do you use any (or a combination) of indicators that can serve as red flags? Can you share some of them?

N/A

FEEDBACK FROM GROUP 2

Question 4

Is the term of “economic substance” specifically defined in your domestic legislation? If not, do you review it indirectly through other means (CFC rules, TP, etc)?

FEEDBACK FROM GROUP 2

When discussing economic substance, an interesting commonality emerged. Most participants indicated that the term "economic substance" is not specifically defined in domestic legislation. Nevertheless, the concept is addressed indirectly through other legal mechanisms.

These mechanisms include:

Transfer pricing rules.

Controlled Foreign Company rules.

General anti-avoidance rules.

Substance-over-form principles.

Examination of the real meaning and economic effect of transactions.

The overall conclusion was that, despite differences in terminology and legal frameworks, tax administrations are asking essentially the same questions: What activities are actually being performed, where are they performed, and by whom?

Question 5

Bearing in mind barriers such as statutes of limitations and internal deadlines, for finishing an audit, how is the decision about the extent of an audit being taken? What type of information is tried to be retrieved domestically and what through exchange of information channels?

FEEDBACK FROM GROUP 2

Participants discussed how audits are conducted within statutory time limits and how information is collected.

While limitation periods vary significantly between countries, a common approach is to first exhaust available domestic sources of information before resorting to Exchange of Information channels. Domestic sources typically include taxpayer requests, banking information, corporate registries, related-party disclosures, and publicly available records.

Exchange of Information is generally used when the necessary data is located abroad, when the taxpayer is unable or unwilling to provide information, or when independent verification is required.

A particularly interesting discussion arose around the concept of "exhausting domestic avenues" before making an international request. Participants shared different legal and practical approaches, and there was consensus that this topic deserves further discussion and clarification at the international level.