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INTERNATIONAL TAX PLANNING AND ITS REFLECTION ON MODERN MARKET ECONOMIES.

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INTERNATIONAL TAX PLANNING AND ITS REFLECTION ON MODERN MARKET ECONOMIES.

PLANEJAMENTO TIBUTÁRIO INTERNACIONAL E O SEU REFLEXO NAS ECONOMIAS DE MERCADO ATUAIS.

Laís Souza de Carvalho Santana[1]

ABSTRACT

This paper intends to cover the idea of international taxation in the 21st century and how its applicability has resulted in an era of international tax planning by Multinational Enterprises (MNEs). It also addresses how tax-planning Multinational Enterprises can outstand themselves in the international market field, in a comparison to domestic firms or non-tax-planning MNEs. The goal of this article is to present the new era of Multinational Enterprises that are upgrading their tax planning method, focusing on how to reduce their tax burden in the international taxation scenario, resulting in a higher mark-up rate and a decreasing of tax burden and an increasing of income.

Key-words: International Market. International Taxation. Multinational Enterprises. Tax Planning.

RESUMO

Este artigo pretende cobrir a ideia de tributação internacional no século XXI e como sua aplicabilidade resultou em uma era de planejamento tributário internacional por Empresas Multinacionais (EMs). Também aborda como as empresas multinacionais que fazem uso planejamento tributário podem se destacar no mercado internacional, em comparação com empresas nacionais ou EMs não-tributárias. O objetivo deste artigo é apresentar a nova era das Empresas Multinacionais que estão atualizando seu método de planejamento tributário, focando em como reduzir sua carga tributária no cenário tributário internacional, resultando em uma taxa de marcação mais alta e uma diminuição da carga

1 Graduanda em Direito pela Universidade Tiradentes – UNIT

tributária e um aumento da renda.

Palavras-chave: Mercado Internacional. Tributação Internacional. Empresas Multinacionais. Planejamento Tributário.

1 INTRODUCTION

The 21st century has proved itself as the era of globalization. People are connected all the time and their relationships are even tighter. So it happens in the market world, companies and governments are brought together by the era of globalization and their bonds gets stronger day by day.

During this time, it has been seen the increasing competition in the international market for mark-ups dominance. Multinational Enterprises (MNEs) have been ranking-up their positions in the market in relation to other enterprises and national firms, they are doing this by stepping up their games while taking advantage on the international tax system.

International taxation is known as the rules that guide international tax transactions, but to rule over such an expanded situation, a country must have a solid internal tax planning. Where it will be possible to arrange better international deals with different tax payers.

The importance of tax planning consists in creating a new strategy for countries or multinational enterprises focusing on guaranteeing better international tax deals. Such examples are from international MNEs that with the use of international tax planning can archive lower tax burden or international tax deals.

Most of the tax planning situations are ruled by States tax rules that are created under their constitutional laws. However, most countries tend to apply for international tax treaties to guarantee more security and more rights under the international tax market.

With tax planning companies can organize their way of acting and where they can act. In that way, they plan where to take their branches and where it would be more profitable to base their activities.

In the 21st century tax planning has been proving to be an effective method to guide multinational enterprises and even smaller companies on how to better apply their incomes in a way to benefit from that. With this method it possible for companies to avoid stablishing their branches activities in places where they will gain better profits from that.

> (...) international taxation deals with the rules applicable to cross- border transactions in various tax jurisdictions. International tax planning combines these transactions in the most tax-efficient structure within the law through

1 Graduanda em Direito pela Universidade Tiradentes – UNIT

> the knowledge of international taxation. (ROHATGI, 2005, page 6)

Some Multinational Enterprises do this with the intention to archive a better mark-up rate or just establish themselves in the market. With tax planning it is possible for MNEs to get a more comfortable and stable position in the market.

With tax planning, enterprises are able to prepare their strategies better aiming to get no only lower tax burden deals with host countries, but also to get a more stable position in the market. With that, companies archive a more secure position and control of their market status.

> It is possible to achieve this by interposing subsidiaries in low-tax jurisdictions such as Ireland or e Netherlands, and then utilize tax treaties to shift income onto tax havens such as Bermuda or the British Virgin Islands, where profits can be stored for years. (KAYIS-KUMAR, 2016, page 374)

Enterprises that focus on tax planning normally locate their activities in lower tax jurisdiction countries, where they can guarantee a better settle for their activities. Lower tax jurisdiction countries are preferable once they assure to the MNEs a reliable place to house their companies.

Under all this discussion, it is still common to MNEs to find themselves dealing with situations of double tax between the parent country and the host country. For such circumstances, the OECD has created a Model Convention on Income and Capital to avoid countries to stablish double taxes and in that way tax the same income two times.

With that convention it is possible to classify the items of income as well as to assign tax rights to the contracting States. As a result, a system is created to classify taxable income into different categories. (OECD, 2017)

However, some MNEs have already archived those accomplishments, but why do they still invest on keeping their positions so well levelled and their dominance in the international and local market? How can they benefit from that and what are the results from such behavior?

This article intends to give a brief explanation towards how international taxation is used in the 21st century by States and Multinational enterprises. As well as how enterprises use the tax planning method and how they can benefit from that, and as result of that how tax planning MNEs can shape a new market structure.

For this research, it was used the academic research methodology, consisting in an abundant research on academic books, articles and journals to find the answers to the questions referred above.

1 Graduanda em Direito pela Universidade Tiradentes – UNIT

2 INTERNATIONAL TAXATION AND ITS APPLICABILITY IN THE 21ST CENTURY

International taxation is the proper applicability of a tax system on a person or on companies by governments or different enterprises. In some situations, those taxed individuals have to deal with a double taxation and all its reflections on the products prices.

Some governments tend to have a multifaceted relationship with Multinational Enterprises and local firms. This relationship between them is based on decisions made by the governments related to the corporation taxation and how those taxations can affect the choices made by MNEs regarding where should they locate their economic activities and where to engage for profits.

However, the 21st century brings with it a new style of how to see the world as well as how to tax companies. MNEs have been facing an era of new taxation, where developed and developing countries are concerned about the tax framework and how to deal with it.

The international framework consists in the communication between domestic tax laws treaties and the allowance of tax rights. In this situation, it is common to address the issue of which country will tax each income item.

It is well known that the international tax initiatives are normally planned by, and even more, for, the developed countries. This situation causes a real problematic scenario in developing countries, once they are the ones to suffer the most with non-practical or way too intricate international tax initiatives.

Under those situations, it is common for MNEs to reduce their tax burden by taking advantages of international differences on tax systems. A way to do it is by shifting their profits to lower tax rate countries where they can achieve higher mark-up rates.

During the globalization age, the borders between countries and areas of taxation had been more and more difficult to identify. The digital economy is a real state of trade and its commerce is now more active, but trying to figure out the source country to properly assign the international tax rules applicable to each situation, is becoming harder, once the commercialization borders are day by day more blended.

“Identifying the source country, which is essential for applying the current international tax rules, is becoming increasingly problematic, especially with the rise of the digital economy.” (MULLINS, 2020, page 3)

In that contest, the economic society normally agrees that the source country (the country where the profit is derived from) has the right to first tax the income. Though,

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this is a no spoken common agreement, most countries do that aiming to tax products incomes by their own policies purposes and advantages.

Normally, it is possibly for a country of residence (where the ratepayer resides) to tax the income acquired in an oversea income source. To archive such possibility two methods are applied, the Worldwide Taxation Method (Residence Taxation) or the Territorial Taxation Method (an exemption system).

The Worldwide Taxation Method consists of the application of taxation on a corporate ratepayer country related to the income earned in a foreign country. In those circumstances, it is very common that the country that pays the profits gives the source country a tax credit, normally used on tax levied.

Generally, this method is used by developing countries, although, yet can still be some exceptions. As it is mentioned by Mullins:

> Countries with a worldwide tax system for corporate taxpayers include Brazil, China, India, Ireland, Kenya, Korea, Mexico, Nigeria, and South Africa. Most developing countries apply a worldwide tax system, although there are some exceptions. (MULLINS, 2020, page 3.)

As for the Territorial Taxation Method, the origin income is only taxed in the source country, leaving the taxpayer's country free of tax charges. Some of the countries that are adepts of this method are Australia, Canada, Hong Kong SAR, Thailand, Malaysia and other, what calls for a presumption that this method is mostly adhered by developed countries.

In some cases, the host country is found with higher tax rates than the home country, in those situations, the MNEs are considered to be in excess foreign credit, what exempts it from the payment of future taxes.

However, it is an usual practice that countries mix both methods with the intention of acquiring a lower tax rate and profiting from that. It is even more normal that those nations tax their taxpayer's in different ways applying different tax systems to either individuals or corporate payers, what results in a double taxation.

MNEs tends to look for host countries with similar legal systems from their home countries, once, these situation strengths the legal works between them. This practice has the intention of not only obtaining a strong legal work relation, but also to advantaging the MNEs positions in the market rates.

On those situations, a free tax country looks more attractive to a MNE to establish their tax relations and settle location for their economics activities. Location choices can be

1 Graduanda em Direito pela Universidade Tiradentes – UNIT

very significant for host countries taxations system on a positive way, though, it can affect negatively on the international taxation system. (MULLINS, 2020)

Analysing the situation, we ted to find that subsidiary companies are often located in larger countries, which, on the other hand, have higher corporate income taxes, what reassures the idea of location being a positive and significant add to parent country's tax systems. However, the location to subsidiary firms are chosen to scape from double international taxation or to, at least, lower their burden.

It is understandable that MNEs have an interest on lower income tax's host countries, once their tax system will lower their international tax burden. If so, it is common to the host country to have a lower GPD growth related to the home country.

Mullins affirms that, the effect from the parent-country corporate tax rate is quite extraordinary, analysing that parent country taxes can affect parent firms at owing assets in a host country under a comparison to potential source country MNEs. Even though, withholding taxes are normally low, those taxes can also put foreign owners at disadvantage to local owners regarding owing local assets.

MNEs tend to analyse deeply before they can actually locate themselves in a country. Taking under consideration all of what had been discussed in here, MNEs still have to deal with the increasing amount of countries, that in the 21st century, are starting to get ready to receive new companies.

For Barrio, Huizinga and Nicodème:

> The number of countries that a multinational can choose from (in a given set of countries) can be seen as one of the 'dimensions' of the location choice problem. Another main dimension of the location problem is the number of foreign subsidiaries that a multinational wishes to establish given the number of countries that it can choose from. (BARRIO, HUZINGA and NOCODÈME, 2009, page 19.)

As result, it is fair to say that international taxation can directly interfere on how multinational enterprises locate their subsidiaries. As well as that some of those companies need to adjust themselves into different kinds of tax systems and for that they need to prepare themselves and stipulate some tax planning situations.

3 THE STRUCTURE OF INTERNATIONAL TAX PLANNING AND ITS USE BY MULTINATIONAL ENTERPRISES

To understand the international tax planning criteria, it is necessary to understand

1 Graduanda em Direito pela Universidade Tiradentes – UNIT

how the international taxation system works. International taxation stands for the global rules that regulates how transactions between States will take place.

However, there is no international tax law to regulate those transactions, the international taxation is controlled by the laws and treaties between the transacting countries. International taxation is based in three main principles, the sovereignty of each country, tax equity and tax neutrality.

When comparing it to domestic tax laws, the second one rules over tax rates and how and where it will be applied. Normally tax laws tend to raise tax liabilities, if there is a connection between the tax jurisdiction and the tax payer or the taxable event. (ROHATGI, 2005.)

As the international taxation needs to deal with different tax jurisdictions, many companies engage in an avoidance high fiscal burden plan. This strategy is known as Tax Planning, and it results in multinational enterprises being able to avoid high tax burdens in overseas source countries.

3.1 The fundaments and structure of tax planning

It is a very common practice for MNEs to analyze and take advantage from the differences between corporate tax systems. While doing this, they aim to reduce their tax burden, and some usual situation is by shifting their profits to lower tax rate countries.

The intention here is, by making usage of tax planning, those MNEs can exploit reasonable advantages over non-tax planning MNEs or local firms to gain market shares. However, this behavior brings fairness and economic issues to the international market and their consumers.

It is notorious that international tax planning can influence in industry growth by creating a competition between other tax-planning MNEs, or smaller enterprises and local firms. This strategy is used to shift income to low tax jurisdiction or into more lightly taxed forms.

> With respect to tax competition and tax rates, the reduction of the basic statutory rate from 35% to 21% was clearly influenced by the desire to attract foreign investment and to reduce the tax burden on United States corporations with mostly domestic operations which might be tempted to move operations abroad. (AULT, 2019, page 11.)

Sometimes, tax planning can end up affecting industry growth by reducing tax rates on the location of their investment, and resulting in a reduce of cross-country corporate tax rates difference. Multinational enterprises can use international structured tax planning

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devices to guarantee their success.

A way of doing this is by the usage of abusive transfer pricing and exploiting related companies' financial transactions. While the first one focus on shifting the source of profits to a jurisdiction that will provides a better tax outcome, the second one consists on locating financing subsidiaries on low tax countries to loan or transact with higher tax countries.

To Mullins:

> The most prominent rules relate to transfer pricing, thin capitalization (interest deduction), and controlled foreign corporations (CFC). Transfer pricing rules seek to limit mispriced transactions between related parties […]. Thin capitalization rules limit deductions for interest expenses, especially if paid to related parties. CFC rules address concerns with MNEs establishing subsidiaries or branches in low tax countries to shelter profits from tax in the residence country of the parent. (MULLINS, 2020, page 5.)

Regarding to transfer pricing method, it can be divided in "Traditional Transaction Method", that consists in an observation of a difference in the controlled transactions from the price to a difference under some uncontrolled transactions. Those observations are made using the commercial and financial relations between enterprises.

Another way to stablish the transfer pricing method is by the "Transaction Profits Method", this one is a less traditional method. The use of this method is more appropriated n situations where the both parties engage in a higher unified transaction activity, making it a fairer method for that. (OECD, 2017)

It is also very usual to see tax-planning MNEs locating their intangibles in low tax countries and locating requires to affiliates in higher tax jurisdictions, with the purpose of arising tax deductions in the high jurisdiction and lowing income in lower tax countries. Another common habit is to exploit treaties with the intent to dissuade income flows to to countries with the best tax system.

Another clear tax planning device is to treat same entities, transactions or instruments with different tax purpose, by that, a new financial instrument is designed with tax charging hybrid characteristic. MNEs can also dispose from their ownership of assets by selling them to overseas subsidiaries, in a way to avoid taxes in the source country. As it is explored by Mullins:

> Such disposals are of particular concern in the extractive industries in low-income countries, where significant interests in petroleum or mining rights can be sold with little tax. Examples of significant indirect sales include in Ghana in 2011, where 18.9 percent equity in two mining companies was sold for $661 million, and Mozambique in 2013, where 28.5 percent of a foreign mining company holding 70 percent of a mining right was sold for

$4.2 billion. (MULLINS, 2020, page 6.)

An extremely important device used by tax planning Multinational Enterprises is conceded by governments themselves. Governments creates a tax competition by taking advantages from the wiling from MNEs for lower taxes and the limitations of the international tax framework.

Those competitions are originated by lower tax regimes, created from lower corporate income tax (CIT) rates or by tax incentive regimes, based on tax holidays or reduced tax rates for certain taxpayers or sectors. Those competitions directly affect foreign investments as other country's income.

3.2 The benefits of using tax planning by multinational enterprises

The competitions and allowances in favour to tax planning MNEs are constantly rising fairness and economic efficiency issues in developed and developing countries. Multinational Enterprises that dedicates themselves to the practicing of international tax planning tend to lower their tax rates and higher their mark-up ones.

By doing this, they crowd out markets, shrinking non-tax planning MNEs and local firms. The result of this is an oligopolistic market, concentrated on industries that have low or almost none local competition and an extent market to explore.

Under those circumstances, consumers find themselves floating between companies that translate theirs prices and reduces their products choices, without concerning about concurrence. (SOBER and JOHANSSON, 2017)

It is common that under those situations, tax planning MNEs will have more advantage in the market and more dominance of commerce. Normally, those situations tend to result in a more monochromatic scenario, where the tax planning enterprises gain space and advantage compared to non tax planning MNEs and small companies.

The tax planning method not only results in a decrease of tax burden to MNEs and a better market position, it does help to bring new advantages in different areas. Tax planning can result in low costs on the production lines, which results in lower prices on the final product.

The consequence of those low prices on the final product is that the enterprise can manage and expand theirs branding and marketing in different countries, which gives them a bigger market range. With that they reach a new consumer market, where not only they can raise their economic gains, but also diversify their products line to adapt to the new consumers.

Tax Planning MNEs make use of international treaties, specially the ones ruled under the Organization for Economic Co-operation and Development (OECD) spectrum, to get better access to lower tax jurisdictions that eventually will turn into lower tax burdens. In such situation, the multinational enterprises will benefit to a more dominance of market and even a monopolism situation.

Tax treaties are created to regulate tax law abuses by countries that intend to over rule the tax system. Those actions tend to create an abusive law situation, where multinational enterprises face many extra taxations over their income.

A common way to do it is when a State, with a unilaterally decision, choose to override a tax treaty with an intern tax law. Under such situation, contracting States have the obligation to negotiate solutions to international treaty violations.

Normally, States tend to suspend either part that violated the treaty and demand a new renegotiation between the parts. It is even possible to demand a compulsory adjudication and even penalties under the jurisdiction on the International Forum. (ROHATGI, 2005)

An override on an international treaty can be seeing as violation the the *pacta sunt servanda*, from article 26 of the Vienna Convention on the Law of Treaties. Under this statement, countries that contracts with a treaty must be bending to it and performing it in good faith.

> Article 26.
> PACTA SUNT SERVANDA
> Every treaty in force is binding upon the parties to it and must be performed by them in good faith. (VIENNA CONVENTION ON THE LAW OF TREATIES, 1980)

Another way of regulating international taxation is through the Model Tax Convention on Income and Capital, focused on the elimination of double tax situations over income and capital. The Convention was created to avoid either double taxation and non-taxation opportunities that would favour some countries or companies.

> Article 9
> Associated Enterprises
> 2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such

1 Graduanda em Direito pela Universidade Tiradentes – UNIT

> adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other. (OECD, 2003)

Some MNEs that use tax planning benefits from the strategy approached on Article 9 of the OECD Model Tax Convention, where host countries provide calculation deals with tax payers MNES, to readjust their liabilities. With such, those companies end up finding the opportunity to restructure their businesses. (OECD, 2017)

Under the view of this article, States should not take advantage over their taxation power and over tax certain companies income as well as they should not avoid to tax companies for their own benefits or will. Even with strong laws around it, MNEs still find a way to over power their business structure.

Those businesses restructure provide to the multinational tax-planning enterprise an opportunity to have a more centralized control and management of their manufacturing production and finale products. In that way, MNEs can shape a new way of how the international market works.

4 THE IMPACT OF TAX PLANNING IN THE INTERNATIONAL MARKET

It is common for MNEs to be able to choose and adapt to the market it is insert in. With the advent of tax planning, it started to be easier for multinational companies to change their area of acting as well as their approach to their public.

Multinational enterprises that use the method of international tax planning, find themselves on a more secure market position. This is due to a high income achievement and strong profits that comes from a strong market stability.

Some enterprises found out that by the use of tax planning they would be able to approach different markets in different countries, but still not having to deal with a high tax burden for that. Because of that, the polarization of multinational enterprises went to a bigger level.

As it was discussed here, tax planning can provide an advantage inside the market, and in the relationship with governments. In such situation, it is common to see MNEs having advantages in the market which they run.

Because of such advantage, some have more confidence to explore different areas of actuation, developing new products out of its ranch. Under this point, the enterprise is now turned into a new competitor in the new field.

In that perspective, the tax planning MNEs that reaches to this point is restructuring their business plan as well as their market extensions. As this happens, a new possibility is introduced to the market, where consumers will now have access to a new set o products and prices.

Besides the economic growth in the market, tax planning influences directly to the economic growth of the parent country and the host country. For Fukao, this economic growth doesn't happen at once, however it is a long-term result that are mostly uncertain, but if successful, extremely recompensing. (FUKAO, 1993)

As a result of that, companies that invest on tax planning, tend to find more suitable host countries with better conditions for paying taxes. With that in mind, it is most certain that the allocation of a new company in a host country, does not only creates more income for that State, but creates as well more job opportunities for its society.

It is a fact that the creation of more labor space in a country has a direct impact in its economic growth. Once the population have proper jobs and economic conditions, they start to become consumers, what creates more consummation demands for companies.

The new rotation of capital inside a country, results in an active consuming market and the reduction of cost of capital. With the reduction of tax wedges, the cost of capital and funds, it increased the economic power of the parent country.

In such situation, it is common for the parent country to find its market having a higher stock prices in their markets. Such thing happened in Japan in the 1980s with the reduction of tax wedges in the United States and United Kingdom.

> (…) business in Japan and Germany appear to have joyed a considerable advantage with regard to the cost of funds over those in the United States and United Kingdom in the 1980s. For Japanese firms, this advantage was due to a higher leverage and, during the second half of the decade, a much lower cost of equity reflecting high stock prices in the Tokyo market. (FUKAO, 1993, page 10.)

With such observation, it is evident that multinational enterprises that adopt the tax planning strategy, can develop better market structures. While those structures not only reflect in their owl market arising but as well as in the host and parent country economic growth.

5 CONCLUSION

Despite the incredible work and deep planning that MNEs need to go through to archive the ideal tax planning level and benefit from it. It is clear that this method is an extremely beneficial way of increasing economic growth to different enterprises.

1 Graduanda em Direito pela Universidade Tiradentes – UNIT

Under this perspective, it is evident that many companies that invest their capital on tax planning can increase their possibility of reduction of tax burden in the international market, as well as to increase the amount of income that is collected.

It is also notorious that not only the multinational enterprises benefits from tax planning. Host countries that bend for international tax treaties and provide the necessary environment for MNEs to allocate their branches in their territories, can heavily benefit from that.

The increase of tax collection in the host country as well as the creation of new job opportunities is a method of improving the monetary circulation. What, results in a more economic activity society and generating more income.

Tax planning MNEs find them selves growing continuously to more secure and stable market, where not only their products becomes a consumer preference but also their brand names gets a more visibility. Under such situation, those MNEs archive a more secure position in the market, guaranteeing then a more stability.

It is also understandable that MNEs that practice tax planning, tend to places their activities in low tax jurisdiction states. Doing such, they normally end up raising their incomes and their profits.

With such powerful MNEs in the market, it is normal to see consumers having to deal with high prices products and limited editions from variety range. This happens once tax planning MNEs are strong enough to apply their profits in managing their actions in the market.

This strategy results on MNEs stroking down smaller multinational enterprises and local companies, which gives them more space to take over their market range space and consumers. As a conclusion, it is possible to say that tax planning MNEs are stronger enterprises in the market and have more space on the market range.

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