

# LLM Programme International and European Legal Studies

## International and European Tax Law

### Tax planning

*Andreas Tsourouflis*

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# Tax planning

## Case study

A Greek software engineer has a promising idea about a new application and software platform. This application and platform are intended to be sold and operated abroad. He is currently planning this software development project and he considers relocating abroad and/or establish a start-up company.

**He requests your professional opinion about the options for carrying out this software development project in a tax-efficient way.**

# Tax planning

## Concept

- Tax planning: Arrangement of a person's business and/or private affairs in order to minimize tax liability
- Distinction to aggressive tax planning (tax avoidance)
- Tax planning is lawful and legitimate
- Tax compliance is not tax planning
- There is a whole industry specializing in tax planning (domestic or international)
- Warren Buffet: "My tax rates are lower than my secretary's"

# Tax planning

## Concept

- Business taxation
  - ♦ Tax planning is an integral part of business management
  - ♦ Every business decision has a tax impact
  - ♦ Tax awareness
  - ♦ Tax planning is a part of financial planning and investment planning
- Individual taxation
  - ♦ Retirement planning
  - ♦ Property planning
  - ♦ Inheritance/Estate planning

# Tax planning

## Concept

- Tax planning may be
  - Domestic
  - International

# Tax planning

## Concept

- Objectives of international tax planning
  - Eliminate double or multiple taxation
  - Ensure tax exemption where provided
  - Make use of tax treaty or domestic benefits
  - Ensure loss relief
  - Avoid capital gains taxation upon cross-border company reorganisations
  - Avoid or minimise taxation of intra-group transactions or flows (e.g. dividends, interest, royalties, etc.)
  - Optimise the group structure
    - Choice of company seat
    - Choice of legal form
    - Choice of intra-group transactions
  - Tax efficient use of profits

# Tax planning

## Concept

- Objectives of international tax planning for individuals
  - Avoidance of high progressive tax rates
  - Making use of tax benefits for children and family members
  - Shifting income sources to other family members
  - Intergenerational transfer of assets with minimal taxation

# Tax planning

## Concept

- Tax planning instruments (companies)
  - ◆ Company forms
  - ◆ PEs vs. Subsidiaries
  - ◆ Offshore companies/jurisdictions
  - ◆ Holding companies
  - ◆ Profits/losses
  - ◆ Treaty/Directive Shopping
  - ◆ Associated companies, intragroup transactions
  - ◆ Company restructuring (mergers, spin-offs)



# Tax planning

## Concept

- Tax planning instruments (individuals)
  - Offshore companies/jurisdictions
  - Trusts
  - Tax residence

## Self-owned or family companies

- Legal framework:
  - ◆ Domestic tax legislation
  - ◆ Domestic company legislation
  - ◆ Domestic social security legislation
  - ◆ Tax treaties (articles about dividends, employment income)

## Self-owned or family companies

- Considerations
  - ◆ Individual tax rates in comparison to company tax rates
  - ◆ Owner's involvement in company activities
  - ◆ Employment of other family members
  - ◆ Inheritance issues

## Self-owned or family companies

- Options
  - ◆ Taking the profits in the form of dividends
  - ◆ Taking the profits in the form of salaries (employment contract with the company)
  - ◆ Directors remuneration
  - ◆ Company loan to owner/director
  - ◆ Employment of family members
  - ◆ Payment of social security contributions/employee pension plans by the company

## Cross-border loss relief

- Legal framework
  - National legislation
    - Loss carry-forward/carry-back
    - Tax consolidation for groups of companies
  - EU legislation
    - EU Merger Directive (2009): the receiving company takes over the losses of the transferring company

## Cross-border loss relief

- Considerations
  - Most jurisdictions provide for a loss carry-forward but only few for a carry-back
  - Only few jurisdiction have a group tax consolidation regime (e.g. Germany, Austria, the Netherlands, US, Denmark, etc.)
  - Group tax consolidation does not extend internationally
  - The application scope of EU Merger Directive is limited to specific company forms
  - Loss relief may be denied if it is considered abusive (e.g. if it fails the Principal Purpose Test)

## Cross-border loss relief

- Tax planning options
  - Sale of a loss making company
    - The price is reduced due to the losses
    - The acquiring company is usually able to make use of losses
  - Offset losses against profits
    - Without company reorganisation
    - With company reorganisation

## Cross-border loss relief

- Tax planning options
  - Offset losses against profits
    - Without company reorganisation
      - ➔ Offset losses against future profits (loss carry-forward)
      - ➔ Offset losses against past profits (loss carry-back)
      - ➔ Offset losses against profits of other group members (group tax consolidation)
    - With company reorganisation
      - ➔ Merger of a profit company with a loss company
      - ➔ Division: transfer of a profitable branch of activity to a loss company
      - ➔ Transfer of a shareholding in a profit company to a loss company
      - ➔ Modification of legal form (e.g. transformation of a loss partnership into a corporation, which is entitled to a group tax consolidation)



## International employee assignment

- Expatriation:
  - Employment in a foreign country permanently or for an extended period of time.
  - The expatriate employee is recruited specifically for the assignment or is sent by the employer to work abroad.
- Secondment:
  - In general the temporary assignment by an employer of an employee to another, typically related, party.
  - The seconded employee is already working for the company and is sent abroad for a limited period.

## International employee assignment

- Legal framework
  - National tax legislation
  - National employment legislation
  - National social security legislation
  - Tax treaties: Art. 15 OECD Model (Income from Employment)
  - EU social security legislation

## International employee assignment

- Art. 15 OECD Model: INCOME FROM EMPLOYMENT

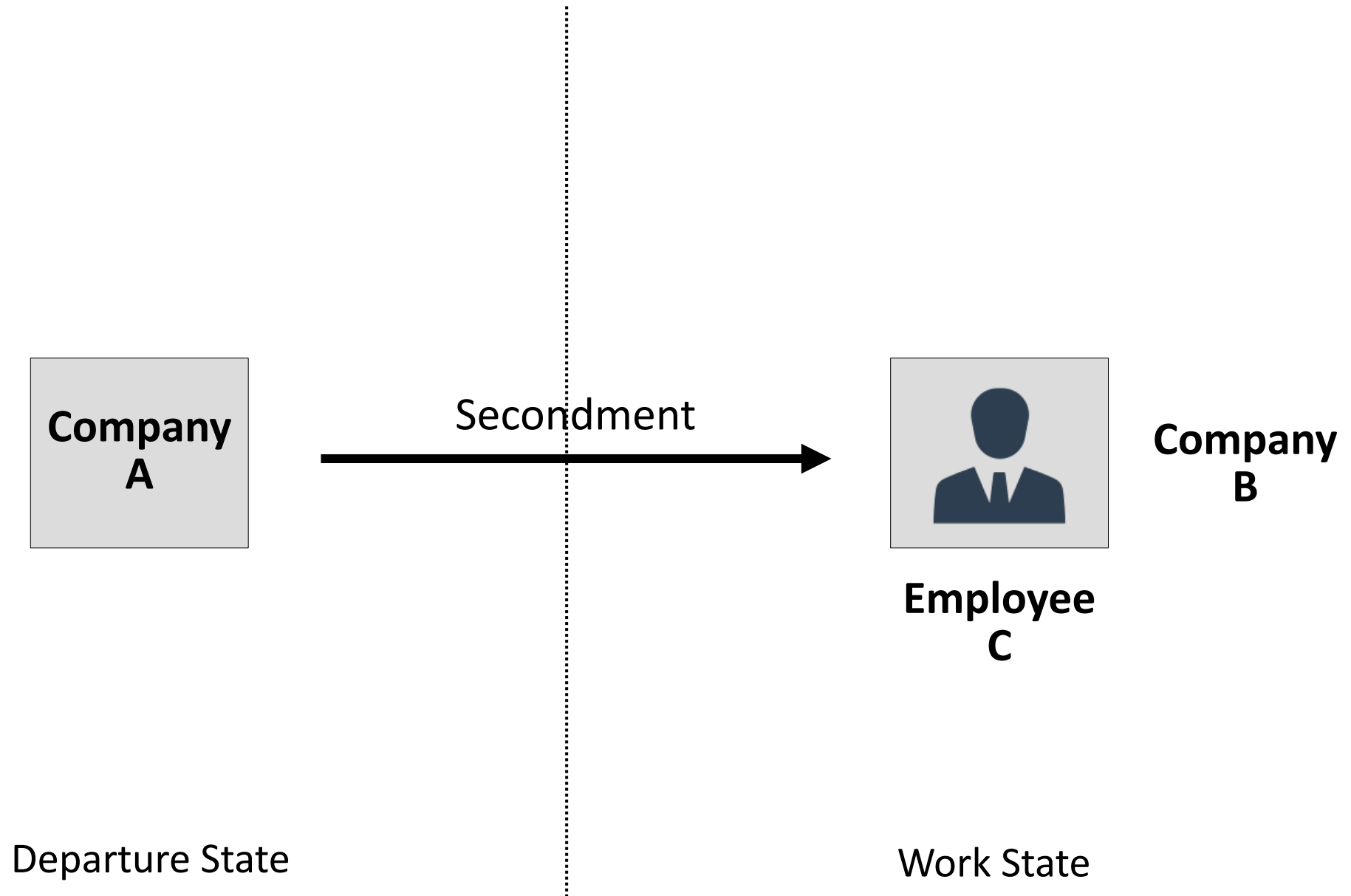
"2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and

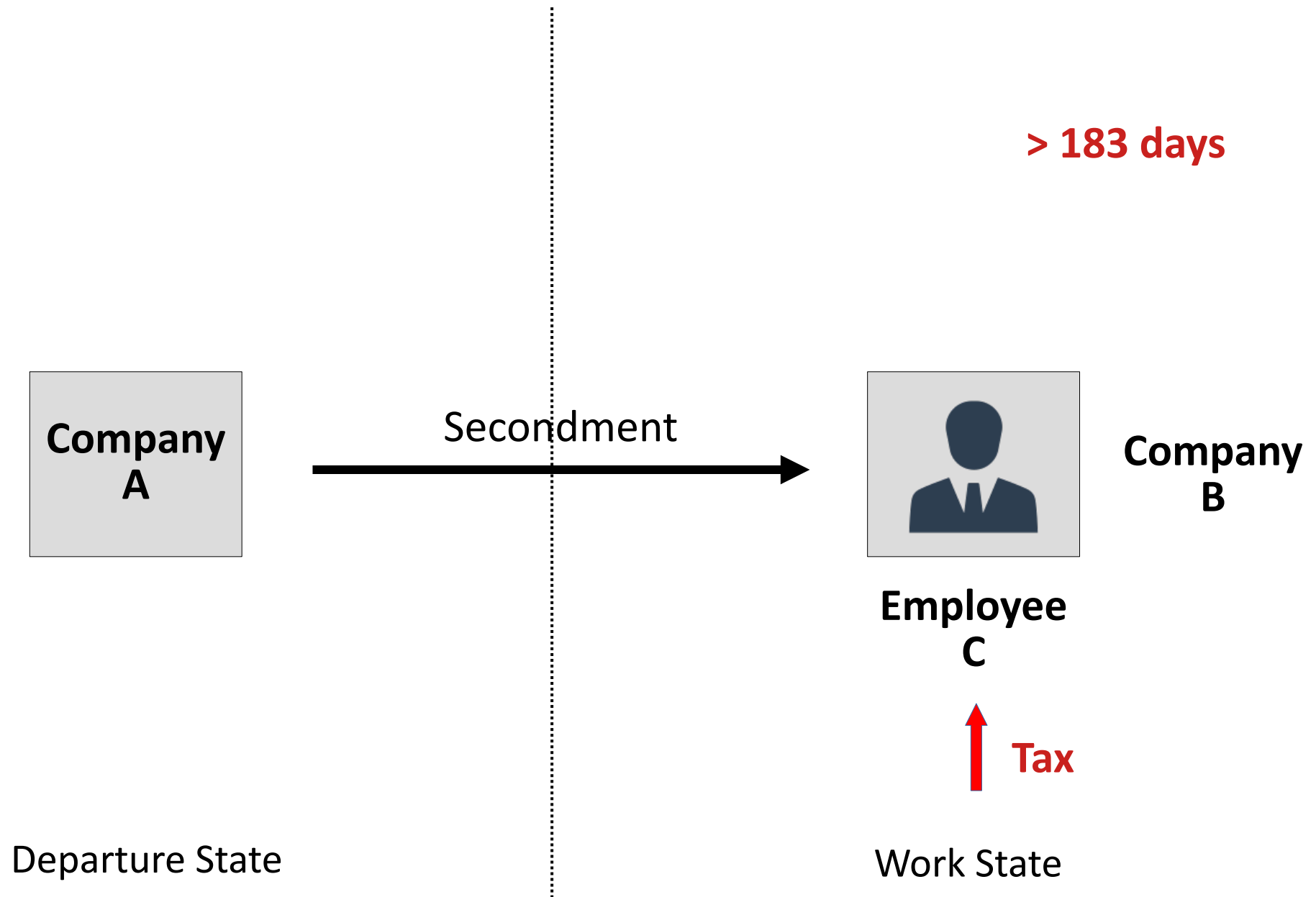
b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

c) the remuneration is not borne by a permanent establishment which the employer has in the other State."

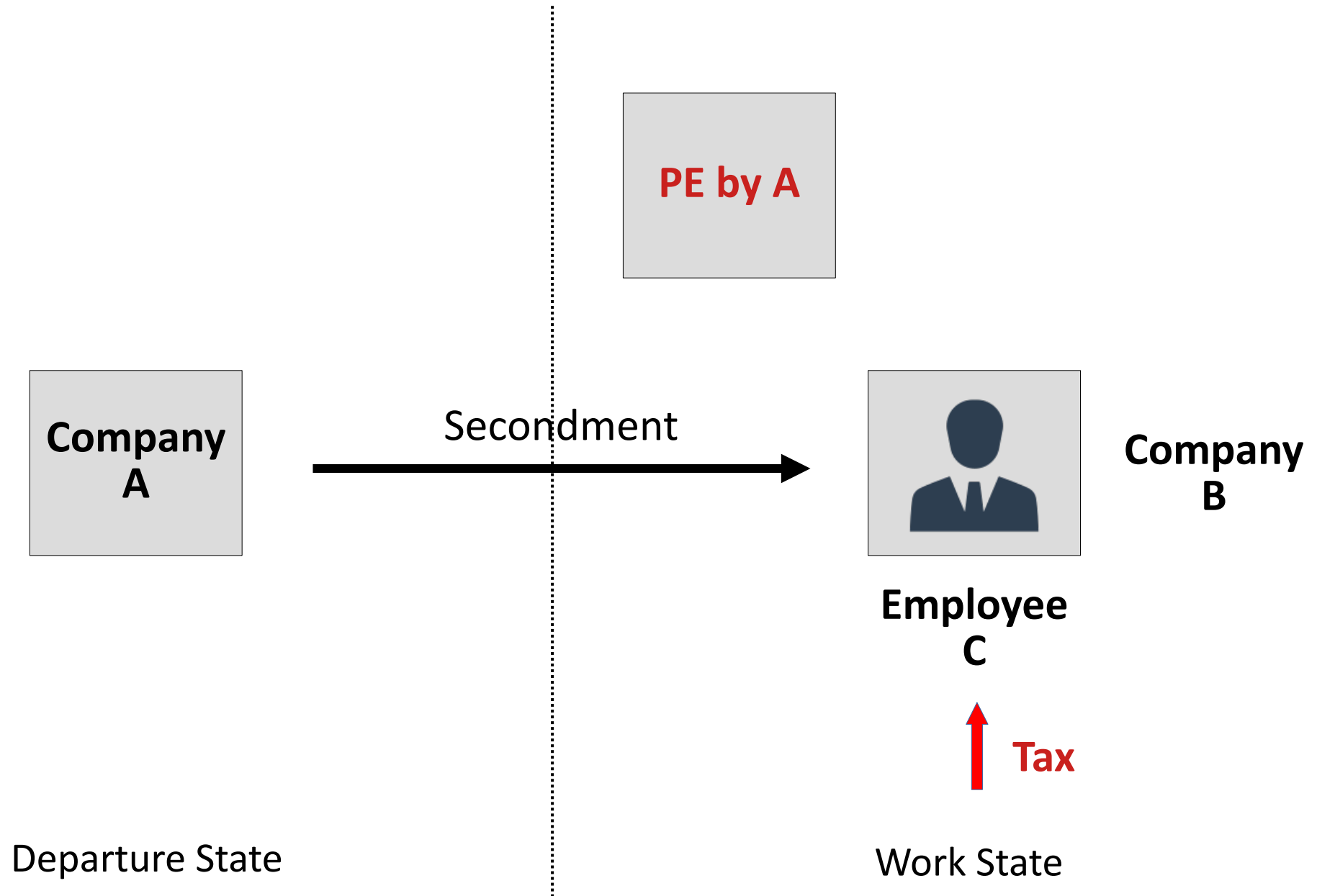
# Tax planning



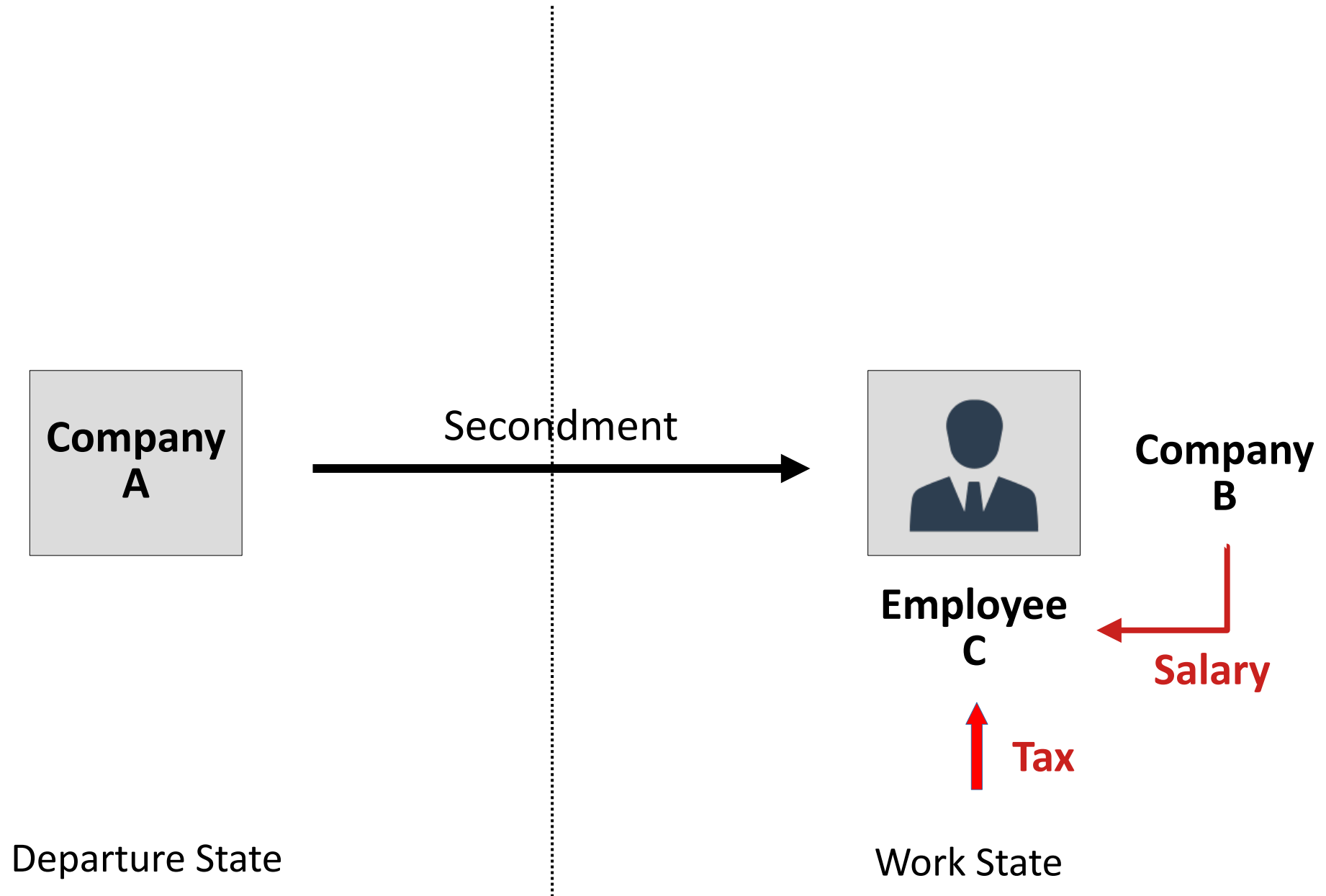
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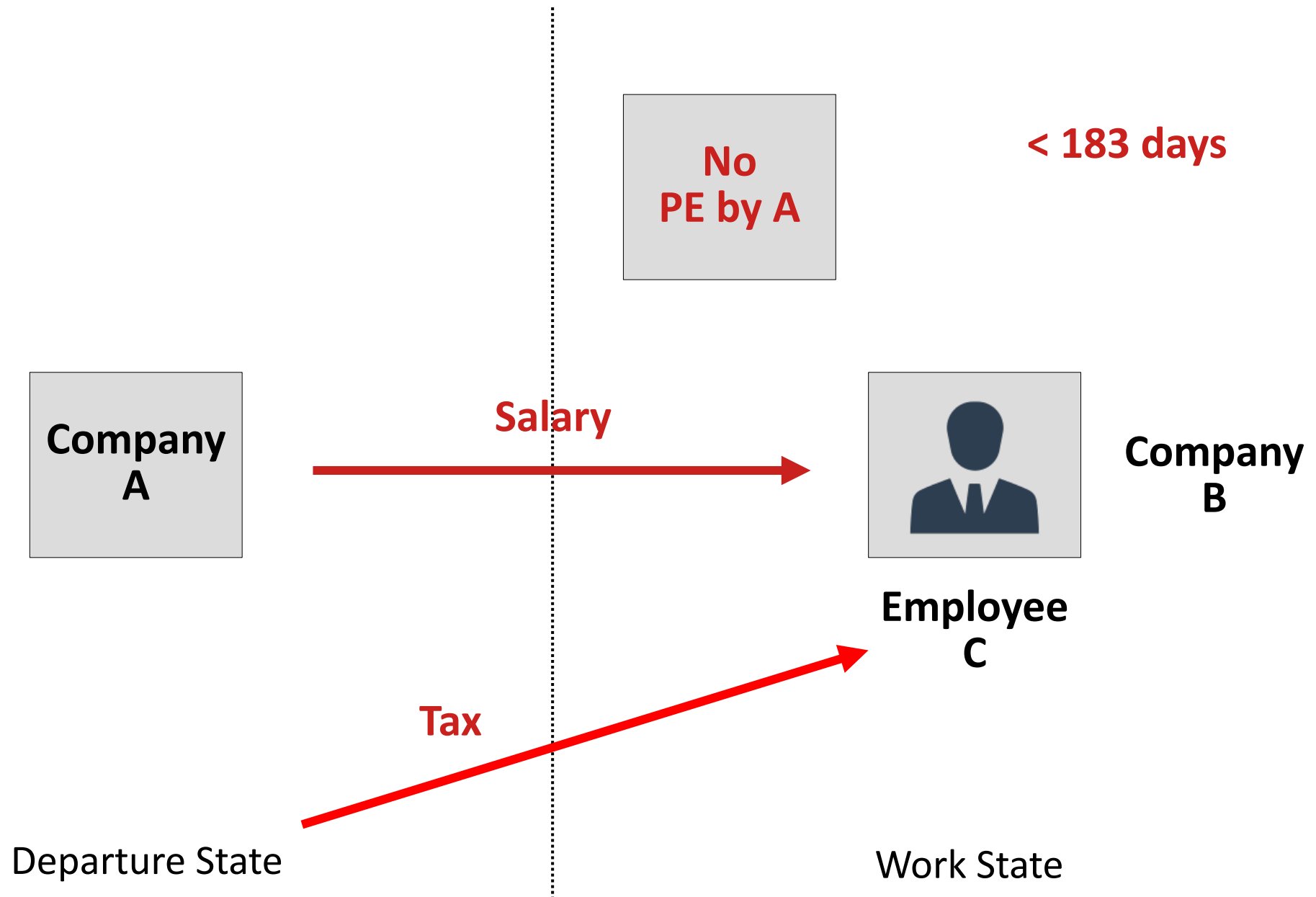
# Tax planning



# Tax planning



# Tax planning





## International employee assignment

- Considerations
  - Duration of secondment
  - Relocation or not of the employee's family
  - Tax rates of the departure state and the work state
  - Social security obligations
  - Other income acquired by the employee

## International employee assignment

- Tax planning options
  - ♦ Salary split: a part is paid by the original company and the rest by the host company
  - ♦ Timing of the departure and repatriation
  - ♦ Form of salary payments
    - Motivation bonuses
    - Stock options
    - One-off payments
    - Employee loan write-off
    - Fringe benefits (e.g. a holiday bonus, travel allowance, etc.)
  - ♦ Timing of employee payments
    - Prepayments
    - Bonuses after the secondment
    - Stock options
  - ♦ Benefits in kind (e.g. free accommodation, meal vouchers, company car, credit card, etc.)

## Hybrid mismatches

- Definition of hybrid: something of mixed character; combining different elements
- Not necessarily bad or illegal
- Examples in tax law
  - ♦ Hybrid systems of double tax relief
    - e.g. exemption method for foreign direct investment income and credit method for foreign passive income
  - ♦ Hybrid accounting method
    - e.g. a taxpayer may use accrual basis accounting with respect to purchases and sales and cash basis accounting in computing all other items of income.
- Instruments of hybrid mismatch planning
  - ♦ Hybrid entities
  - ♦ Hybrid instruments

## Hybrid mismatches

- Hybrid entities: transparent vs. opaque
- Common examples
  - Partnerships
  - Silent partnerships
  - Limited partnerships
  - Atypical silent partnerships
  - US "check the box" rules

## Hybrid mismatches

- Common examples of hybrid entities
  - Partnerships
    - Fiscally transparent in most countries but separate tax subjects in some others
  - Silent partnerships
    - a silent partner does not participate in the activities of the partnership but merely provides capital.
    - Income is treated as interest in some countries, as dividends in others
    - e.g. German "Stille Gesellschaft"
  - Limited partnerships
    - the partner has no responsibility for the debts of the partnership beyond his investment.
    - Income is treated as interest in some countries, as dividends in others
    - Common in Germany: "Kommanditgesellschaft»

## Hybrid mismatches

- Common examples of hybrid entities
  - ♦ Atypical silent partnerships
    - Combining features of both the typical silent partnership and the limited partnership
    - The partner is involved in the management of the enterprise and often commands a premium rate of return on his investment.
    - Income is treated as interest in some countries, as dividends in others
  - ♦ US "check the box" rules
    - A US taxpayer may choose whether an entity is to be regarded as transparent or opaque for US tax purposes
    - No option in the case of "per se" corporations

## Hybrid mismatches

- Hybrid financial instruments: equity vs. debt
- Common examples
  - Jouissance rights
  - Certain types of preference shares
  - Profit participating loans
  - Convertible bonds
  - Subordinated loan

## Hybrid mismatches

- Hybrid financial instruments: equity vs. debt
- Common examples
  - ♦ Jouissance rights
    - shares which grant rights like those enjoyed by shareholders but which, in some jurisdictions, are viewed as debt rather than equity.
  - ♦ Certain types of preference shares
    - income from preference shares is usually classified as a dividend, however depending on the particular terms it may be classified as interest
    - e.g. redeemable shares, carrying a cumulative fixed rate of dividend and ranking before other classes of shares on a winding-up



## Hybrid mismatches

- Common examples
  - Profit participating loans
    - The capital is repayable but the return and possibly also the amount repayable is linked to the profits of the borrower.
  - Convertible bonds
    - the holder has the right to convert the bonds into share capital at some point in the future.
  - Subordinated loan
    - the situation where a bank lends and agrees that its right to repayment ranks behind that of certain other investors
    - This has some characteristics of equity capital.
    - Banks charge high rates of interest on these loans to compensate for the increased risk.

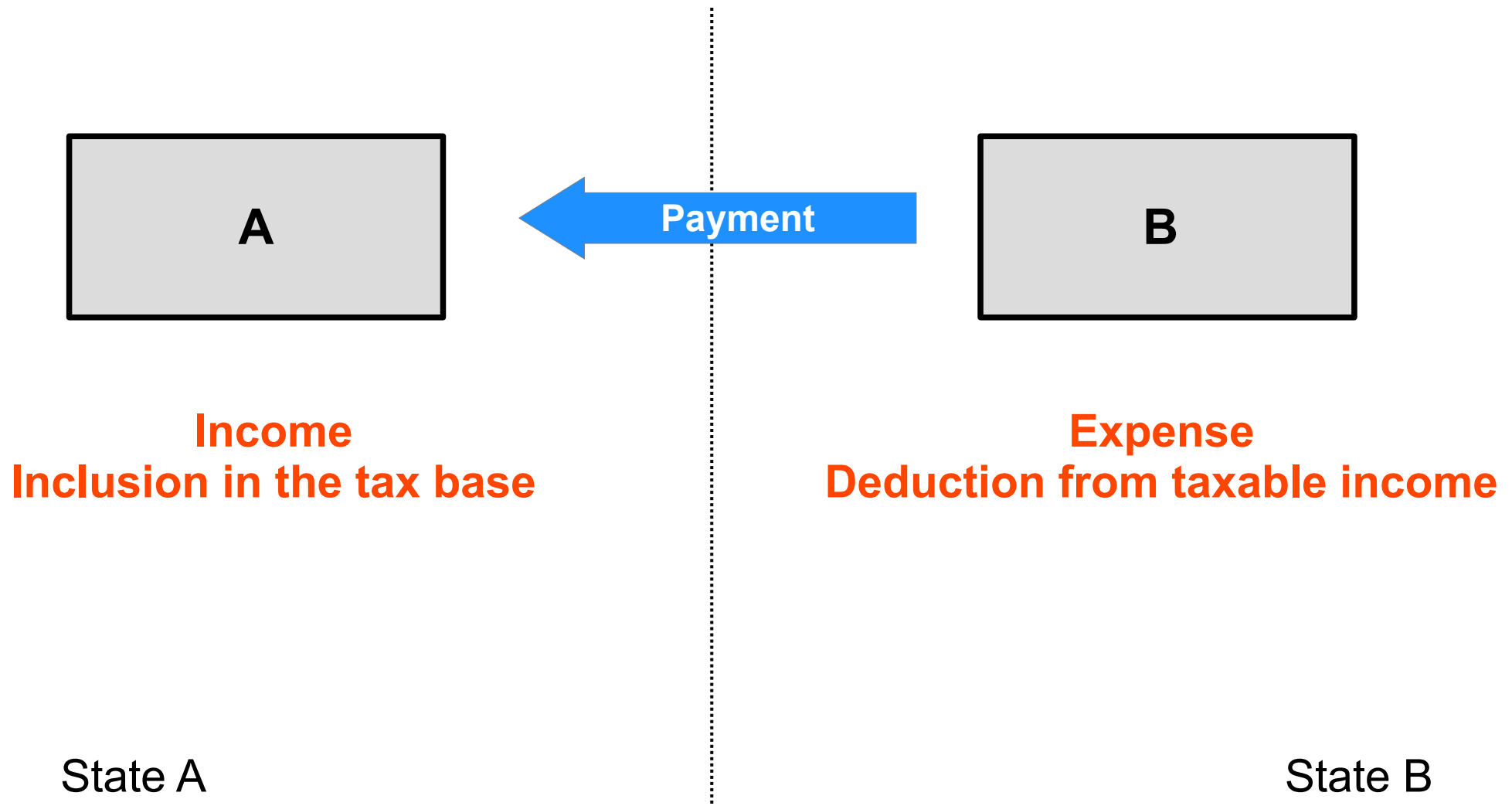
## Hybrid mismatches

- Hybrid mismatches
  - ◆ Arrangements that exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation, including long-term deferral.
- Disambiguation: other mismatches (not hybrid)
  - ◆ Branch mismatches
  - ◆ Residence mismatches

# BEPS

## Hybrid mismatches

- Regular situation



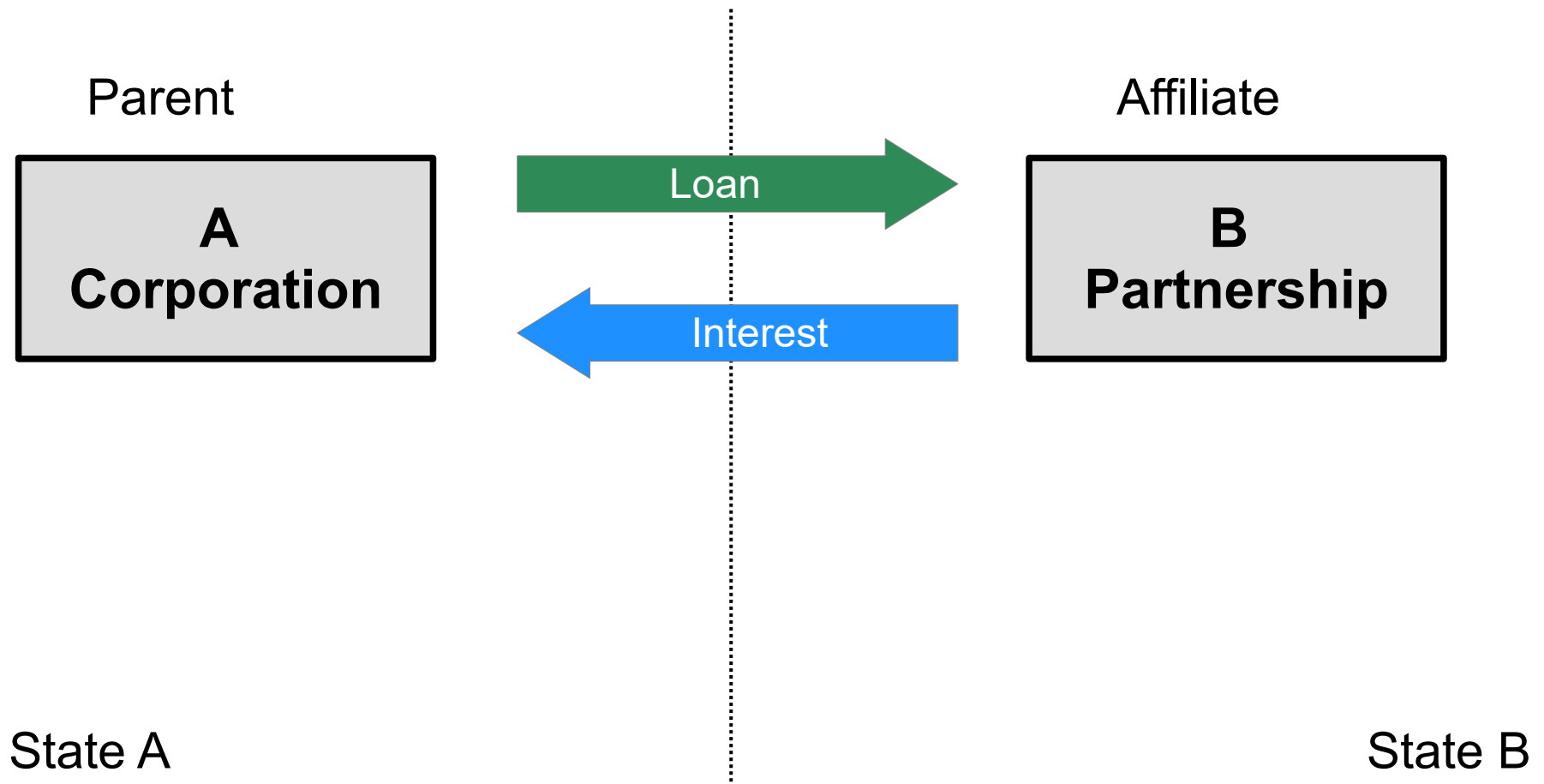
## Hybrid mismatches

- Hybrid mismatches – Tax consequences
  - ◆ Deduction but no inclusion (D/NI)
    - a deduction is claimed in the country where a payment is done but the income is not included in the taxable income of the recipient.
  - ◆ Double deduction (DD)
    - two countries allow a deduction for the same payment

# BEPS

## Hybrid mismatches

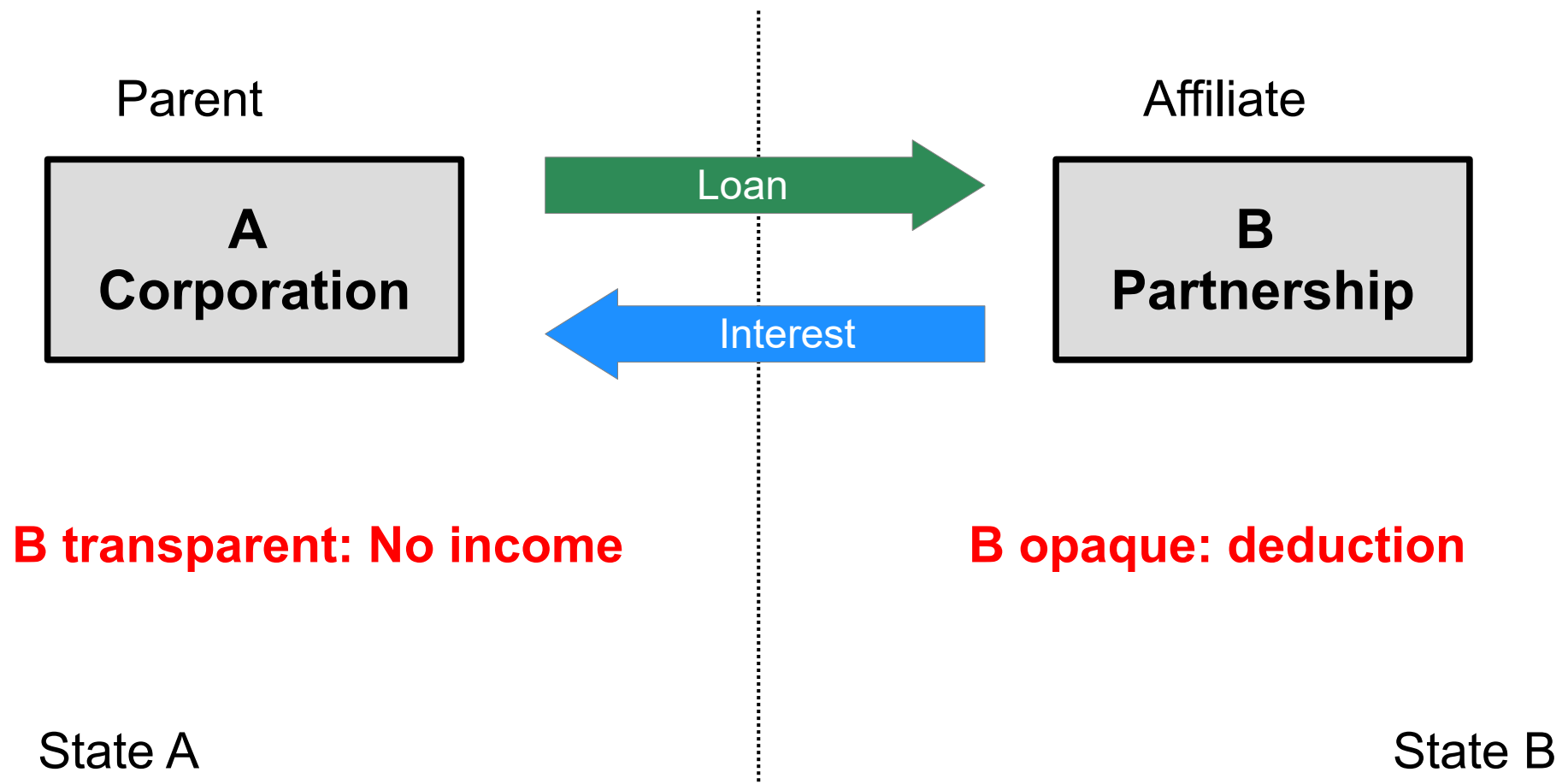
- Deduction but no inclusion (D/NI)



# BEPS

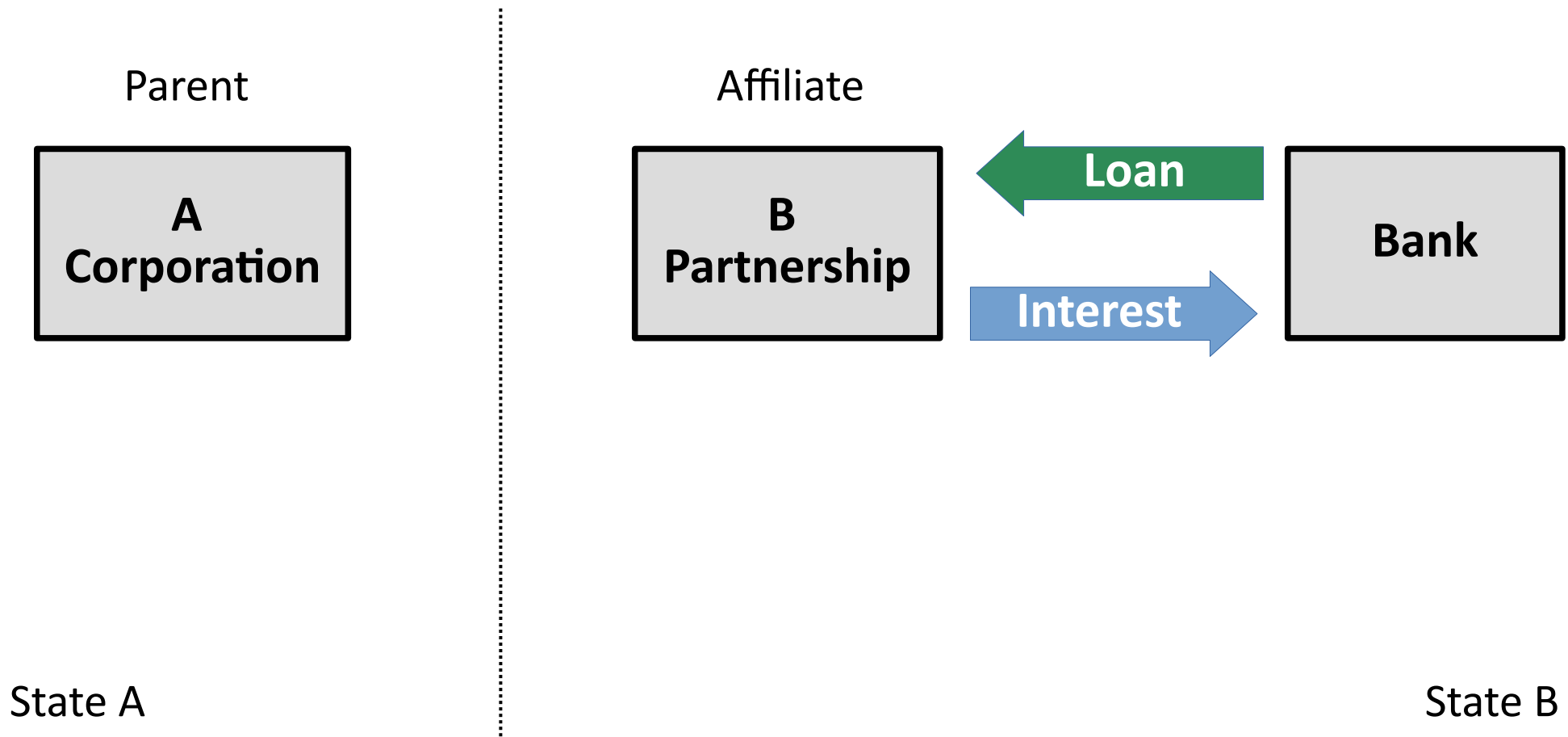
## Hybrid mismatches

- Deduction but no inclusion (D/NI)



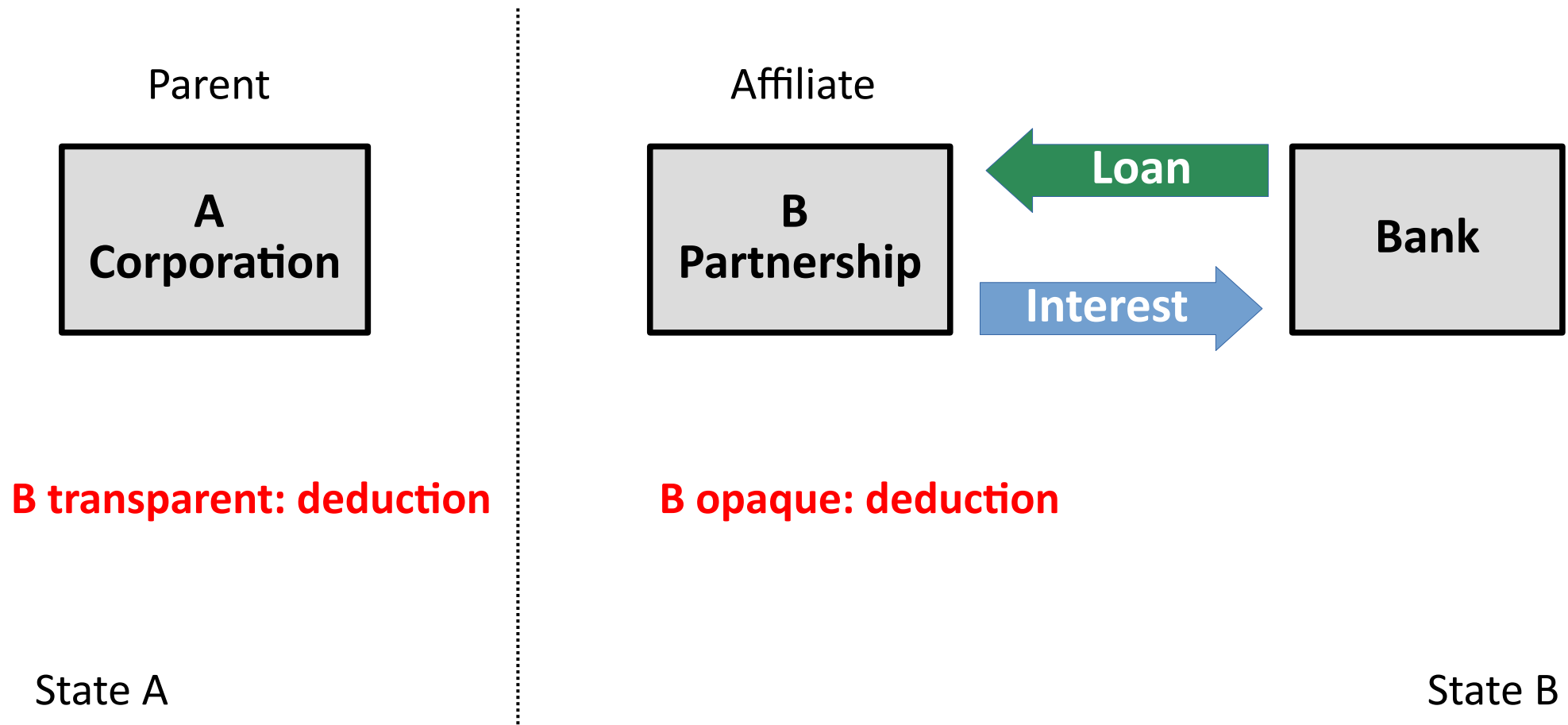
## Hybrid mismatches

- Double deduction (DD)



## Hybrid mismatches

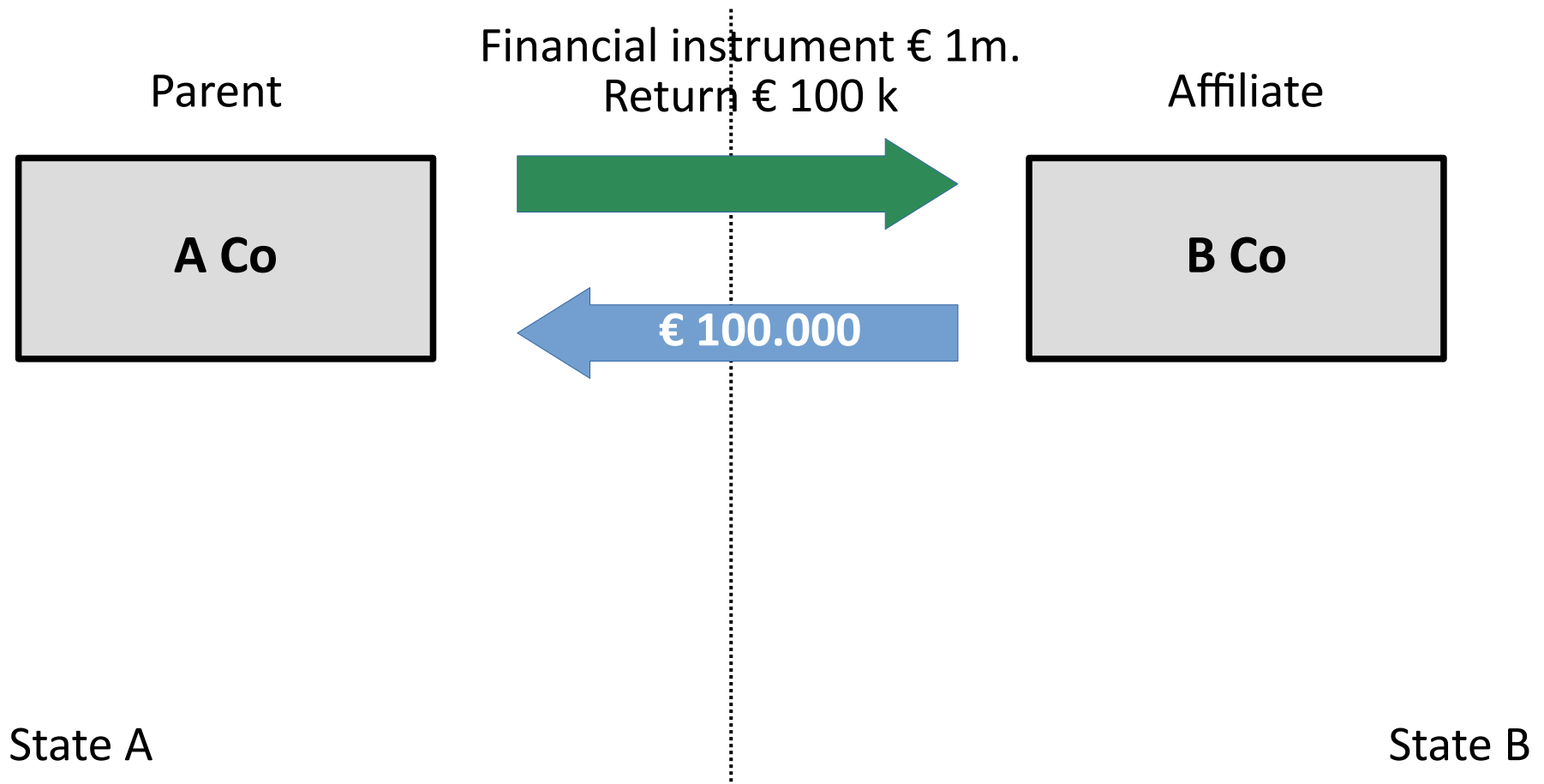
- Double deduction (DD)





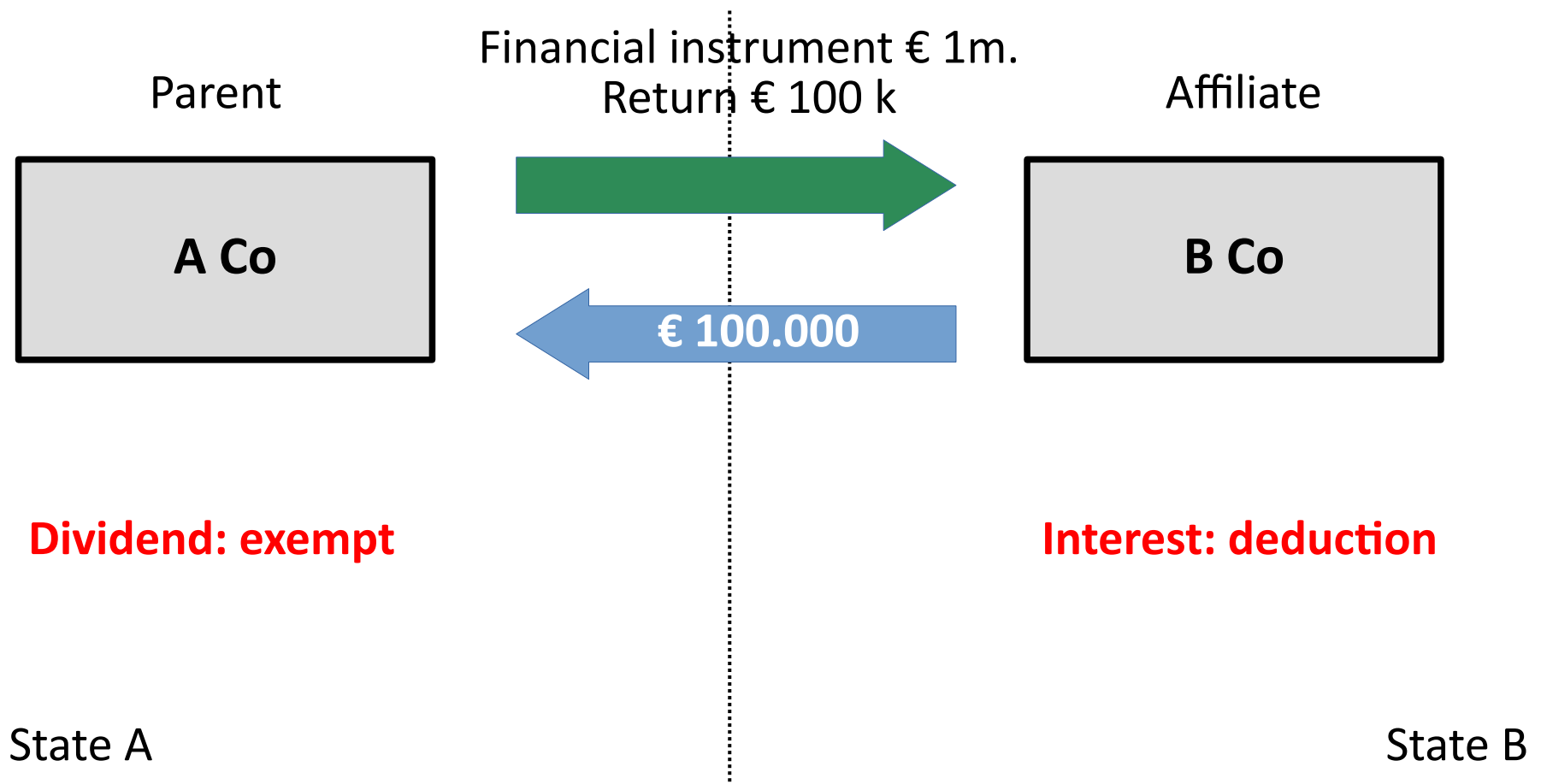
## Hybrid mismatches

- Deduction but no inclusion (D/NI)



## Hybrid mismatches

- Deduction but no inclusion (D/NI)



## International air transport

- Legal framework

- Art. 8 OECD Model (as of 2017):

- "INTERNATIONAL SHIPPING AND AIR TRANSPORT**

- 1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State"

- Art. 8 OECD Model (prior to 2017):

- "INTERNATIONAL SHIPPING AND AIR TRANSPORT**

- 1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated."

## International air transport

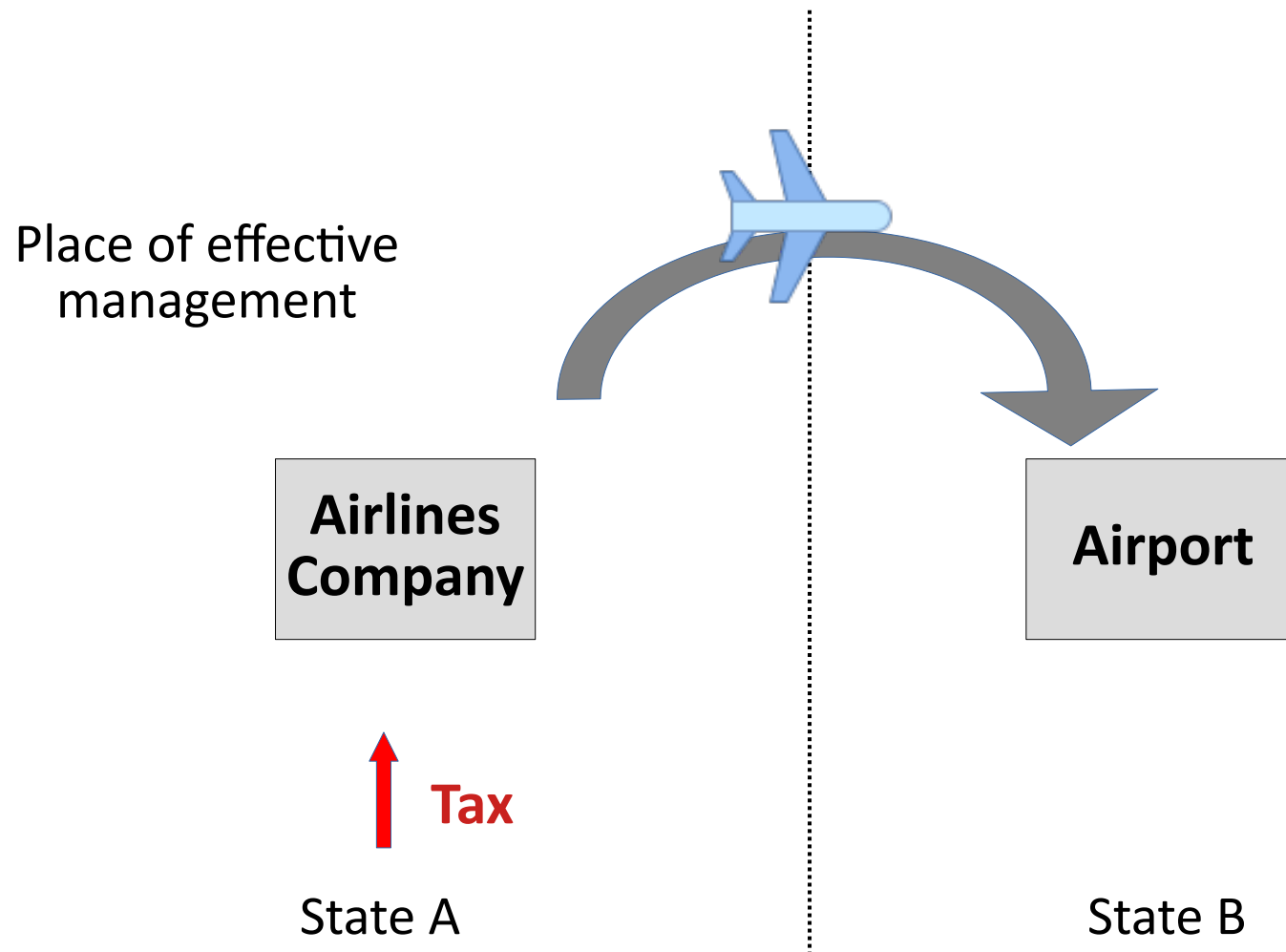
- Considerations
  - Some tax treaties follow the 2017 Model, others follow the previous Model
  - Art. 8 covers
    - profits from activities directly connected with international flight operations
    - profits from activities not directly connected with international flight operations as long as they are ancillary to such operations.

## International air transport

- Tax planning options
  - If the applicable tax treaty follows the older OECD Model (place of effective management), an international flight company may change its tax liability by moving the place of management

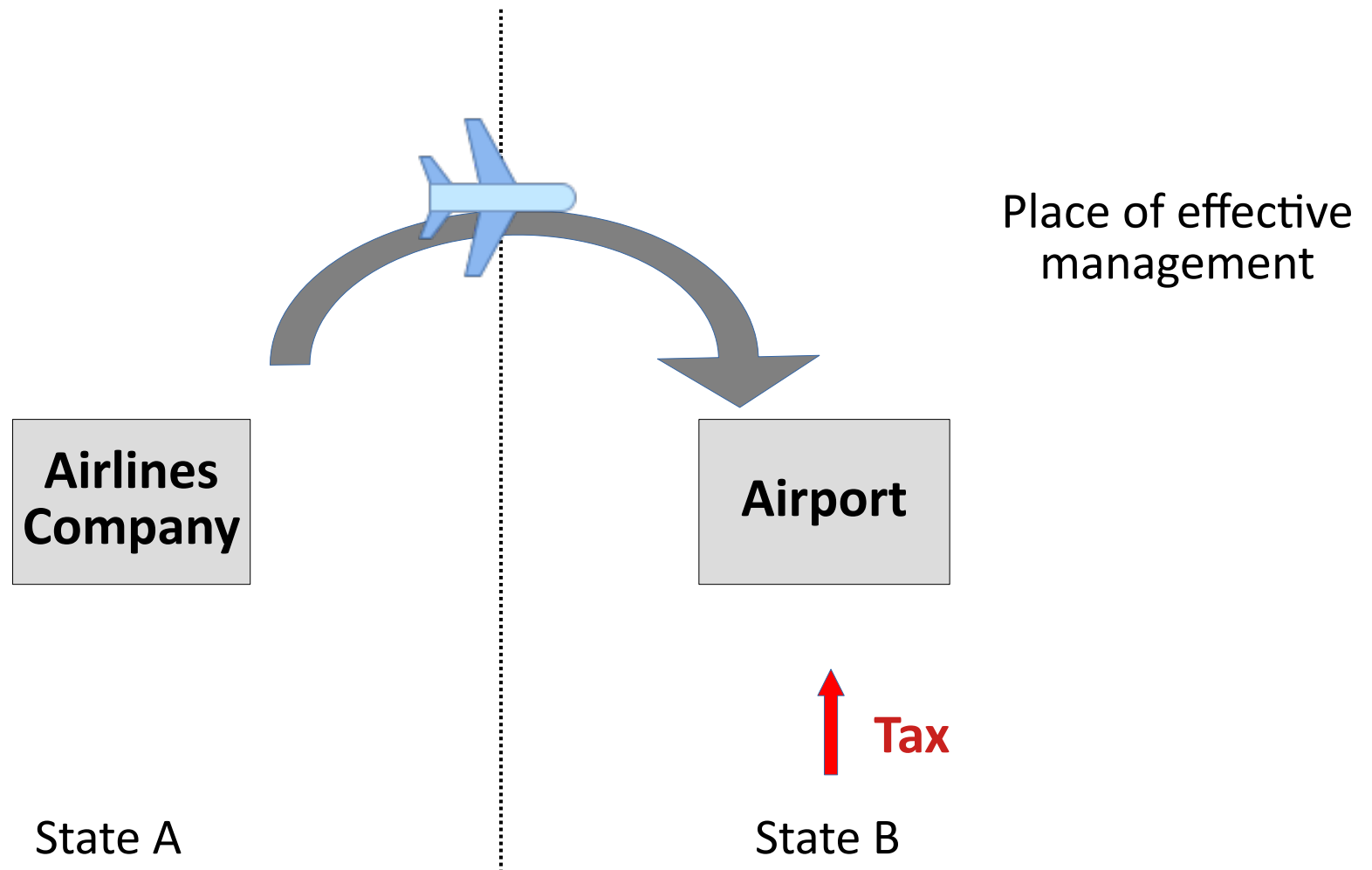
# Tax planning

## International air transport



# Tax planning

## International air transport



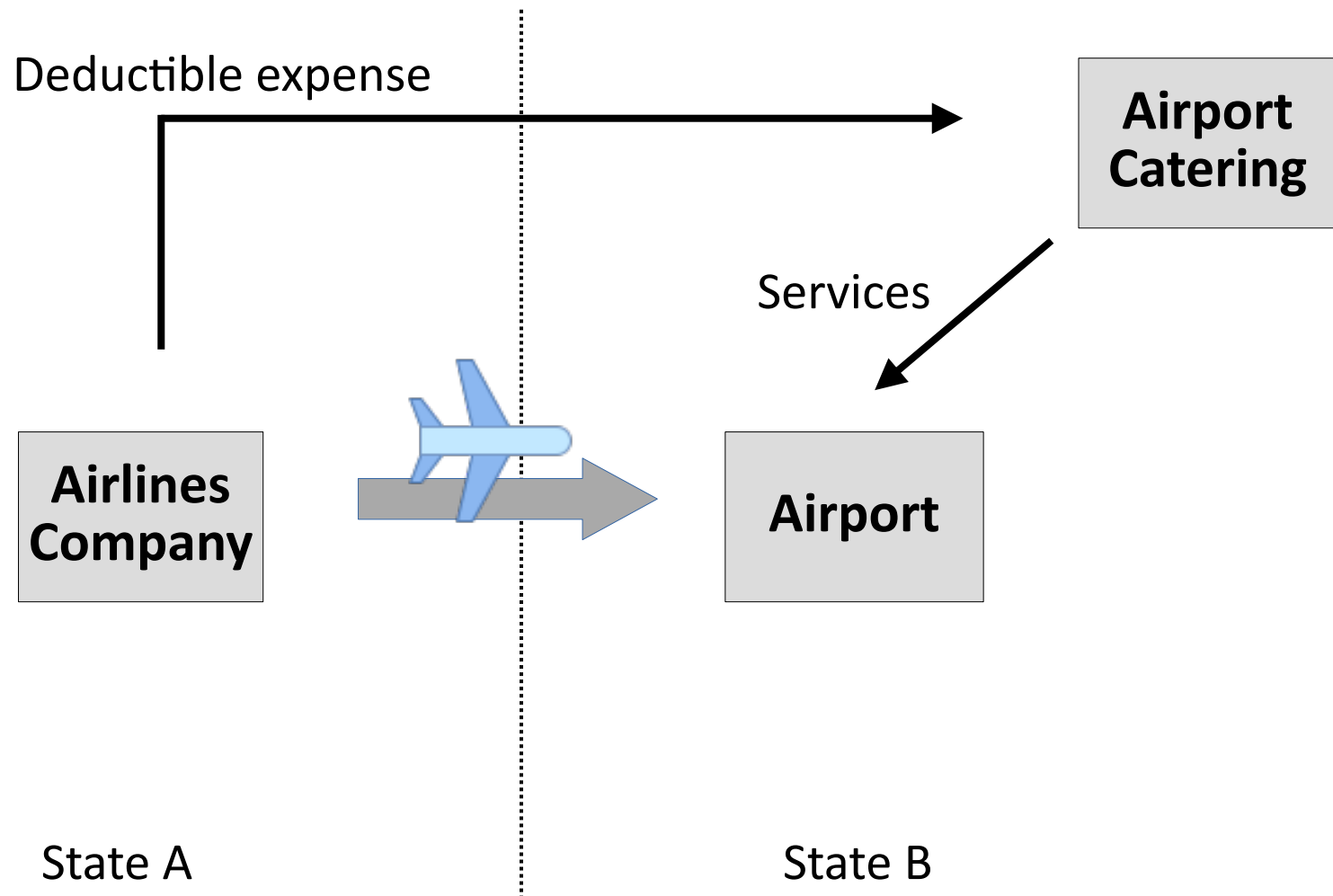
## International air transport

- Tax planning options
  - Ancillary activities (e.g. catering, ground-handling, ticket selling, bus transport to and from the airport, technical maintenance, etc.)
    - Provided by the airport company:
      - ➔ No profit
      - ➔ Deductible expense
    - Provided by a permanent establishment
      - ➔ Profit
      - ➔ Taxable (partly) in the state of residence
    - Provided by a subsidiary
      - ➔ Profit
      - ➔ Taxable in the state of the subsidiary



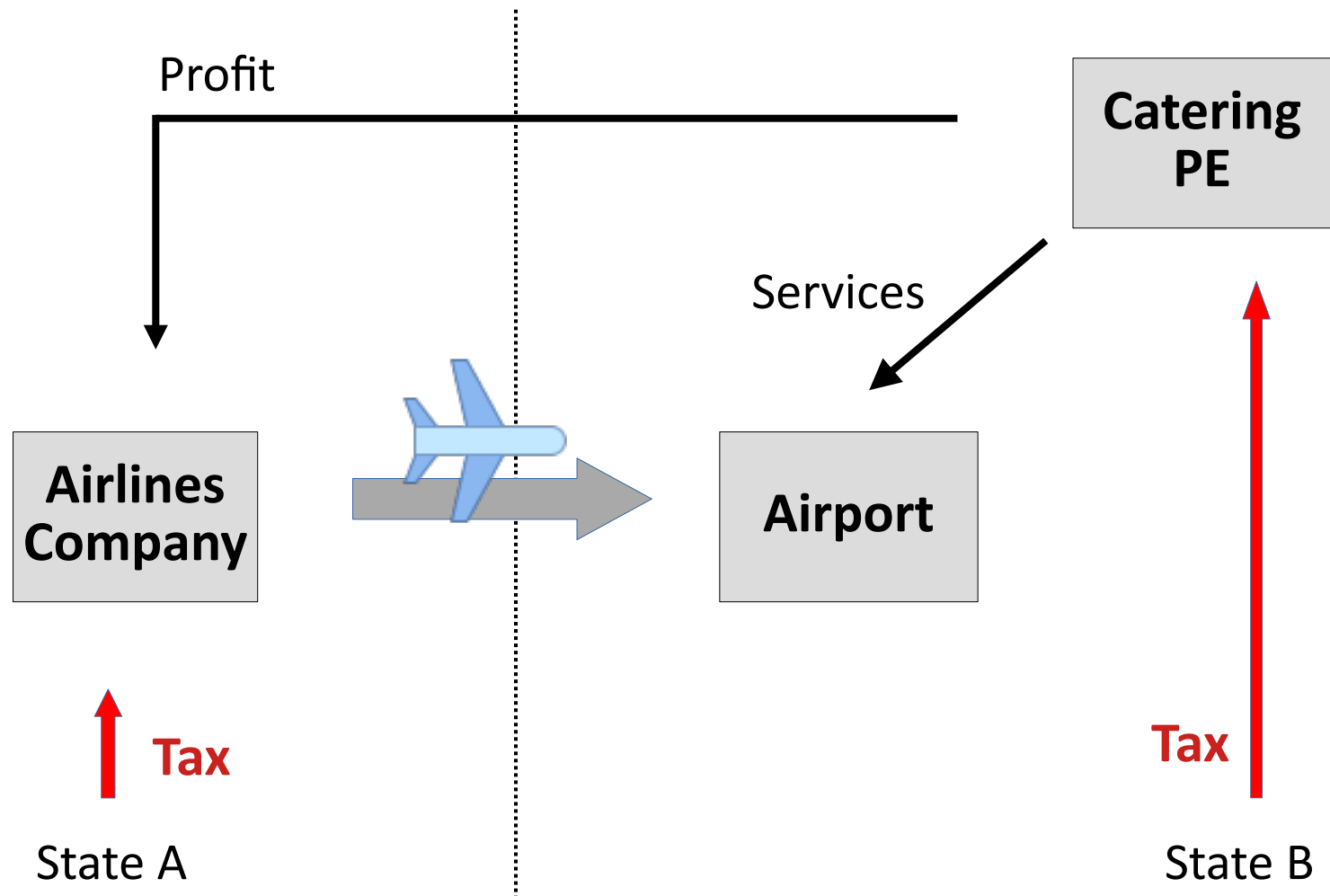
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## International air transport



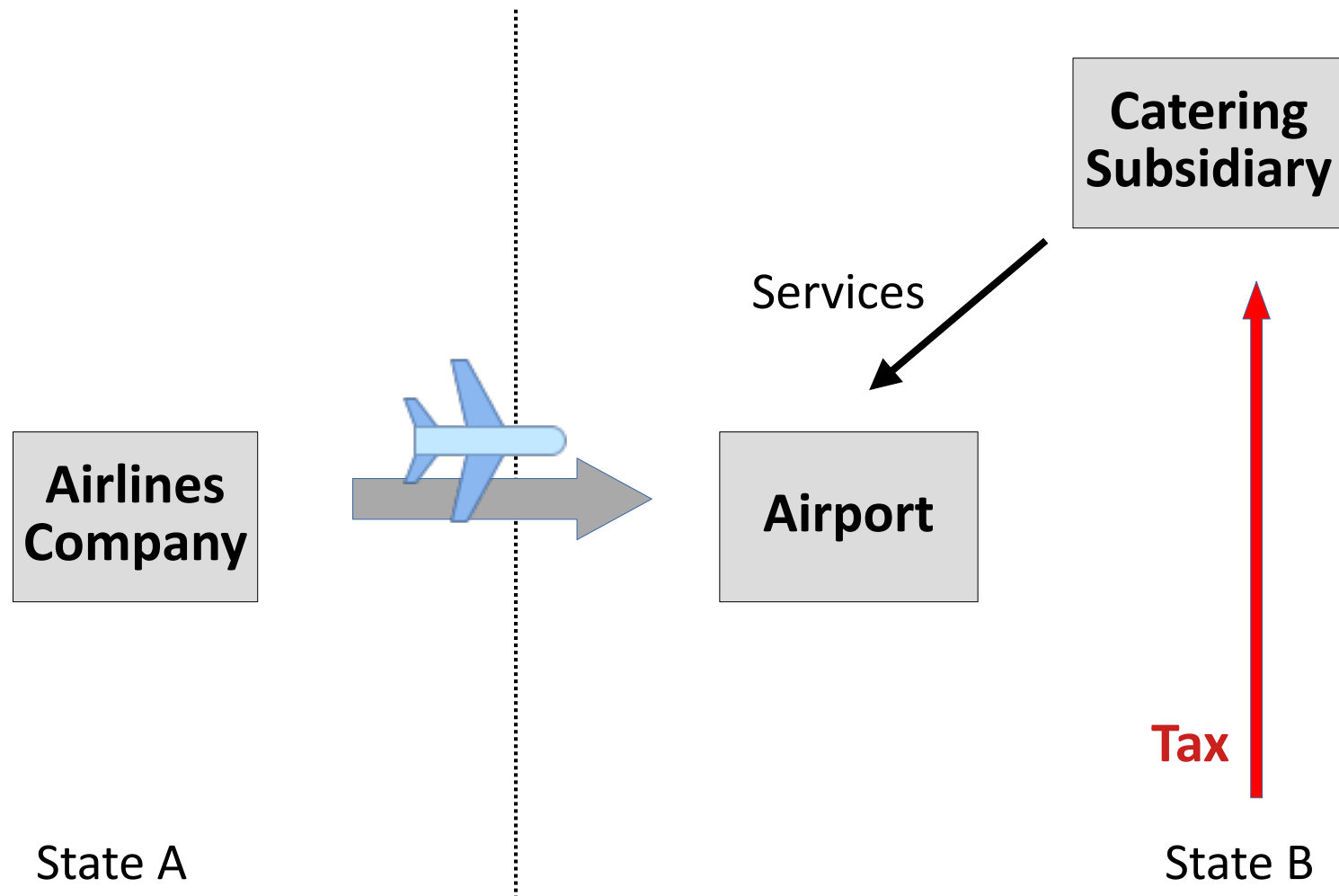
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## International air transport



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## International air transport

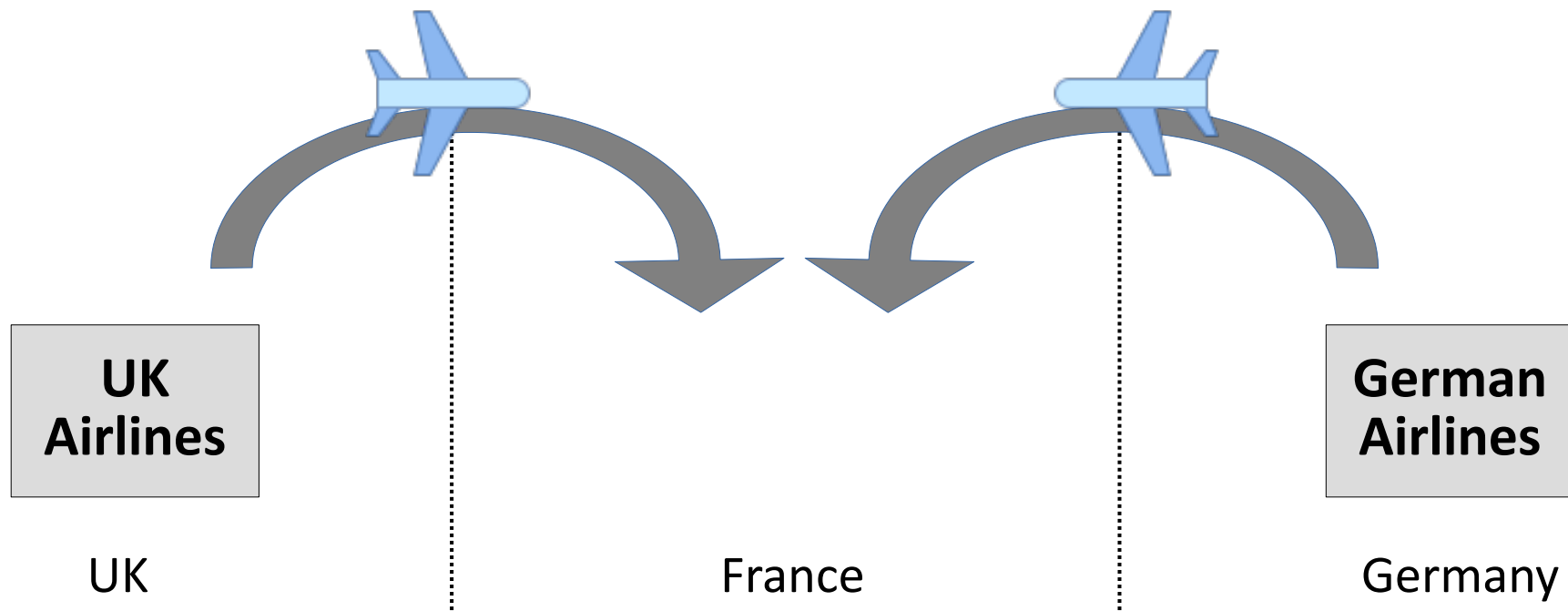


## International air transport

- Tax planning options
  - Pooling operations, joint-ventures
    - Income from pooling operations is attributed to pool members
    - Joint venture companies are taxed at their state of residence

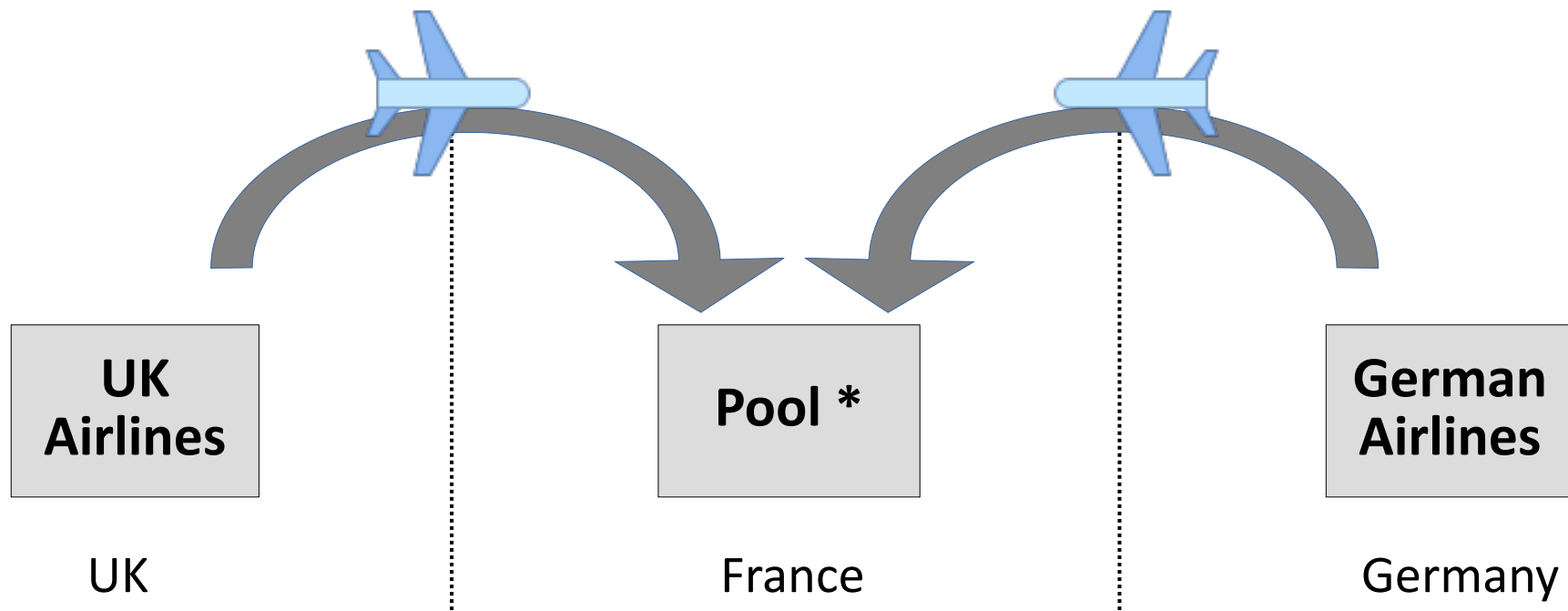
# Tax planning

## International air transport



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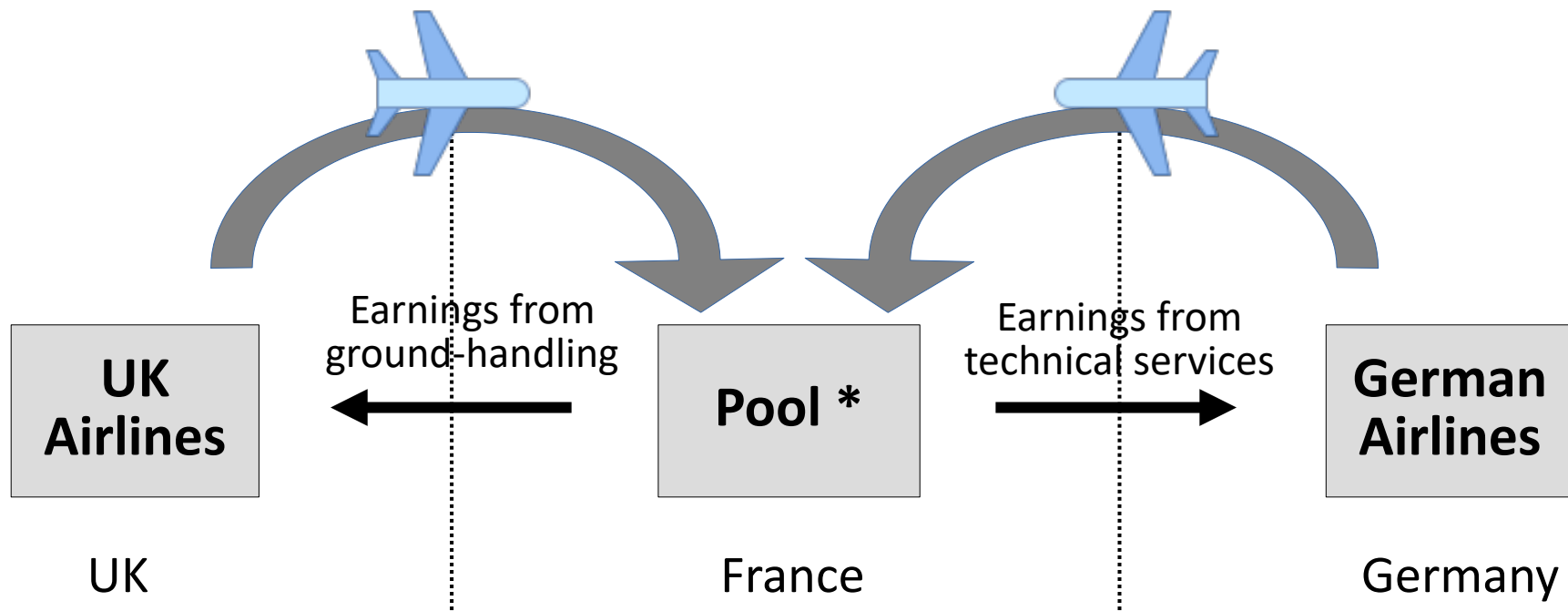
## International air transport



\* Pool: UK ground-handling, German: technical services

# Tax planning

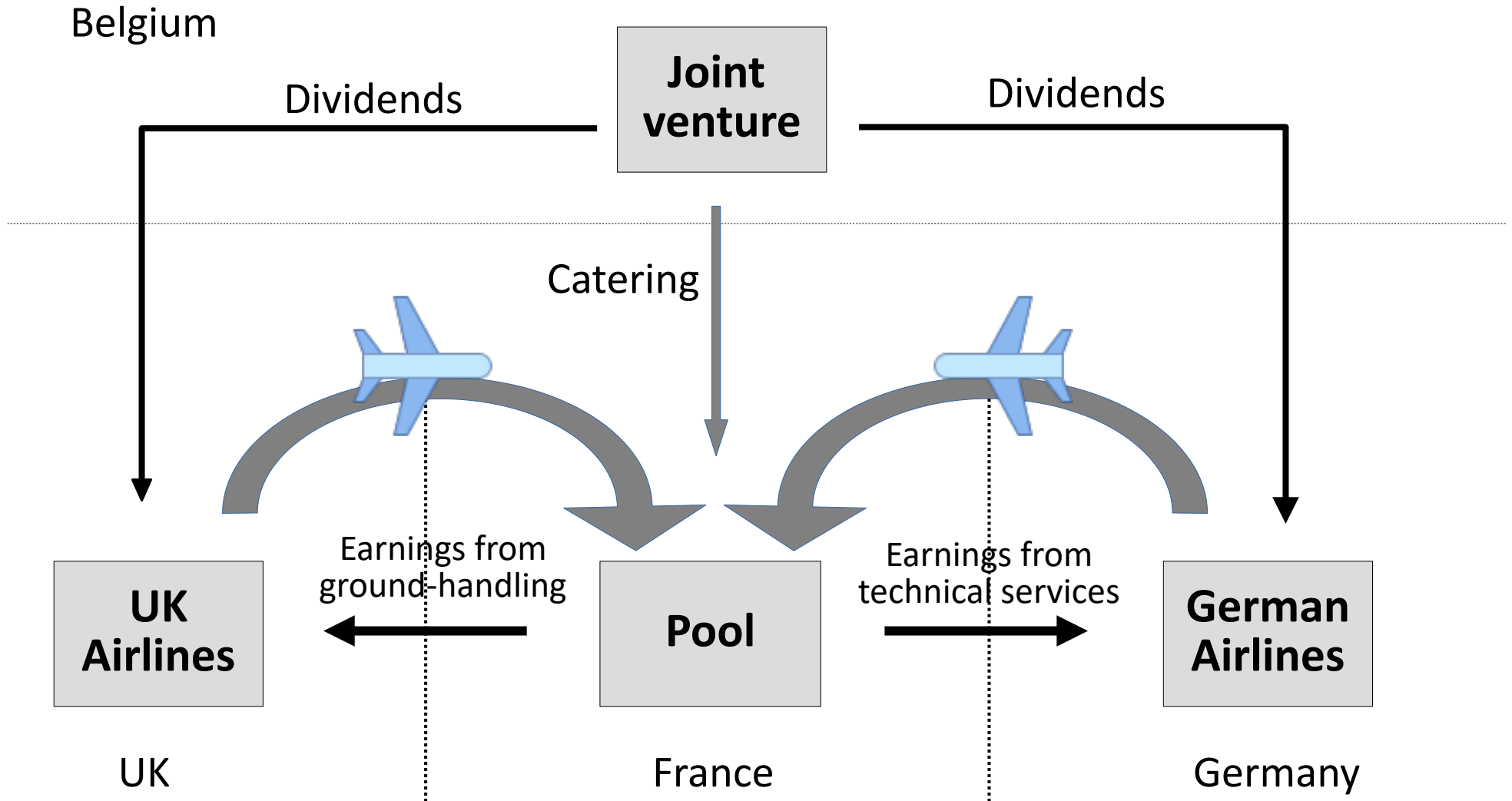
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## International air transport





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## Case study

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**He requests your professional opinion about the options for carrying out this software development project in a tax-efficient way.**