Base Erosion and Profit Shifting

For Prelims: Global minimum corporate tax rate, Organisation for Economic Co-operation and Development (OECD), Base Erosion and Profit-Shifting (BEPS), G20, digital transactions, equalisation levy

For Mains: Role of Organisation for Economic Co-operation and Development (OECD) in addressing global challenges, the significance of Base Erosion and Profit-Shifting (BEPS) in promoting cooperation.

Source: OECD

Why in News?

Recently, the Organisation for Economic Co-operation and Development (OECD) welcomed the commitment of the **147 Members** of the Inclusive Framework on Base Erosion and Profit-Shifting (BEPS) to keep working to resolve any remaining issues in the signing process of the Multilateral Convention (MLC).

What is Base Erosion and Profit Shifting (BEPS)?

- **About**
  - The BEPS initiative is an OECD initiative, approved by the G20, to identify ways of providing more standardised tax rules globally.
  - BEPS refers to tax strategies exploiting differences in tax rules across countries **to minimise overall corporate tax payments.**
- **Aim:**
  - This strategy aims **to reduce overall corporate tax liability** by making profits seem to vanish or by moving them to low-tax regions with minimal real economic activity.
    - While often not illegal, BEPS tactics capitalise on variations in international tax regulations.
  - Developing countries are particularly vulnerable to BEPS due to their strong dependence on corporate income tax, especially from multinational corporations.
- **Inclusive Framework on BEPS:**
  - Inclusive Framework was **established by** the OECD and G20 **in 2016.**
  - It unites **147 countries and jurisdictions**, to combat tax avoidance and promote equitable tax practices, and comprises two pillars.
    - **First Pillar:**
      - It addresses **cross-border profit shifting** by multinational and digital companies.
      - It aims to ensure these large enterprises pay taxes where they generate profits, potentially reallocating over USD 100 billion annually to market jurisdictions.
    - **Second Pillar**:
      - It proposes a global minimum corporate tax rate, currently suggested at **15%,** to prevent harmful tax competition among countries.
      - It will raise significant revenues of **up to USD 192 billion** per year for

developed and developing countries.

What is the Global Minimum Tax (GMT)?

- A globally agreed minimum tax rate, currently suggested at **15%** could mitigate tax base erosion without putting the companies at a financial disadvantage.
- Through GMT, leading nations seek **to curb profit shifting** by multinationals to **low-tax jurisdictions,** irrespective of where their actual sales occur.
- There's a growing trend of companies moving income from intangibles like **patents, software, and IP royalties to tax havens,** thereby sidestepping higher taxes in their home countries.
- The G20 and the OECD will spearhead crucial decisions regarding this global minimum tax initiative.

What is the Significance of BEPS?

- **Equitable Tax Contributions:** It ensures multinational enterprises (MNEs) pay their fair share where they do business. **For example,** A global coffee chain would pay taxes in each country where it sells, not just where it's headquartered.
- **Fiscal Healing:** It helps governments raise crucial funds to mend public finances strained by various unforeseen conditions (Man-made or Natural disasters).
    - A country can use additional tax revenue to reduce pandemic-induced debt. Increased tax income allows for upgrading healthcare facilities or expanding broadband access.
- **Competitive Balance**: It reduces the tax advantages of larger corporations over smaller, domestic businesses.
- **Digital-Era Readiness**: This tax systems **catch up with online commerce**. Like, An e-commerce platform pays taxes where customers shop, even without physical stores.
- **Worldwide Teamwork:** It emphasises an international commitment to solving cross-border tax challenges.

What is the OECD?

- It is an intergovernmental economic organisation, founded in **1961** with its Headquarters in **Paris, France.**
- It has a total membership of **38 countries.**
- **India is not a member but a key partner of the OECD.**
- It aims to stimulate economic progress and world trade.
- Most OECD members are **high-income economies** and are regarded as developed countries.

What is India's Position on Global Tax Reform?

- **Signing Global Tax Reform:** Indian multinational enterprises will have to start reviewing and accounting for any additional tax liability as per the global tax reform signed by India.
    - For Example, India joined the **Multilateral Competent Authority Agreement** on **Automatic Exchange of Financial Account** Information in 2015.
    - It is **to exchange a wide range of financial information** after collecting the same from financial institutions in their country/jurisdictions
- **Consensus-Driven Solution**: The country supports a **consensus-driven solution** that's easy to implement and comply with.
    - India advocates for broader implementation of the **new tax law** to ensure it doesn't collect less than its current equalisation levy revenue.
- **Abiding Market Jurisdiction**: India emphasises that the solution should allocate **substantial and sustainable revenue** to market jurisdictions, especially developing and emerging economies.

- The **Two-Pillar Plan aligns with India's stance** on granting markets a larger profit share and factoring in **demand-side elements i**n profit allocation.
- India has ratified the **Multilateral Convention** to Implement **tax treaty-Related** Measures to Prevent Base Erosion and Profit Shifting.

Note:

- India initiated a **6% levy on online advertisement** services by non-residents in 2016. From 1st April 2020, a **2% levy** was imposed on [digital transactions] by foreign entities operating in India or accessing the local market.

What are the Concerns Related to Global Tax Reform?

- **Sovereignty Issues**: The reform may infringe upon a **nation's sovereign right** to determine its own tax policies.
  - A global minimum tax rate **could deprive countries of a policy instrument** used to promote their individual interests.
- **Limiting Tax Competition**: Some argue that the **fear of tax competition** restrains governments from imposing **excessive taxes on citizens** to finance extravagant spending.
- **Effectiveness:** Critics, including organisations like Oxfam, question the reform's potency, **suggesting it may not eliminate tax havens** as multinational companies continue to engage in aggressive **tax planning strategies that exploit regulatory gaps** and inconsistencies.
  - Such as a multinational tech might sell **intellectual property rights (such as patents or trademarks)** to a subsidiary located in a **low-tax jurisdiction** at a price that undervalues these assets.

Way Forward

- **Flexible Implementation:** Allow **countries to adapt the rules to their specific economic** contexts while maintaining the spirit of the agreement.
  - For example, a developing country might be permitted a grace period before fully implementing the minimum tax rate.
- **Strengthen International Cooperation:** Enhance information sharing and joint audits to tackle complex cross-border tax issues.
  - Such as the **Multilateral Competent Authority Agreement** on **Automatic Exchange of Financial Accounts.**
- **Public Transparency**: Encourage or mandate **public country-by-country reporting by large multinationals.**
  - Like, a tech giant publicly disclosing how much revenue it earned and tax it paid in each country of operation.

Drishti Mains Questions:

How do base erosion and profit shifting (BEPS) impact countries globally? What challenges do countries face in effectively addressing BEPS?

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims

Q. The term 'Base Erosion and Profit Shifting' is sometimes seen in the news in the context of (2016)

(a) mining operation by multinational companies in resource-rich but backward areas

(b) curbing of the tax evasion by multinational companies
(c) exploitation of genetic resources of a country by multinational companies
(d) lack of consideration of environmental costs in the planning and implementation of developmental projects

Ans: (b)

Mains

Q. If the last few decades were Asia’s growth story, the next few are expected to be Africa’s. In light of this statement, examine India’s influence in Africa in recent years. **(2021)**