UPSC PREPARATION

Base Erosion and Profit Shifting (BEPS)

Base Erosion and Profit Shifting (BEPS) refers to the strategies used by multinational companies to avoid paying tax, by exploiting the mismatches and gaps in the tax rules. Base Erosion and Profit Shifting (BEPS) is mostly prevalent in Intellectual Property (IP) intensive Technology domain (companies like Google, Apple etc) and the companies in Life Sciences domain like Pfizer, Merck etc.

How Does Base Erosion and Profit Shifting (BEPS) Work?

- Tax is levied on the multinational company by the Government as a percentage of the profit or income of the multinational company.
- Using the loopholes, the multinational company shifts its income or profit to another country which could be a tax haven.
- As a result, the country which helps the multinational company generate its revenues does not get any tax or there is tax erosion due to the shifting of income or profits by the company.

Issues with BEPS

- BEPS practice is a major problem since nations have lost tax revenues to the tune of $ 100 billion to $ 240 billion annually, as per statistics put out by the Organisation for Economic Cooperation and Development (OECD). The above revenue which is lost is equivalent to 4 % to 10 % of the total income tax revenue at a global level.

- This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level.

- when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

Measures taken by India to solve the BEPS issue

Indian is playing an important role in the BEPS Project initiated by the OECD. India is working on amending its laws to tackle the problem of Base Erosion and Profit Shifting(BEPS).

India has already implemented some of the important recommendations of the BEPS project through amendments in its domestic tax laws such as

- **Country-by-Country Reporting (CbCR)** – It is part of the Organization of Economic Cooperation and Development’s Base Erosion and Profit Shifting **Action Plan 13.** As per Indian Income Tax Act, Section 286(2), the CbCR is required to be submitted by an Indian affiliate of a foreign-parented group or Indian parent company.
  - India and the U.S. signed an inter-government agreement for the automatic exchange of country-by-country (CbC) reports.
  - This will reduce the compliance burden for Indian subsidiary companies of U.S. parent companies.
  - This is a key step in making India compliant with the Base Erosion and Profit Shifting (BEPS) project, of which it is an active participant.

- **Thin capitalization –** Thin Capitalisation refers to a condition where a company is financed with a high level of debt compared to the equity (highly leveraged)
- **Secondary Adjustments –** On 30 September 2019, Rule 10CB of Income Tax rules amendments were notified by the Central Board of Direct Taxes (CBDT).
- **Patent Box tax regime –** It was introduced in India by enacting new Section 115BBF as per Finance Act, 2016.

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) was signed by former Finance Minister Arun Jaitley in Paris on June 7, 2017. The provisions in the framework will come into effect from 2020-21 for bilateral tax treaties.

The Convention ensures consistency and certainty in the implementation of the BEPS Project in a multilateral context. The Convention also provides flexibility to exclude a specific tax treaty and to opt-out of provisions or parts of provisions through making of reservations.

Benefits for India

- The Multilateral Convention will enable the application of BEPS outcomes through modification of existing tax treaties of India in a swift manner.
- It is also in India's interest to ensure that all its treaty partners adopt the BEPS anti-abuse outcomes.
- The Convention will enable the curbing of revenue loss through treaty abuse and base erosion and profit shifting strategies by ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created.

BEPS Project – Launched by OECD

- Organisation for Economic Cooperation and Development launched the BEPS project to tackle the problem of tax avoidance, to bring in a transparent tax environment and bring in more synergy to the international tax rules.
- There are 15 Action Plans that are being implemented by 135 countries.
- Countries now have the tools to tax the company that is generating profits and value in that particular country.
- These tools also reduce disputes.

Frequently Asked Questions on Base Erosion and Profit Sharing

Q 1. What does Base Erosion and Profit Sharing mean?

Ans. When a multinational company exploits the tax rules by finding gaps in the system and avoids paying the tax to the Government, it is known as Base Erosion and Profit Shifting (BEPS).

Q 2. How many BEPS actions are there?

Ans. The Organisation for Economic Co-operation and Development (OECD) is currently working on 15 BEPS actions.