# 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)**