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OECD BEPS Initiative meeting

What is the issue?

- The Organisation for Economic Co-operation and Development's (OECD) BEPS Initiative is going to meet on October 19, 2019.
- The Indian government should be desperate to raise more tax revenues.

What is happening?

- India missed its tax targets in the fiscal year 2018-2019, largely because of poor Goods and Services Tax (GST) collections.
- Its declared budgetary target for 2019 requires tax receipts to increase by around 25%
- But, the increase in the first quarter of 2019 was only 6% over 2018's.
- There is a belief that what is required now to address the current slowdown is more tax relief to corporate.
- So, it has offered tax rate reductions to 25% of profits to companies that do not avail of other concessions, and further rebates to new companies.
- Very significant tax shortfalls are likely even in 2019, unless the government takes proactive measures.

What could be understood by looking at MNCs?

- But such measures should not take the form of the tax terrorism that this government has been prone to, or increasing GST rates, which would be regressive and counterproductive in the slowdown.
- Fortunately, there are other measures that could provide significantly more tax revenues to the government.
- One obvious low-hanging fruit is a strategy to ensure that multinational companies (MNCs) actually pay their fair share of taxes.
- MNCs manage to avoid taxation in most countries, by shifting their declared costs and revenues through transfer pricing across subsidiaries, practices described as Base Erosion and Profit Shifting (BEPS).
- Some of the largest digital companies which make billions of dollar profits across the globe barely pay any taxes anywhere.

- The International Monetary Fund (IMF) has estimated that countries lose $500 billion a year because of this.
- Also, it creates an uneven playing field, since domestic companies have to pay taxes that MNCs can avoid.

How the idea works?

- The OECD has now recognised this through its BEPS Initiative.
- It has attempted a belated attempt to include developing countries through what it calls its inclusive process.
- So far, this process has delivered a few benefits, but these are limited.
- This is so as it has continued to operate on the basis of the arm's-length principle of treating the subsidiaries as separate entities.
- But this can change if there is **political will**.
- The basic idea is simple, since an MNC actually functions as one entity, it should be treated that way for tax purposes.
- So the total global profits of an MNC should be calculated and then apportioned across countries according to some **formula based on sales, employment and users** (for digital companies).
- This is actually already used in the U.S. where state governments have the power to set direct and indirect tax rates.
- A minimum corporate tax should be internationally agreed upon for this to prevent companies shifting to low tax jurisdictions.
- Then, each country can simply impose taxes on the MNCs operating in their jurisdictions, in terms of their own shares based on the formula.
- If the U.S. and the European Union together decided to tax according to this proposed principle, there would be little incentive for many MNCs to try and shift reported profits to other places.
- Indeed, the Indian government has already proposed in a white paper that it could take such a unilateral initiative for digital companies.
- The OECD BEPS Initiative will be meeting on October 19, 2019 to set out its own proposal and it is willing to consider the possibility of unitary taxation.
- But there are some stings in the tail that may well render the proposed measures practically impotent.

What are the key concerns?

- In the proposal, there is only an **arbitrary separation** between what OECD calls routine and residual profits.
- The residual profits only will be subject to unitary taxation.
- This has no economic justification, since profits are anyway net of various costs and interest.
- The proposal specifies that the "arm's-length principle" criteria will be used

for determining routine profits, which defeats the entire purpose.

- As it happens, there is no system of corporate taxation anywhere in the world that makes such a distinction.
- So this raise a question of why should an international system rely on this.
- The **formula to be used to distribute taxable profits** is another concern.
- OECD's suggestion – To use only sales revenues as the criterion.
- But developing countries would lose out from this because they are often the producers of commodities that are consumed in the advanced economies.
- G24 group's suggestion - a combination of sales/users and employment should be used, which makes much more sense.
- It is important for the Indian government to take a clear position at the OECD meeting, because the outcome will be very important for its own ability to raise tax revenues.

Source: The Hindu