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BEPS
(Base Erosion and Profit Shifting)

ACTION PLAN 1 AND 2
Basic understanding

OVERVIEW:

With the development of technology and globalization of businesses, Multinational enterprises (MNEs) have started designing their business operations in a way to minimize their global tax costs through making effective use of tax rules and applicable exemptions available under tax treaties. On the other hand, International tax rules have not been able to keep pace with developments in the world economy, resulting in double non-taxation and stateless income.

BEPS REFERS TO TAX PLANNING STRATEGIES USED BY MNEs THAT EXPLOIT GAPS AND MISMATCHES IN TAX RULES TO AVOID PAYING TAX

As a result, Organization for Economic Cooperation and Development (OECD) started to shape out a plan to mitigate harmful tax practices to ward off the negative effects of MNEs' tax avoidance strategies on national tax bases. The OECD published a report on "Addressing Base Erosion and Profit Shifting" iterating the need for analyzing the issue of tax base erosion and profit shifting by global corporations. The OECD followed it up with publishing an Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) in July 2013. The BEPS action plan identifies fifteen actions to address BEPS in a comprehensive manner and sets a deadline to implement those actions.

Let us have a look at those Action Plans.

Action Plan – 1 (Addressing the challenges of the Digital Economy)

With the advent of digitalization, the mode of undertaking the transactions have significantly changed. For eg. Earlier we used to buy CD from music store to listen to music but now we could just download one application in our phone like saavn.com and enjoy the music. Similar type of services that have changed the manner of working with digitalization are:

- Online advertising services;
- Online search engines;
- Online gaming;
- Cloud computing services;

- Digital content services etc.

The transaction now takes place in cyberspace due to which taxation issue arises in taxation of digital economy. This Action Plan undertakes a coherent and concurrent review of the fundamental element of global tax system i.e. Nexus Rule (where taxes should be paid – based on physical presence) and Profit Allocation Rule (what portion of profit should be taxed)

There are two Pillars included in current work program:

Pillar 1: Reallocation of taxing rights

This pillar involves work of potential solutions for determining where tax should be paid and on what basis, as well as the proportion of profit that should be taxed in jurisdiction of customer or user. Allocating more taxing rights to country where customers or users are located ("Market Country")

Pillar 2: Global anti-base erosion mechanism

This Pillar ensures:

- To stop the shifting of profit to low or no tax jurisdiction;
- Minimum level of tax to be paid by MNEs;
- Levels playing field between traditional and digital companies.

Action Plan – 2 (Neutralise the effect of Hybrid Mismatch Arrangement and Branch Mismatch Arrangements)

Hybrid Mismatch Arrangement exploit differences in tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation.

Branch Mismatch Arrangement arises where rules of allocating income and expenditure between branch office and head office results in portion of net income of taxpayer escaping the charge to taxation in both branch and residence jurisdiction.

Possible arrangements can be:

- *Double deduction:* Arrangement where deduction related to same contractual obligation is claimed for income tax purpose in two different countries;
- *Deduction/ No inclusion scheme:* Arrangement that create deduction in one country and non inclusion of income in another country

The OECD intends to neutralize the effects of hybrid mismatch arrangements by making changes to the model tax convention and providing recommendations on the design of domestic rules to neutralise the effects of hybrid instruments and entities (e.g. double non-taxation, double deduction, long-term deferral)

The report recommends rule based tax:

- *Primary rule:* Deny taxpayers deduction for a payment to the extent it is not included in the taxable income of the recipient or also deductible in recipient's jurisdiction

- *Secondary or defensive rule:* Recipient's jurisdiction can include the deductible kspayment in income or deny duplicate deduction.

MEASURES TAKEN BY INDIA

Action Plan 1:

- Introduction of concept of ***"Significant Economic Presence"*** in the definition of 'business connection'
- Introduction of ***Equalisation Levy***

Action Plan 2:

- Introduction of Super rich tax through surcharge
- Finance Bill 2021 prescribes tax treaty only where the entity is *"liable to tax"* in their home jurisdiction though exempt from tax

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