

## Combating BEPS

# Need to go beyond OECD path

Many developing countries have pressed for addressing concerns specific to them

**T**he world over, tax avoidance by MNCs, resulting in the erosion of base as they shift profits to tax havens or low-cost jurisdictions, has been a matter of concern. This is particularly worrisome for developing countries as this robs them of critical resources needed for development and poverty alleviation. Besides, this enhances the tax burden of those who pay legitimate taxes and violates horizontal equity between domestic companies and multinationals.

Wilful tax avoidance by MNCs, as mentioned above, is a global phenomenon. There is overwhelming evidence of the practice in both developing and developed countries. In India, there is considerable evidence to show that MNCs have been indulging in abusive tax practices. The studies done at the NIPFP by Kavita Rao and DP Sengupta, for the period 2006-11, show that the effective corporation tax rate on multinational companies was significantly lower than domestic companies and the interest paid by them were much higher. The paper also shows that from 2008 to 2011, while the royalty payments by the top 25 multinationals doubled, their dividend payments increased by just 30%. They point out a number of cases of base erosion in Indian context.

Multinational companies indulge in tax abuse in a variety of ways. Creating a web of complex subsidiaries and branches and locating them in tax havens and low tax jurisdictions and artificially allocating profits to these jurisdictions and taking advantage of the tax treaties to minimise tax payments is a common method. Manipulating prices in related party transactions, or what is called transfer-pricing, to reduce the tax liability is another. Although there are "arm's length pricing rules" to deal with transfer-pricing issue, it is difficult to apply them in practice when intangible assets are involved and these include trade names, goodwill, and brand recognition as well as intellectual property, such as patents, copyrights, brands and trademarks and business methodologies. Multinational companies also act as in-

termediaries in product sales and distribution, make loans and interest payments to one another and charge fees to one another for activities such as management services, treasury services and investment services to reduce the tax liability. The UK Public Accounts Committee's investigations in 2011 on Starbucks, Amazon and Google revealed massive underpayment of taxes. Starbucks paid corporation tax of only £8.6 million since 1998. Amazon paid only £1.8 million on the revenues of £207 million which works out to be 1% and Google, despite generating \$18 billion in revenues from 2006-11, paid only \$16 million in taxes. The 2012 US Senate Subcommittee after investigations reported that Microsoft avoided US corporate tax on 47% of its US sales, transferring the right to market its intellectual property rights to a Puerto Rico subsidiary. These examples can be multiplied. The subcommittee's findings on Hewlett-Packard, Apple and Caterpillar are equally revealing. These are only some examples.

The concern about the tax abuse has led the G-20 to take up the initiative to deal with the problem of Base Erosion and Profit Shifting (BEPS) and ask the OECD to prepare an action plan to counter the menace. The OECD has submitted a 15-point action plan. While this is an important step in for harmonising the tax systems to curb tax competition, better coordination and information exchange across countries, many developing countries feel that action should go beyond the plan recommended by the OECD report on BEPS. There is a feeling that the initiative should be more inclusive than OECD and G-20, and even though OECD has involved other coun-



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tries in the discussion, they did not have the voting rights. It is also felt that much of the discussion on BEPS within the OECD countries is dominated by multinational companies. For example, in the BEPS consultation on digital economy the leading technology companies were united against any discussion on tax rates. Furthermore, the OECD action plan does not deal with the problem of apportioning profits to subsidiaries located in low-cost jurisdictions as it takes the prevailing separate entity system as given. A proper way to deal with the problem is to consolidate the transactions of all branches and subsidiaries and attribute the profits based on where the business is carried out.

A broad coalition of civil society and labour organisations (which includes ActionAid, Alliance-Sud, CCFD-Terre Solidaire, Christian Aid, the Council for Global Unions, the Global Alliance for Tax Justice, Oxfam, Public Services International, Tax Justice Network and the World Council of Churches) has appointed an Independent Commission for the Reform of International Corporate Taxation (ICRICT) to make recommendations on the ways to minimise the tax abuse in multinational companies. The Commission has made a set of 34 recommendations (available at [bit.ly/1HxOgXH](http://bit.ly/1HxOgXH)) and these include: (i) the multinationals should be taxed as a single unit and a model bilateral and multilateral agreement should be worked out to apportion the revenues and costs attributable to each subsidiary. In the long-term, the apportionment rule could be used even if they are taxed as unified entities; To prevent attribution of intellectual property rev-

enues to low tax jurisdictions, it is necessary to allocate its ownership based on objective factors such as sales or employment; (ii) The countries should curb temptation to indulge in the race to the bottom and should declare the tax preferences transparently; (iii) Undertake measures to strengthen enforcement and that includes imposition of criminal penalties for abusive tax practices, strengthen tax administration with adequate resources and capacity building in appropriate legal framework and enforcement; (iv) evolve a model withholdings system with the help of multilateral organisations; (v) increase transparency by requiring the multinationals to file country by country reports on the businesses carried out and advance pricing agreements including those of the subsidiaries and make them available in public domain and reform the tax treaties to avoid any restrictions on tax withholding, measures to prevent double non-taxation, and include general anti avoidance rules the model tax treaties.

The issue of tax abuse by multinationals is a matter of great concern, particularly to developing countries. With technological advances and the spread of e-commerce, the issue is likely to become even more complex in the years to come and immediate global effort to curb this is called for. It is not easy to catch up with the multinationals having enormous resources at their command. In this environment, immediate collective action is necessary and it is important to oversee the effort by a non-partisan agency. The ICRICT has recommended that the UN Committee of Experts should be upgraded into an international commission to oversee compliance. Perhaps, the UN Committee may be upgraded to create a World Tax Authority on the lines of WTO.

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