TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

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109 | Base Erosion and Profit Shifting

Multinational base erosion and profit shifting costs Australia billions of dollars in tax.

Base Erosion and Profit Shifting

But it isn't just Australia that suffers from base erosion and profit shifting but most countries outside of low-tax or no-tax zones are affected. In this episode Simon Dorevitch of A & A Tax Legal Consulting in Melbourne will give you an overview of what base erosion and profit shifting is about. Here is what we learned.

Legal Tax Planning

Multinational companies commonly use base erosion and profit shifting (BEPS) as a tax planning strategy to shift profits to low or no-tax jurisdictions. Most of these schemes are perfectly legal using loopholes in current double tax agreements (DTA).

Base Erosion

Base erosion is about reducing a company's taxable profits. Multinationals structure income and expenses to achieve a more favourable tax treatment.

Profit Shifting

Profit shifting involves making payments to group companies overseas to move profits from high-tax jurisdictions to low-tax regimes. These intra-group transfers usually happen in the form of royalty and / or interest charges and hence reduce pre-tax profits. Some jurisdictions like Luxembourg and the Netherlands charge lower tax rates on royalties and IP.

Profit shifting reduces the group's overall tax expense and hence increases the overall profits available to group shareholders. Australia's transfer pricing rules haven't been able to stop this practice.

Economic Loss

BEPS erodes the revenue base and hence results in tax not being paid in the jurisdiction where economic activity occurs.

The Organisation for Economic Co-operation and Development (OECD) conservatively estimates the annual worldwide revenue loss due to BEPS at $100 to $240 billion USD.

Damage

But the damage goes beyond the direct loss of tax revenue.

BEPS undermines the fairness and integrity of a country's tax system and hence taxpayers' morale and willingness to comply with their own tax obligations.

And it gives multinational businesses using BEPS a competitive advantage over domestic operators.

OECD

To address this issue, the G20 finance ministers asked the OECD to develop an action plan addressing BEPS in a coordinated and comprehensive manner.

Over 100 countries have been collaborating and contributing to this OECD / G20 project.

BEPS Action Plan

The answer is the OECD BEPS 15 Action Plan that the OECD released in October 2015. The action plan contains 15 actions. They are to plug the loopholes multinationals have been using.

1 – Address the tax challenges of the **digital economy**
2 – Neutralise the effects of **hybrid mismatch arrangements**
3 – Strengthen **controlled foreign company (CFC)** rules
4 – Limit base erosion involving **interest deductions and other financial payments**
5 – Counter harmful tax practices more effectively, taking into account transparency and substance
6 – Prevent treaty abuse
7 – Prevent artificial avoidance of the **permanent establishment** status
8-10 Assure that **transfer pricing** outcomes are in line with value creation
11 – Establish methodologies to collect and analyse data on BEPS and the actions to address it
12 – Require taxpayers to disclose their aggressive tax planning arrangements
13 – Re-examine transfer pricing documentation
14 – Make dispute resolution mechanisms more effective
15 – Develop a multilateral instrument to modify bilateral tax treaties

Multilateral Instrument

To make these 15 actions happen, the OECD has developed a multilateral instrument (MLI). This MLI when implemented by two countries will limit the chance of BEPS happening between those two countries.

Australia

Australia has implemented the MLI in September 2018 with effect from 1 January 2019 or there after, depending on what Australia's counterpart does. However, Australia didn't adopt all articles of the MLI.

All this is just our brief take on the issue, but please listen to the episode above. Simon Dorevitch explains all this in a much better way than we ever could.

MORE

Review of Small Business Tax Concessions

Board of Taxation

[Master of Taxation]

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