What's up with BEPS?

José-Manuel MARTIN CORONADO[1]

Almost five years ago, I was reading the blog of one of my teachers at C.E. Garrigues, and I found an interesting topic called "BEPS and International Taxation". The name sounded odd, my tax assistant didn't understand a bit of it, but the content was astonishing. Quickly enough, I hurried up to explain that new view of world taxation on a Tax Conference organized by the Universidad Federico Villarreal in Lima, Peru. It was a very enlightening experience, as I had another of my tax teachers on one side of the table and a Tax Administration office on the other, during the presentation. Both were very interested on what I had to say. Thus, thanks to my postgraduate teacher, I was perhaps one of the first to talk about BEPS in Peru, right almost when it started. But, what is BEPS? What's up with that topic? Let's go back in time.

In recent years, the media have focused on how little Multinational Enterprises (MNEs) pay in taxes worldwide. Everyone has heard stories about Google, Facebook, Apple, Samsung, Amazon, Starbucks among others, on how low their tax burden is. Thus, at the beginning, the public opinion might have pushed for a response on that matter from political authorities of worldwide governments, with direct incidence on Tax Administrations who are usually in charge of collecting taxes.

[1] *ADIT (CIOT, UK). Msc. Spanish & European Taxation. (C.E. Garrigues). Msc Ex. International Taxation (C.E. Garrigues). Postgraduate studies UTC Leiden (NL). Senior Tax Associate at EMAE.*

In those years, the traditional discussion was related to clarify the difference between tax avoidance and tax evasion, with multiple gray areas given by the "Economy of Choice" principle, the loopholes of tax laws, tax treaty shopping and abusing the non double taxation principle. Many developed countries were starting to worry where the taxable profits were going and why there weren't enough resources to overcome the crisis. In the mean time, some developing countries, such as Latin American economies, were still in the old discussion such as who has the right to collect taxes, what is confiscatory taxation and what are the limits of due process.

However, the BEPS Project, which started in early 2013, took the discussion to another level. It proposed that any tax strategy that were followed by a Base Erosion or caused by Profit Shifting shall be considered as aggressive tax planning, where the main goal was to reduce or eliminate tax burden, and therefore unwanted in the tax community. So, this new Tax Era had to rely on a new interpretation of the words "spirit of the law", "economic substance", "value creation" among others to analyze taxation beyond what tax laws described literally.

Indeed, the main issue was the persistence of a tax collection lower than expected by governments or public opinion, because of an eroded Tax Base significantly lower that it was estimated by Tax Administrations, or because of business profits apparently of a specific country but declared in that jurisdiction (with a lower tax rate) or not declared at all (due to a tax deferral strategy).

Why some MNEs did implemented such strategies? For instance, to defer the tax payment at a more favorable time for the company's finances, to minimize the risk of double taxation, minimize the current tax payment, to skip payment in countries other than the parent company or anywhere at all, to conceal notoriously non-deductible expenses (for example personal expenses, unjustified Bonus to Directors) and, also, to execute money laundering and other criminal figures.

Thus, the use of Hybrid mismatches (for example dividends covered as interests and thus deductible) or the creation of Special Purpose Entities (for example Finance subsidiaries or non-taxable partnerships) and the implementation of transfer pricing strategies, have helped on this unlawful matter.

But was there really a problem? While companies exercise their right to decide where they want to locate their net profits, their business units (or subsidiaries), the owners, the directors or sometimes the managers can decide how much income and expenses each of them will have. This seems perfectly legitimate.

However there are two essential issues. 1) If the companies are linked, those decisions (of choosing where to take profits) can be made at the convenience of the group, for a specific purpose. 2) This economic convenience can become a totally artificial decision with the sole (or main) purpose of paying almost nothing or no tax.

In this sense, profit shifting is one of the main causes of erosion, and it's highly related to the application of transfer prices strategies. So, the problem is that such artificial or unrealistic operations, or those outside a competitive market relationship, have an impact on the taxable base, which causes these companies to change their tax base aside business reasons.

In conclusion, the 15 item actions of the BEPS project aim to prevent all the unwanted tax strategies indicated above. And it's not only a matter of tax collection for exiting the recession, but to obtain a sustained growth or a more equal society. More recently, one key aspect of BEPS being discussed is the neutralization the tax effects of branch mismatch arrangements, the application of Permanent Establishments to Services, the taxation of intangibles, the taxation of the digital economy and the implementation of Country by Country Reporting. The project is still going inevitably because the non-payment of taxes can represent billions of dollars per year, a loss that no country can reasonably afford, whether there is recession or not.