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SPECIFIC ASPECTS OF BASE EROSION AND PROFIT SHIFTING

Adequate public revenues form an indispensable base for proper functioning of a state. Ensuring such revenues should be therefore considered as a *conditio sine qua non* for any attempt to substantially reform the justice system. This paper outlines some aspects of the Base Erosion and Profit Shifting (BEPS) phenomenon. BEPS constitutes a major challenge in terms of ensuring adequate financial public revenues and may, in some circumstances, endanger the proper functioning of the state institutions. The issues connected to BEPS have become much more acute due to the consequences of the 2008 financial crisis.

BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules in order to artificially shift profits to low or no-tax jurisdiction where there is little or no substantial economic activity. This, in turn, results in little or no overall corporate tax being paid [1]. BEPS is closely related to globalisation. Economic activities are being increasingly internationalised, at the same time an increasing portion of these activities is being conducted by Multi-national Enterprises (MNE). Such entities are functioning on a regional and global scale and their activities *ipso facto* involve multiple tax jurisdictions. As a result MNEs acquire opportunities to substantially decrease their tax burdens. These issues are worsened by the growing sophistication of tax planners in identifying and using the possibilities connected to legal arbitrage and to the boundaries of acceptable tax planning [2, 7-8]. It is acknowledged that rules for corporate taxation, that are currently in place, are no longer adequate as corporate income is being taxed at national level while economic environment is becoming increasingly not only globalised but also mobile and digital [3].

According to OECD the most important implications of BEPS are following:

1) Governments are being harmed.
2) Tax payers are being harmed.
3) Businesses are being harmed [2, 8].

Ad. 1. The harm to the governments stems from a number of factors. Firstly many of them have to cope with the loss of revenue and higher costs of compliance. Secondly BEPS undermines the integrity of the tax system as the society deems reported low corporate tax rates to be unfair which, indirectly, further undermines the overall tax system. Thirdly, in developing countries, insufficient tax revenue results in critical under-funding of public investment that could help in promoting economic growth. Finally general allocation of the resources is negatively affected by the tax incentives that result from BEPS.

Ad. 2. If tax law permits enterprises to reduce their tax burdens *via* shifting their income from the jurisdictions where actual economic activity is being conducted, other taxpayers in such jurisdiction bear a greater share of the burden.

Ad. 3. MNEs themselves may face significant risks in terms of reputation if their effective tax rate is perceived to be too low. Additionally such risks may not be weighted by different enterprises in the same way which may put some of them in an unwarranted competitive disadvantage. Similarly the businesses that operate on the domestic market may have difficulty competing with MNEs. As the result fair competition is being harmed [2, 8].

It should be highlighted that no singular tax rule, by itself, makes BEPS possible. It is rather the relations between different factors that cause it [4, 5]. In other words the

interplay of the functioning of different tax jurisdictions creates international tax gaps which result with lowered taxation or even no taxation of certain incomes. The creation of international tax gaps is, very often, unintentional. Such gaps can be created as a result of the fact that there exists a multitude of different tax jurisdictions, which are not coordinated, together with more than 3 500 bilateral tax treaties [4, 9]. However certain tax jurisdictions intentionally shape their tax regulations in such ways as to intentionally create and (or) take advantage of international tax gaps. Strategies to exploit international tax gaps are being developed and conducted not only by MESs themselves but also by international tax consulting businesses. Strategies developed by these actors are usually several steps ahead of national tax regulations [5, 293]. It may appear that solutions to this problem may be found in a close cooperation between national tax authorities and international tax consulting businesses. Such approaches are however very unlikely to be successful [6].

Profit shifting can be considered to be one of the most efficient methods of avoiding taxation *via* international tax gaps. Such activities may be summarised as making specific changes to the prices of goods and services [7, 72].

The approach developed by G20 and OECD in regards to BEPS consists of the BEPS Package that involves the following Actions:

1) Address the Tax Challenges of the Digital Economy.
2) Neutralise the Effects of Hybrid Mismatch Arrangements.
3) Strengthen Controlled Foreign Corporation Rules.
4) Limit Base Erosion *via* Interest Deductions and Other Financial Payments.
5) Counter Harmful Tax Practises More Effectively, Taking into Account Transparency and Substance.
6) Prevent Treaty Abuse.
7) Prevent the Artificial Avoidance of Permanent Establishment Status.
8-10) Assure that Transfer Pricing Outcomes are in Line with Value Creation.
11) Measuring and Monitoring BEPS.
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 [4, 13-18].

From the perspective of developing countries the OECD Reports to G20 Development Working Group on the Impact of BEPS in Low Income Countries merit special attention. From the perspective of a developing country the following BEPS issues are considered to be most relevant:

1) Base erosion caused by excessive payments to foreign affiliated companies in respect of interest, service charges, management and technical fees and royalties.
2) Profit shifting through supply chain restructuring that contractually relocates risks, and associated profit, to affiliated companies in low tax jurisdictions.
3) Significant difficulties in obtaining the information needed to assess and address BEPS issues, and to apply their transfer pricing rules.
4) The use of techniques to obtain benefits in situations where such benefits were not intended.
5) Tax loss caused by the techniques used to avoid tax paid when assets situated in developing countries are sold [9, 4].

The scope of this Paper does not allow for elaborating on the aforementioned issues. It cannot be stressed enough however that countries that are not members of

G20 and OECD should pay very close attention to these developments since, currently, there are virtually no states that are not being affected by BEPS[1].

It is important to note that tackling BEPS requires adequate human resources. This is particularly problematic in the developing countries where it is easier for the private sector to siphon out competent personnel from the given country's tax authorities. This makes reacting to the ever-changing international tax law environment exceptionally challenging. It seems that addressing this problem should involve actions such as providing market rate remuneration packages, strong leadership and strong team ethic [10, 24].

Considering the challenges that stem from BEPS, from the perspective of a developing country, should take into account strong pressures to attract investment, through offering tax incentives, that such countries are often faced with. Incentives of this kind may have a very adverse impact on given state's tax base with very little corresponding benefit. This is often accompanied by strong lobbying against implementing measures aimed at tackling BEPS and for introducing regulations that contribute to the creation of tax gaps.

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