CAPABILITY WISE

4 FAQs
About Base Erosion and Profit Shifting (BEPS)

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What is Base Erosion and Profit Shifting (BEPS)?

BEPS refers to the corporate tax planning strategies used by multinational enterprises to exploit the gaps and mismatches in tax rules between different countries' tax systems.

Profits are typically "shifted" from higher-tax jurisdictions (like the United Kingdom) to lower-tax jurisdictions (like The Cayman Islands). Profits can also be shifted to no-tax locations (like Monaco) where there is limited or nonexistent economic activity.

BEPS erodes the tax base of higher-tax jurisdictions using deductible payments, like royalties and interest. This also increases the overall profits available to group shareholders.

1

How Does BEPS Impact Countries and Jurisdictions?

BEPS results in taxes not being paid in the jurisdictions where economic activity occurs. This erodes the revenue bases of the impacted countries and undermines the fairness and integrity of their tax systems.

BEPS is particularly harmful to developing countries since they're more reliant on tax revenues from MNEs to finance investments in infrastructure, human capital, and the provision of services to businesses and citizens.

The impact of BEPS on all countries goes beyond tax revenues, as this strategy undermines the credibility of tax systems in the eyes of taxpayers. If wealthy and powerful MNEs are openly avoiding their tax liabilities, it weakens voluntary compliance by all taxpayers and destroys the public's confidence in their tax systems.

2

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Why Do Some Multinational Enterprises Use BEPS?

Some MNEs may use BEPS as part of their tax avoidance tactics since their international operations create a ready-made network of companies that facilitate the movement of group funds. MNEs also have the financial means to establish and maintain the entities needed for tax reduction purposes.

Just as importantly, MNEs have incomes that are large enough to:

- Support the costs associated with taking advice on tax structuring,
- Establish and maintain the recommended tax structure, and
- Update the tax structure as per each country's' annual changes in tax laws.

3

What BEPS Tactics are Commonly Used by MNEs?

Placing assets into entities without substance

Some countries have introduced preferential tax regimes to attract more business. If used for BEPS, this type of tax competition only erodes the tax base of the country where the economic activity took place.

Supporting hybrid mismatch arrangements

Different tax rules among countries can sometimes lead to unintended consequences, like double non-taxation. MNEs might exploit double non-taxation to reduce their tax liabilities.

4

Transfer pricing/trademark and technology licensing

These practices involve managing the group’s patents, designs, and trademark via an entity that applies a lower tax rate to intellectual property. Group companies are then charged royalties on the use of the brand.