Implementation of BEPS Project - Stakes, Expectations, Challenges

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Abstract

The financial systems' efficiency of the states largely depends on the harmonization of the legislation in the field of taxation. Innovative mechanisms for conducting cross-border financial transactions make it increasingly difficult for the state tax authorities to trace tax bases.

Our paper addresses a current issue, i.e. the BEPS project - a project in the implementation phase, but also the harmonization with other regulations. The topic generates interest among the representatives of the academic environment, financial analysts, experts, but also the participants in the economic environment.

Key words: BEPS, aggressive tax planning, fiscal optimization, international tax law, transfer pricing
J.E.L. classification: H25, H30, K34

1. Introduction

The fiscal system of each state ensures most of the budgetary resources and, therefore, its independence and development. Against the background of the modernization of financial transactions and as a result of their increasing complexity, an adaptation or innovation of taxation at European and world level was also required, especially since more and more companies engage in activities in several countries.

Naturally, due to their desire to increase their profit margin, investors apply fiscal optimization schemes and models that implicitly lead to the lowering of the tax base and other elements of legal tax evasion. In recent years, both at the level of the European Union and at the OECD level, important steps have been taken to harmonize tax legislation and to simplify the identification of non-compliant situations by national tax authorities.

The new version of the OECD guide includes a series of recommendations taken from BEPS reports - Tax base erosion and profit shifting. The issues addressed are current, especially since Romania has been a BEPS associate member starting from June 2017.

2. Theoretical background

The increasing extent of fraudulent practices related to value-added tax has urged the European Union to find solutions to tackle them, using intra-EU trade networks' analysis tools (Dobrescu, 2018).

Interest in the economic value of transfers has highlighted the connection between transfer pricing and customs value, as well as the impact of transfer pricing adjustments on customs value (Nag, 2019). Moreover, from the perspective of transfer pricing, new debates and analyses have emerged regarding the stages and methodology for attributing the profits to a permanent office in other tax jurisdictions (Saulescu, 2018).

The expression "tax base erosion and profit shifting" (BEPS) refers to the tax planning strategies of the business entities taxpayers, which exploit the gaps (deficiencies) and the inconsistencies in the tax regulations in order to artificially move or transfer profit to locations (tax havens) with low or zero rates of taxation where, in fact, economic activity is reduced or does not exist.

3. Stakes, expectations, challenges regarding the implementation of BEPS Project

The fiscal strategies practiced by multinationals, by reducing the corporate taxes paid or even the non-payment of corporate taxes, lead to annual losses for the governments from non-payment of corporate taxes of at least $ 100-240 billion, equivalent to 4-10% of corporate tax revenues worldwide. This is the financial stake of the BEPS project.

Another essential stake of the BEPS project is the reform of the fiscal rules and of the tax authorities following the digitization of the economy and fiscal globalization.

Eliminating disagreements regarding setting transfer pricing for determining the taxable value of intra-group activities within the EU is a technical and practical stake of this project.

In 2015, within the OECD / G20 BEPS Project, over 60 countries formulated / agreed upon / established 15 measures/actions aimed at preventing tax evasion, improving international coherence and ensuring a greater transparency of the fiscal environment (the so-called BEPS package of measures). The measures to be taken in the BEPS Project are: *1. Digital economy; 2. Hybrids; 3 Rules; 4 Interest deductions; 5 Harmful tax practices; 6 Treaty abuse; 7. Permanent establishment; 8-10 Transfer pricing; 11 BEPS data analysis; 12. Aggressive tax planning; 13 Transfer pricing documentation; 14 Dispute resolution; 15 Multilateral instrument.*

In 2015, the Inclusive Framework on tax base erosion and profit shifting (IF on BEPS) was established to ensure that fiscal countries and jurisdictions, including the developing ones, can participate on equal terms in the development of standards on BEPS issues, in conjunction with the review and monitoring of the implementation of the BEPS project initiated by the OECD/G20.

The Inclusive Framework OECD/G20 on BEPS has over 130 members, of which: 28% are OECD member countries, 6% are G20 group countries (non-OECD members) and 66% are from other jurisdictions.

In 2017, for the first time, the signing at the highest level of the Multilateral Instrument (MLI) took place. Since that time, over 85 jurisdictions signed the Multilateral Instrument which allows the effective implementation of the tax treaty on BEPS measures without the need for individual renegotiation of tax treaties. Thus, over 1500 tax treaties would be modified.

In 2018/2019, the members of the Multilateral Instrument developed a Work Program that aims to provide, on a consensual basis, long-term solutions to the fiscal challenges arising from the digitization of the economy, by 2020. This program will explore the following issues:

- In the first stage (pillar I), potential solutions to determine the allocation of tax rights based on the fiscal connection (nexux and profit allocation).
- In the second stage (pillar II), the design of a system that ensures the payment of the corporate tax at a minimum level by the multinational companies with multilateral fiscal connections. This system addresses the remaining/final aspects of the PEBS Project initiated by the OECD/G20.

The Inclusive Framework OECD/G20, which works with parties/jurisdictions and groups of countries, performs technical work under the guidance of the Working Group (IF Steering Group). Based on the previous consultations, a set of regional information events on the digitization of the economy was planned, in partnership with regional organizations and development banks.

The plenary meetings of the Inclusive Framework (IF on BEPS) usually take place twice a year: in January in Paris and in May/June in a member country. In order to become a member of the Framework (IF on BEPS), a country or jurisdiction must commit to the implementation of the PEPS package of measures and pay an annual contribution of EUR 25,500 (adjusted to the inflation rate annually).

The plenary meeting of the Inclusive Framework where these rules were established took place in Lima, Peru on June 27-28, 2018.

4. Measures to counteract BEPS at European Union level - CCTB Project

The imposition by new tax treaties of a common consolidated tax base of CC (C) TB companies in the European Union (EU) will drastically change the corporation tax, being an indispensable measure in order to limit the *aggressive tax planning strategy* and eliminate the difficulty in setting transfer pricing. Even if the principle of withholding tax is not applied, the proposal of the European Commission (EC) for CC (C) TB is welcome, as bureaucracy will be reduced both for taxpayers and for tax authorities.

The project elaborated by the European Commission divides the consolidated profits of the multinational associations based on a calculation formula which, in turn, depends on the volume of sales, the number of employees and the capital invested. It is estimated that the results of this proposal, as envisaged in the European Parliament in March 2018, are even more detailed than the recommendations envisaged by the OECD. The final version of the CC (C) TB is to be discussed and submitted for approval (by unanimous vote) in the Council of the European Union, and the biggest challenge will be to obtain political agreement. The application of the CC (C) TB principle will divide the profits of the enterprises between the Member States of the European Union, and some founding states will lose tax revenues because pieces of the profits to be taxed will be allocated to other states. This project will be very successful only if the proposed calculation method is applied globally (the effects of the new law are expected to also occur outside the EU borders). The advantages and disadvantages are summarized in table no. 1.

Table no. 1. The advantages / disadvantages of CC (C) TB regulations

Advantages	Disadvantages
Homogenization and legal certainty of profit taxation in EU countries	Reducing / eliminating the fiscal sovereignty of the Member States
Budget balance - Member States will not be able to make changes to the basic structure of the corporate tax system through annual budgets or tax laws	Limiting the freedom of fiscal optimization, CC (C) TB will become obligatory for groups with consolidated global incomes over 750 million euros in the previous year
Undifferentiated legal definitions for basic concepts regarding the regulation of corporate tax	The transition costs for the new system will be very high (there is no study / evaluation yet)
Deduction of expenses for research and development in all EU countries, a regulation which is placed first	There will be additional regulations to avoid double taxation; for example, in Germany, the local trade tax doubles compared to CC (C) TB
Additional deduction: 50% for research and development expenses up to EUR 20 million and an additional 25% increase in costs	The possibility for multinationals to benefit from tax incentives (such as patents for inventions or innovations) will be limited.
Small independent businesses, which have been on the market for less than 5 years, can request an additional 100% deduction for research and development expenses (up to 20 million euros)	Competition through the tax rate is maintained because the harmonization of the corporate tax quotas is not provided by the CC (C) TB.
Some states, such as Belgium and Italy, have introduced interest rate deduction for equity loans, which is quite attractive for SMEs.	Fiscal competition through the CCCTB will be reduced because the levers of state intervention on the economy are limited.
Cross-border compensation for tax losses is currently prohibited	The European Union will be competitively disadvantaged on the profit oriented global market
Elimination of disagreements regarding transfer pricing for determining the taxable value of intra-group activities within the EU	
The one-stop shop is a tax authority that determines the consolidated profit and distributes it, thus reducing the tax administrative burden	

Source: Own design, after Tofan M. (2019)

Following the adoption of the CC (C) TB project in the European Parliament, France and Germany agreed on a common position in support of the European Commission’s proposal to establish a common corporate tax base. This led to ***The Mesenberg Declaration*** being signed on June 19, 2018.

France and Germany express their full support for both proposed directives, with the aim of encouraging fiscal harmonization in Europe, confirming that they are fully committed to the rapid adoption of CC (C) TB regulations and are seeking for ways to harmonize the corporate tax system. A detailed objective in this common position is to stimulate discussions to enable the other EU Member States to adopt the CCTB Directive as soon as possible, before considering the possible adoption of the CCCTB Directive.

The joint declaration of France and Germany envisages, among others:

- ✓ Broadening the scope of the CCTB directive and making it mandatory for all companies that are subject to corporate tax (regardless of their legal form or size).
- ✓ In order to ensure an effective tax harmonization of the corporate tax base, further discussions will be needed, in particular as to the possibility for Member States to grant other fiscal policy measures "outside" the scope of the CCTB Directive (for example, tax credits); the proposal would therefore be effective by ensuring similar values of the corporate tax rates.
- ✓ For optimum implementation, from a technical point of view, both countries endorse a reasonable transition period of at least four years. Therefore, the directive should propose transitional rules.

In Germany’s case, the consequences of such a radical change in the transfer pricing system would be enormous, in terms of the volume of export activities. Whereas the idea of using a formula-based apportionment instead of the proximity principle (arm’s length) means more of a revolution than a reform of international taxation, and the effects on the distribution of taxable profits are major. An estimate based on data available for EU Member States and G20 countries supports this view.

5. Conclusions

At the European Union’s level, the complexity of the integration process and the cooperation that the Member States carry out essentially impose the adoption of fiscal rules, in order to ensure the smooth functioning of the single market. A form of fiscal cooperation is inevitable, with progresses registered in fiscal harmonization and integration.

In the present context, a limited harmonization is justified, aiming at avoiding discrimination, double taxation or withholding tax, regarding direct taxes. Equally, a closer coordination is needed in this area, in order to counteract the distortions generated by the allocation of resources.

CCTB represents a broad reform of the tax regime in the EU, through deeper fiscal harmonization methods and mechanisms than the recommendations on international taxation of the G20 and OECD anti-BEPS initiatives. From a global perspective, the fiscal competition environment in the EU could be disadvantaged by the introduction of stricter measures than those recommended by the OECD / BEP, but the proper functioning of the internal market requires a more comprehensive solution, including tackling tax evasion. If in the 2011 CCTB project the focus was on the administrative burden and on the monitoring of transfer pricing, at present, the CC (C) TB regulation promotes the mechanism of consolidation and the distribution of the profit for taxation, as a fair and efficient answer to profit shifting and to limit aggressive tax planning. The formula for profit distribution, which is the key element of CC (C) TB, is quite convincing from a political point of view, and not from an economic point of view, because the principle of withholding tax would be eliminated. However, due to the difficulties of determining appropriate transfer pricing, the change proposed by the European Council is welcome.

There are several possible obstacles in the way of a CC (C) TB, of which an identified issue refers to the lack of harmonization of the deduction rules, which determines the establishment of the sovereign taxation bases by the national tax authorities. Therefore, these tax bases are at least as important as the tax rates from the point of view of sovereign tax law.

Furthermore, the effects of profit distribution based on a single formula on Member States' tax revenues should not be neglected. Smaller countries would lose some of their tax base, while larger countries would win due to the proposed allocation formula. This makes finding a sustainable solution extremely complex. Compensation for losses could be politically appropriate for smaller countries.

The European Union's regulatory proposal for the CCCTB is an ambitious and promising objective that will stimulate economic growth in the EU and boost research and innovation activities.

As a result of this research, we have found out that there are many other directions worth exploring and that the issue at global and European level is complementary, which Malherbe (2017 p. 140) pointed out, stating that the fundamental methodological problem remains the allocation of the tax base both in the BEPS project, and in the CCCTB project.

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