

BEPS and the digital economy - trying to understand the issues

T.P. Ostwal, Partner, T.P. Ostwal & Associates, gives his opinion on Base Erosion and Profit Shifting (BEPS) and its potential ramifications for businesses operating in multiple jurisdictions.

UNDER BEPS, THERE IS GOING TO BE A CHANGE in how firms do business abroad, according to Ostwal. “Interpretation of tax laws will change,” he says, highlighting a critical point for the financial services industry.

In a post-BEPS environment, every multinational company operating in more than one jurisdiction will

have to report their assets, investments, number of employees etc., in each jurisdiction. That will allow tax authorities to gauge the profit a firm has made in each jurisdiction, and if there is a case of shifting profits from high tax jurisdictions to low tax jurisdictions, he explains.

In this new scenario, multinational corporations will be looked through a new lens by tax authorities, according to Ostwal. “For example, if you say you are carrying on an activity in another country and do not have a permanent establishment there, income tax authorities will not believe it,” he cautions. “They will look at the substance of the transaction.”

Tax authorities will want to see that all the activities claimed by the business in jurisdictions are carried out by people who are physically present in that country, he explains. “And then that will fulfil the base of substance. And if you do not have substance, you’ll be recharacterised. You will end up with multiple taxation.”

One holdout in the implementation of BEPS is the Digital Economy. According to Ostwal, progress on this project at the Organisation for Economic Co-operation and Development (OECD), which is spearheading BEPS, stalled with the US disagreeing to the approach. Other countries, however, have started thinking about it independently. For example, India has introduced a new concept of Significant Economic Presence this year, he notes.

In the digital economy, firms claim tax exemptions by being present in a country virtually and not physically, and thus not creating permanent establishment. Under this new concept, however, India is saying that a significant economic presence is equal to a physical presence, and it will create a permanent establishment. This, Ostwal notes, will bring in companies like Netflix, Airbnb, Uber etc., under the purview of India’s taxation system. ■



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