1. A Tax Policy that Could Works

Context:

- Government missed its tax targets massively in the last fiscal year, largely because of poor goods and services tax (GST) collections. Its declared budgetary target for the current year requires tax receipts to increase by around 25%.
- In this context the government should now be desperate to raise more Tax Revenues.

Current Status:

- Recently, to address the current slowdown the government given more tax relief to corporate, it has offered tax rate reductions to 25% of profits to companies that do not avail of other concessions, and further rebates to new companies. So very significant tax shortfalls are likely even in the current year, unless the government takes proactive measures.

Measures Needed:

- Measures needed to increase the tax revenue should not take the form of tax terrorism or increasing GST rates which would be regressive and counterproductive in the slowdown. Fortunately, there are other measures that could provide significantly more tax revenues to the government. One obvious low-hanging fruit is a strategy to ensure that multinational companies (MNCs) actually pay their fair share of taxes.

Looking at MNCs:

- It is well known that MNCs manage to avoid taxation in most countries, by shifting their declared costs and revenues through transfer pricing across subsidiaries, practices described as "base erosion and profit shifting" (BEPS).
- Matters have got even worse with digital companies, some of the largest of which make billions of dollars in profits across the globe, but pay barely any taxes anywhere.
- The International Monetary Fund has estimated that countries lose $500 billion a year because of this. Also, it creates an uneven playing field, since domestic companies have to pay taxes that MNCs can avoid.

What is Base Erosion and Profit Shifting?

- Base erosion and profit shifting refers to the phenomenon where companies shift their profits to other tax jurisdictions, which usually have lower rates, thereby eroding the tax base in India.

- The Convention is an outcome of the OECD / G20 BEPS Project to tackle base erosion and profit shifting through tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

How the Idea Works:

- The Organisation for Economic Co-operation and Development (OECD) has now recognised this through its BEPS Initiative, and has even attempted a belated attempt to include developing countries through what it calls its inclusive process.
- So far, this process has delivered a few benefits, but these are limited because it has continued to operate on the basis of the arm's-length principle of treating the subsidiaries as separate entities.
- But this can change if there is political will. The basic idea is an MNC actually functions as one entity; it should be treated that way for tax purposes. So the total global profits of a multinational should be calculated, and then apportioned across countries according to some formula based on sales, employment and users (for digital companies). This is something that is actually already used in the United States where state governments have the power to set direct and indirect tax rates.
- Obviously, a minimum corporate tax should be internationally agreed upon for this to prevent companies shifting to low tax jurisdictions. It should be 25%.

Way Forward:

- It could be argued that this would only work if all countries agree, and certainly that is the ideal to be aimed at. But the beauty of this proposal is that just some large countries can move the debate and make it less advantageous for global companies to shift their profits around.
- If the big markets such as the United States and the European Union together decided to tax according to this proposed principle, there would be little incentive for many MNCs to try and shift reported profits to other places. Indeed, the Indian government has already proposed in a white paper that it could take such a unilateral initiative for digital companies.
- It is important for the Indian government to look at this issue seriously and take a clear position. Because the outcome will be very important for its own ability to Raise Tax Revenues.