G20 nations set to endorse new tax framework to ensure fair play

Proposal seeks to tighten international tax norms to ensure multinational companies do not shift part of their income to lower tax jurisdiction to reduce their tax liability.

India and other G20 members are set to endorse a new tax framework that could force multinational companies to abandon aggressive tax planning and trigger restructuring of their operations.

Finance Minister Nirmala Sitharaman will press for adoption of the stringent rules under this framework at the meeting being held in Japan to ensure a fair play in tax revenues.

"This is a very crucial proposal-….We are keenly pursuing it," said a government official, privy to the deliberations.

The proposal, which will be taken up along with taxation of digital companies, seeks to tighten international tax norms to ensure multinational companies do not shift part of their income to lower tax jurisdiction to reduce their tax liability.

This plan could dramatically change the tax landscape globally by ending tax arbitrage due to lower rates offered by countries to attract investments.

"The twin efforts of the G20 are in advance state of formulation and hopefully will be announced by the 2020 deadline," said Rohinton Sidhwa, partner, Deloitte India.

Sidhwa said this pillar involving base erosion and income inclusion rules are aimed to stop the practice of several countries competing for investment by providing tax breaks and an unhealthy practice of a race to the bottom.

PROFIT SHIFTING

The new framework seeks to prevent situations where a multinational may set up intermediary operations in a low tax jurisdiction and use that as a base to charge high costs to its operations in a high tax country.

This will reduce the profits in that country, denying it more taxes.

For example, Singapore remains a favoured destination for MNCs to set up a regional headquarter location with oversight over several Asian countries including India.

The placement of some management executives in that jurisdiction necessitates a charge to India for services provided and profit being taxed in Singapore usually at a low tax rate, thereby lowering the effective tax rate for the company.

A deduction of expenses is claimed in India, allowing for an effective tax arbitrage to be set up.

A similar income inclusion rule will also apply for the residence country of a MNC group that parks its profits in an intermediary low tax jurisdiction. For example, many US companies set up subsidiaries in Ireland to lower their tax outgo.

The Central Board of Direct Taxes had set up a committee to examine the existing scheme of profit attribution to permanent establishment and to recommend changes to the existing rules in income tax law. The committee's report was released for public consultation on April 18, 2019.

The G20 finance ministers will also finalise on the broad principles of digital tax and steps to prevent profit shifting by MNCs while its contours would be finalised later.

For digital companies, India has backed an approach that allocates profits using revenues of the jurisdiction where sales take place and supplies are undertaken.

"Our approach has already been outlined….We insist on fractional apportionment of revenues based on significant economic presence," said a government official.

This proposal has the backing of many developing countries, which find proposals put forth by the US and UK difficult to implement because they involve a complex determination of residual profits.

Tax experts say the issue needs to be approached with caution.

CBDT should clarify that these provisions will apply only when a foreign digital business doesn't have an entity or branch or presence in India. Else, even those digital companies who already have a presence in India may face additional tax demands and resultant uncertainty," said Sudhir Kapadia, national tax leader, EY India.

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