Transfer pricing - Base erosion and profit shifting (BEPS)

In today’s world, aggressive tax avoidance is the new tax evasion

Taxpayers, corporate and individuals must pay attention to their tax affairs now more than ever before and must temper their appetite for aggressive tax planning with a pinch of morality to ensure that a fair amount of their profits is paid in taxes in locations where their business functions are performed.

Lionel Messi, the Argentine footballer who plays as a forward for La Liga club FC Barcelona and the Argentina national team, is without a doubt one of the World’s best footballers of all time. Added to his extra ordinary talent is his decent and friendly disposition which has endeared him to many fans around the world. Very likeable indeed but may be not to the taxman, at least in Spain, where he has been accused of tax evasion.

Messi has been resident in Barcelona since 2000 and gained Spanish citizenship in 2005. It was alleged that Messi and his father Jorge avoided paying millions of euros in back taxes on Messi’s image rights income through complex overseas structures in Uruguay, Belize and Switzerland. Messi is reported to have earned $41.3 million in 2013 up to June, $20.3 million from his club salary and $21 million in endorsements. The
prosecutor claims that Messi used shell companies in low
tax jurisdictions and tax haven to avoid paying tax on his
image rights earnings.

According to a statement credited to Messi in response
to the allegation, he said “It is something that surprises
us because we have never committed any offence.”
Unfortunately it seems the taxman has changed the
goal post such that tax avoidance, which is essentially
tax planning within the ambit of the law, is now being
considered as tax evasion which is criminal. Dolce and
Gabbana were recently convicted of tax evasion in Italy
under more or less similar circumstances.

As the world becomes more borderless and physical
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locations of business activities become less relevant,
governments around the world are battling to keep their
traditional tax base in the face of stiff tax competitions
among nations. Intuitively every rational person wants
to minimize their tax bill hence the continuous search
for legitimate tax planning by exploiting loopholes in the
tax laws. Unfortunately, the line between illegality (tax
evasion) and legitimate tax planning (tax avoidance) is
becoming thinner by the day.

G8, the group of eighth of the world’s most developed
countries met recently to discuss key issues including Tax,
Trade and Transparency. The entire discussion around “Tax”
centered on transfer pricing whereby multinationals and
high net worth individuals are accused of shifting their
profits from countries where their business activities are
conducted into low tax jurisdiction or worse still into tax
havens.

Corporations, big or small and especially multinationals,
are expected to contribute into government funding by
way of taxes. In Europe and particularly in the UK, some of
the multinationals recently accused of tax mispricing
include Google, Facebook, Starbucks and Amazon.
Although parliament agreed that these corporations did not
violate any laws it however questioned their morality with
respect to the payment of their fair share of tax. This raises
another question of whether it is wrong to avoid paying
taxes legally if you can.

The major cause of base erosion and profit shifting (BEPS)
is that as businesses have become more sophisticated and
complex, tax rules remain largely the same in the 21st
century as they were in the pre industrialization era. It is
common sense that you cannot expect tax rules designed to
address traditional commerce to adequately tackle today’s
economic environment of global businesses characterised
by information and communication technologies. The
fluidity of intellectual property coupled with the ease
of risk portability and the delivery of digital goods and
services mean that tax arbitrage is not only easier but also
economically attractive. In addition, competitiveness and
the quest for super efficiency in the face of harsh economic
conditions is making shared service centers, captive
insurance, central procurement and other arrangements
more popular with the potential to result in base erosion
and profit shifting.

The OECD has been working on BEPS, which is likely to
change how we view tax planning since it is becoming
apparent that aggressive tax avoidance may now be viewed
as tax evasion thereby attracting not just a civil sanction
but also a criminal liability. The OECD’s BEPS project is
looking at whether and why multinationals’ taxable profits
are being allocated to locations different from those where
the actual business activity takes place. This effort is being
followed and supported by the G20. In June 2012, the
G20 Leaders in their declaration at Los Cabos said “… we
reiterate the need to prevent base erosion and profit shifting
and we will follow with attention the ongoing work of the
OECD in this area”

Also there are moves to introduce more transparency
around taxation by global organisations through the
adoption of country by country reporting. It is said that
African countries lose more money to tax mispricing
that to corruption so the focus on this important subject is
only going to become more intense. Nigeria, Ghana, Angola,
Kenya, Malawi, Namibia, South Africa, Uganda and Zambia
are some of the countries in Africa that have introduced
formal transfer pricing rules with more expected in the
coming years.

Taxpayers, corporate and individuals must therefore pay
sufficient attention to their tax affairs now more than
ever before and must temper their appetite for aggressive
tax planning with a pinch of morality to ensure that a
fair amount of their profits is paid in taxes in locations
where their business functions are performed. Whilst it is
generally agreed that governments should avoid excessive
or double taxation which is anti-investment, taxpayers also
should not seek to achieve double non taxation. Sometimes
it not just about tax, it is also about fair trade as transfer
mispricing and the attendant artificially low taxes will
confer undue advantage on the benefiting organisations to
the detriment of others.

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