Chapter 5
Base Erosion and Profit Shifting (BEPS) and the Digital Economy:
Challenges and Issues

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ABSTRACT

The digital economy, undoubtedly, has contributed to the immense task of clearly identifying, ascertaining, and accounting for sources, rationales, and audit trails relating to tax transactions. This is not only evident owing to difficulties associated with cross-border transaction regulations which govern different jurisdictions as well as the enforcement of such regulations, but also in respect of risks associated with the present global financial environment – all having generated from the rise in automation, increased and improved sophisticated technologies, globalization, and conglomeration. This chapter not only seeks to highlight the extent, contribution, and significance of the digital economy in respect of those risks associated with base erosion and profit shifting (BEPS) but also amongst other aims and objectives to recommend measures whereby regulations can be better enforced as a means of addressing practices associated with BEPS.

INTRODUCTION

The digital economy is known to have "accelerated and changed the spread of global value chains in which multinational enterprises integrate their worldwide operations and whilst the digital economy and its business models do not generate unique BEPS issues, some of its key features exacerbate BEPS risks" (OECD, 2015:5,6).

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Aims and Objectives of the Chapter

Hence the aims and objectives of the chapter are as follows:

- To investigate those risks associated with base erosion and profit shifting
- To highlight and evaluate global transparency initiatives made in relation to BEPs – inclusively of those involving the digital economy: namely, B2C digital supplies GST/VAT registration and B2C physical supplies
- To evaluate legislative initiatives in respect of interest deductions (India Finance Act 2017 EBITDA rule), for example. Traditional debt equity based rules have been retained or made more stringent by some Asia Pacific jurisdictions (Australia) with others such as Indonesia and Malaysia introducing such regulations. Other initiatives undertaken in Europe, the United States and Latin America, will also considered.
- To highlight the extent, contribution and significance of the digital economy in respect of those risks associated with base erosion and profit shifting
- To investigate how joint audits are able to contribute to better compliance, enforcement and monitoring strategies
- To recommend measures whereby regulations can be better enforced, as a means of addressing practices associated with BEPS.

Hence this chapter will focus on one particular form of base erosion and profit shifting, namely, hybrid mismatch arrangements – as well as the impact of such arrangements in the global economy. The use of vehicles and financial instruments such as hybrid entities, hybrid instruments and hybrid transfers has been known to contribute to various forms of risks – particularly fueled by the digital economy and advanced technologies. Just as conglomeration has made it more difficult to distinguish between banking, insurance and securities based activities, particularly facilitating shadow banking activities, the digital economy has also contributed to the channels through which hybrid instruments are able to operate. For these reasons, and given the fact that risks, are by nature, difficult to quantify, audits provide a more reliable way of quantifying and accounting for such risks. However, as will be revealed in the chapter, the very essence and foundation of generating certainty and clarity, whereby a common set of rules can be applied, is not exactly a feasible or easily accomplishable task.

Literature Review and Background to the Chapter

The Final Report (OECD, 2015:28,29) provides a revised guidance which includes two important clarifications relating to risks and intangibles:

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