

OECD attempts to combat harmful tax competition

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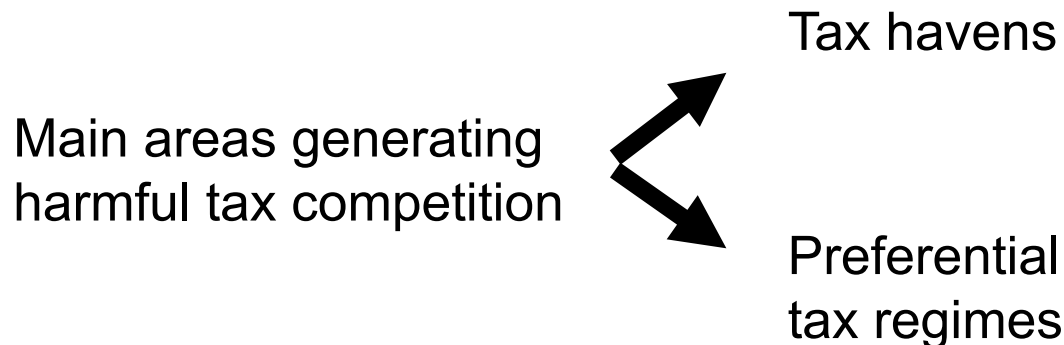
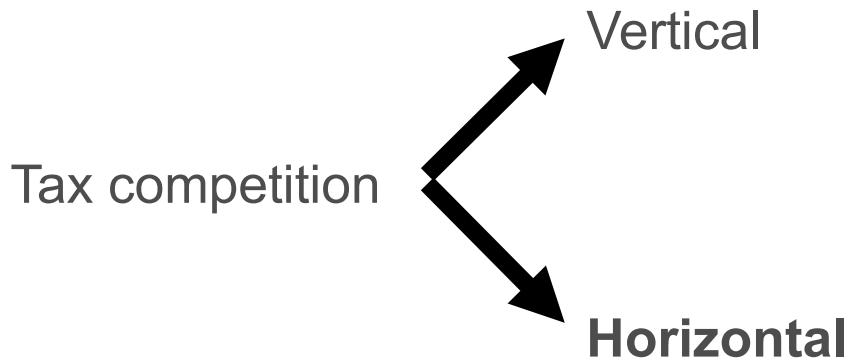
Topics

- I. Underlying concepts
- II. Beneficial effects of tax competition
- III. Negative effects of tax competition
- IV. Areas generating harmful tax competition
- IV. Combating harmful tax competition
- V. BEPS 5



I. Conceptual basis

- **Tax competition** = any form of providing non-cooperative tax concessions by independent governments with the aim of attracting tax base to the country (lack of tax harmonization)



II. Positive effects of tax competition

- Tax competition emerges as a useful constraint on the power of policy-makers (“Leviathan”) → **Fiscal discipline**
- Downward pressure on tax burden
- Better use of sources
- Economic growth
- Capital mobility protects against government abuses



III. Negative effects of tax competition

1. Only in the source country – from which the tax base is shifted away to another:
 - Causes distortion on the economic market
 - Diminishes global welfare

2. Both in the source and in the target state:
 - May alter the structure of taxation
 - Undermines taxpayer confidence in the integrity of tax systems



IV. Areas generating harmful tax competition

Key factors set out in the 1998 Report:

1. Tax havens

- a) No or only nominal taxes
- b) Lack of effective exchange of information
- c) Lack of transparency

d) No substantial activity requirement

2. Preferential tax regimes

- a) No or nominal taxes
- b) Lack of effective exchange of information
- c) Lack of transparency

a) “Ring-fencing” of regimes





V. Solutions of the OECD

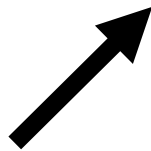
- 1998 Report
- Tax Information Exchange Agreement
- Global Forum on Transparency and Exchange of Information for Tax Purposes
- Action 5 of the BEPS



VI. BEPS 5

Preferential regimes that risk being used for artificial profit shifting (firstly IP regimes)

Against



Lack of transparency

- Ongoing monitoring and receiving mechanism



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- **Substantial activity requirement**= in order for a significant proportion of IP income to qualify for benefits, a significant proportion of the actual R & D activities must have been undertaken by the qualifying taxpayer itself
 - **Nexus approach**= a certain nexus between the activities of the taxpayer and the mobile instrument generating the income subject to preferential treatment



$$\frac{\text{Qualifying expenditure incurred by IP owner to develop IP asset} \times 130\%}{\text{Overall expenditure incurred by IP owner on IP asset, including acquisition costs}} \times \text{Net income from IP asset} = \text{Income receiving tax benefits}$$

- **Qualifying expenditures**= shall mean R & D expenses, but shall never include the
 - 1) Acquisition costs
 - 2) Financial costs of the development
 - 3) Building costs
 - 4) Any other expenses directly not linkable to the IP asset
- **Overall expenditures**= the qualifying expenditures + the related party outsourcing costs + IP acquisition costs



IP assets that could qualify for tax benefits under an IP regime

- 1) Patents
- 2) Copyrighted software
- 3) Other IP assets that are subject to transparent certification by governmental authorities (medicines)



Modified Nexus Approach

- Up-lift of qualifying expenditure → 30%

$$\frac{\text{Qualifying expenditure incurred by IP owner to develop IP asset} \times 130\%}{\text{Overall expenditure incurred by IP owner on IP asset, including acquisition costs}} \times \text{Net income from IP asset} = \text{Income receiving tax benefits}$$

- Transition period → 30 June, 2016
- Abolition period → 30 June, 2021



- 43 preferential regimes

➤ 16 are inconsistent with the nexus approach
(Hungary, Italy, UK, France, Belgium, Spain,
Spain – Basque Country, Spain – Navarra,
Portugal, Luxemburg, Netherlands, Switzerland
– Canton of Nidwalden, People's Republic of
China, Colombia, Turkey)

Hungary: IP regime for royalties and capital gains (definition of Ips, and no substantial activity requirement)

Italy: patent box, includes trademarks



Thank you for your attention!



E.g. for the calculation of the income receiving tax benefits

- Parent company incurred qualified expenses of **100**
 - Parent company incurred costs of acquisition of IP assets of **10**
 - Subsidiary company incurred R & D expenses of **40**
 - Overall income from IP asset: **300**
- Maximum up-lift amount= **100 x 30 % = 30**
- Overall qualifying expenses including a limited percentage of acquisition and outsourcing costs = **130**

$$\frac{130}{150} \times 300 = 260 \rightarrow \text{the amount of IP revenue eligible to the tax benefits}$$

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- EU already disclosed the draft directive
 - Exchange information
 - Will enter into force as of January 1, 2017

State aid investigations against countries that issued the preferential rulings (e.g. Apple ruling, Starbucks ruling, Fiat ruling)



VI. 1998 Report

Harmful tax competition: An Emerging Global Issue

- 1. Recommendations concerning domestic legislation → indicate how to increase the effectiveness of the counteracting measures of the countries
- 2. Recommendations concerning tax treaties
- 3. Recommendations for intensification of international cooperation



Transparency

Framework covering all rulings that could give rise to BEPS concerns in the absence of compulsory spontaneous exchange has been agreed

- 1) rulings related to pref. regimes
- 2) Cross border unilateral APAs
- 3) Rulings giving downward adjustment to profits
- 4) Conduit rulings
- 5) Any other that FHTP agrees that it gives rise to BEPS concerns

