OECD releases final report on countering harmful tax practices under Action 5

Executive summary


The Final Report covers two main areas: (i) the definition of a “substantial activity” criterion to be applied when determining whether tax regimes are harmful; and (ii) improving transparency. In doing so, it touches on a wide variety of topics, including substance requirements for intellectual property (IP) and other regimes, the determination of which IP regimes are allowable and which need to be phased out, what constitutes a harmful preferential regime, which ruling information is to be mandatorily exchanged and to whom, what qualifies as a “ruling” and best practices for cross-border rulings (the process for granting rulings, terms, publication).

In the first instance, the Harmful Tax Practices Report defines the substantial activity requirement in relation to IP regimes by presenting the “nexus approach” as the agreed approach. Under this approach, the application of an IP regime should be dependent on the level of research and development (R&D) activities carried out by the taxpayer itself. In addition, IP regimes should essentially be limited to patents (under a broad definition) and copyrighted software. Sixteen existing IP regimes were reviewed and found not to meet the nexus approach. No new entrants should be permitted to these regimes (and any other IP regime that does not meet the substantial activity requirement) after 30 June 2016 (or the effective date of a new regime consistent with the nexus approach if this is introduced before that date). The grandfather period may not be longer than five years after the date the regime
is closed to new entrants. Enhanced transparency requirements will apply to new entrants into an IP regime after 6 February 2015 and the benefits of an IP regime should not be granted in respect of IP acquired directly or indirectly from related parties after 1 January 2016 (except in cases of acquisitions as a result of a domestic or international business restructuring).

When applying the nexus approach to activities other than IP, there would also need to be a link between the income qualifying for benefits and the core activities necessary to earn the income. The Final Report lists types of activities that could be used to establish a link with different types of financial and other service activities, namely headquarters regimes, distribution and service centers, financing or leasing, fund management, banking and insurance and shipping.

With respect to holding company activities, the Final Report states that there may not in fact be much substance required but many of the concerns raised by holding regimes may be dealt with through existing factors that indicate that a regime is harmful or other work of the OECD (e.g., through Actions 2 and 6).

The second priority area of Action 5 is improving transparency through a framework for the compulsory spontaneous exchange of information on certain rulings. This framework will apply to taxpayer-specific rulings that are (i) rulings on preferential regimes; (ii) unilateral advance pricing agreements (APAs) or other cross-border unilateral rulings in respect of transfer pricing; (iii) cross-border rulings providing for a downward adjustment of taxable profits (in particular excess profit and informal capital rulings); (iv) permanent establishment (PE) rulings; or (v) related party conduit rulings. The framework may be expanded to other types of ruling in the future. The information exchange requirement would not relate to the ruling itself, but to certain information as contained in a template included in the Final Report. The ruling itself could, however, be exchanged on request in a second step. The framework also deals with questions such as time limits, legal basis, confidentiality and the countries with which information would have to be exchanged. Information exchange will not only apply to future rulings, but also to rulings that were issued on or after 1 January 2010 and were still in effect as from 1 January 2014. An ongoing monitoring and review mechanism, including annual review, will be put in place to ensure countries' compliance.

EY is hosting a series of webcasts that will provide a comprehensive review of the final BEPS reports and outlook for country action. The final report on Action 5 will be addressed in webcasts on:

- OECD BEPS Project Outcomes: Highlights and Next Steps - 15 October, 10am EDT and
- Anti-abuse Measures under BEPS Actions 3, 5, 6 and 12 - 19 November, 10am EST

Detailed discussion

On 5 October 2015, the OECD released final reports on all 15 focus areas in its Action Plan on Base Erosion and Profit Shifting (BEPS). The final reports were presented at the G20 Finance Ministers’ meeting in Lima, Peru on 8 October 2015. After review by the finance ministers, the BEPS package will go to the G20 leaders for their approval at the summit meeting scheduled for 15-16 November in Antalya, Turkey.

This Alert summarizes the OECD’s final report on Action 5, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance.

Introduction

The OECD started work on addressing harmful tax competition in the late 1990s, resulting in a 1998 report, Harmful Tax Competition: An Emerging Global Issue (the 1998 Report). It also created the Forum on Harmful Tax Practices (FHTP) to take this work forward.

In Action 5, the OECD builds on the conclusions of the 1998 Report. It expands the role of the FHTP, by committing the FHTP to “revamp the work on harmful tax practices.” The FHTP is asked to focus particularly on defining substantial activity as a requirement for any preferential regime; improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes; and evaluating preferential tax regimes in the BEPS context.
The Harmful Tax Practices Report follows a progress report that was released on 16 September 2014 (the 2014 Progress Report).1

Harmful tax practices as defined by the OECD

The OECD uses the framework under the 1998 Report for determining whether a regime is a harmful preferential regime.

Which “regimes” are within the scope of work of FHTP

The FHTP focuses exclusively on regimes applying to income from geographically mobile activities, such as financial and other service activities, including the provision of intangibles. Preferential regimes designed to attract investment in plant, building, and equipment are outside the scope. Also, the focus is mostly on business taxation, including both national and sub-national taxes. Consumption taxes are explicitly excluded.

What is a “preferential” regime

In order for a regime to be considered preferential, it must offer some form of tax preference in comparison with the general tax rules in the relevant country. This would include reduced tax rates as well as reductions in the tax base or preferential terms for the payment or repayment of taxes. Even a small degree of preference is sufficient for the regime to be considered preferential. However, the inquiry does not focus on whether a regime is preferential in comparison with other countries.

What makes a preferential regime “potentially harmful”

Once a regime has been identified as “preferential,” four key factors and eight other factors are used to determine whether the preferential regime is potentially harmful. The four key factors are:

i. The regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities.

ii. The regime is ring-fenced from the domestic economy.

iii. The regime lacks transparency (e.g., the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure).

iv. There is no effective exchange of information with respect to the regime.

The first factor (no or low effective tax) is a gateway criterion: if this criterion is not met, the regime will not be considered harmful. If the criterion is met, the other three key factors and, where relevant, the eight other factors need to be evaluated. It only takes one of the remaining three key factors to be met to have a regime characterized as potentially harmful.

The eight other factors generally help to spell out, in more detail, some of the principles and assumptions that should be considered in applying the key factors themselves. They are:

i. Artificial definition of the tax base

ii. Failure to adhere to international transfer pricing principles

iii. Foreign source income exempt from residence country taxation

iv. Negotiable tax rate or tax base

v. Existence of secrecy provisions

vi. Access to a wide network of tax treaties

vii. Promotion of the regime as a tax minimization vehicle

viii. Encouragement of operations or arrangements that are purely tax-driven and involve no substantial activities

What makes a potentially harmful regime “actually harmful”

The final step is to determine whether a “potentially” harmful regime, according to the factors described above, is “actually harmful” by analyzing whether it has harmful economic effects. This analysis considers whether the regime results in a shift of activities from one country to the country providing the regime rather than generating new activities, whether the activities in the host country are commensurate with the amount of investment or income, and whether the preferential regime is the primary motivation for the location of an activity.

Consequences of a regime being found to be harmful

Where a regime is found to be harmful, the relevant country is given the opportunity to abolish the regime or remove the features that create the harmful effect. Other countries may take defensive measures to
counter the effects of the harmful regime. Also, under BEPS Action 5, rulings on potentially harmful regimes would have to be spontaneously exchanged with foreign tax authorities. This requirement would apply whether or not the regime is actually harmful.

New focus on substantial activity

Substantial activity was already considered as one of the “other factors” in the 1998 Report. This factor looks at whether a regime “encourages purely tax-driven operations or arrangements” and states that “many harmful preferential tax regimes are designed in a way that allows taxpayers to derive benefits from the regime while engaging in operations that are purely tax-driven and involve no substantial activities.”

Action 5 elevates the “substantial activity requirement” in importance. Going forward it will be considered alongside the four key factors when determining whether a regime is potentially harmful. This means that a regime that meets the “no or low effective tax rates” test (key factor 1, which acts as a gateway test) will be considered harmful if there is no substantial activity in the country granting the regime. This is a significant change from the practice of the OECD to date. It is therefore critically important how “substantial activity” is defined. Very limited guidance on what constitutes “substantial activity” was included in the 1998 Report.

The substantial activity requirement applies to all preferential regimes in scope. However, in the first instance the FHTP focused on defining the concept of substantial activity in the context of IP regimes (i.e., regimes providing preferential tax treatment for income arising from qualifying intellectual property).

Substantial activity requirement in the context of IP regimes

Definition of substantial activity

The FHTP considered the following approaches to defining the substantial activity requirement in relation to IP regimes:

- A value creation approach that would require taxpayers to undertake a set number of significant development activities in order to be entitled to an IP regime.
- A transfer pricing approach that would require a set level of important functions being assumed in the jurisdiction of the regime by the taxpayer that intends to apply the regime. The taxpayer would have to be the legal owner of the assets giving rise to the tax benefits, use those assets, and bear the economic risks of such assets.
- A nexus approach that links the benefits of the regime with the R&D expenses incurred by the taxpayer.

The 2014 Progress Report suggested that the nexus approach was the most appropriate, indicating that the transfer pricing approach was only supported by a few countries and the value creation approach did not have any support over the other two. Consensus on the application of the nexus approach was reached in February 2015 when the G20 endorsed the nexus approach as presented by the OECD in a document titled, Action 5: Agreement on Modified Nexus Approach for IP Regimes (the February Action Paper). This approach is further developed in the Final Report.

Under the agreed nexus approach, benefits would only be granted in respect of income arising from IP where the actual R&D activity was undertaken by the taxpayer itself. According to the OECD, “expenditures act as a proxy for substantial activities.” Mere capital contributions or expenditures for substantial R&D activity by parties other than the taxpayer are not qualifying IP expenditures, except where such activities are undertaken by unrelated parties, irrespective of their residence. Expenditures for activities undertaken by related parties would not count as qualifying expenditures. The rationale behind this approach is that the FHTP considers it unlikely that a company will outsource the fundamental value-creating activities to an unrelated party, regardless of where that unrelated party is located. In a change from the 2014 Progress Report, the Final Report gives countries the option to limit unrelated outsourcing to a certain percentage or proportion.
The proportion of income that may benefit from an IP regime ("the nexus ratio") is the same proportion as that of qualifying expenditures compared to overall expenditures. This is summarized in the following formula given in the Final Report:

\[
\frac{a+b}{a+b+c+d}
\]

- "a" represents R&D expenditures incurred by the taxpayer itself
- "b" represents expenditures for unrelated-party outsourcing
- "c" represents acquisition costs of IP
- "d" represents expenditures for related-party outsourcing

The expenditures covered in "a" and "b" are referred to as "qualifying expenditure," with the sum of all four categories of expenditures or costs constituting "overall expenditure."

To counter any possible incentives for taxpayers to undervalue transfers between related parties, any related party acquisitions of IP will require documentation substantiating the arm's length price. "Acquisitions" include any transfer of rights whether or not a payment was actually made.

A number of the current IP regimes also apply to acquired IP. Under the nexus approach, these IP regimes need to be amended to avoid being considered harmful tax regimes, because capital expenditures to acquire IP will be excluded from qualifying expenditures. Only the expenditures incurred for improving the IP asset after it was acquired will be treated as qualifying expenditures. Acquisition costs will, however, be included in overall expenditures and will therefore reduce the portion of qualifying expenditures compared to overall expenditures (which in turn will reduce the income that could benefit from an IP regime). As a result, if a taxpayer does not continue to develop acquired IP, there will effectively be no benefit under an OECD-compliant IP regime under this approach. Where the taxpayer continues to develop the IP, the benefits will likely be reduced under this approach compared to the benefits currently available under a number of IP regimes.

When calculating qualifying expenditures, countries may permit taxpayers to apply a 30% "up-lift." This up-lift may increase qualifying expenditures (i.e., "a" and "b" in the above formula) but only to the extent that the taxpayer has non-qualifying expenditures (i.e., "c" and "d" in the above formula). This means that the increased amount of qualifying expenditures cannot exceed the taxpayer's overall expenditures. This up-lift concept was not included in the 2014 Progress Report, but was introduced in the February Action Paper. According to the Final Report, its purpose is to ensure that the nexus approach does not penalize taxpayers excessively for acquiring IP or outsourcing R&D activities to related parties. The Final Report acknowledges that taxpayers that acquired IP or outsourced a portion of the R&D to a related party may be responsible for much of the value creation themselves. Nevertheless, the up-lift still requires taxpayers to themselves carry out R&D activities, as the up-lift is defined as a percentage of qualifying expenditure.

Countries may treat the nexus ratio as a rebuttable presumption. If this option is used, taxpayers would have the possibility to prove that more income should qualify for the IP regime. This would be limited to "exceptional circumstances" and requires that taxpayers be able to establish that the application of the nexus ratio leads to an outcome that is not commensurate with the level of their R&D activity. The Final Report contains strict and detailed rules on the application of the rebuttable presumption, including a mandatory annual review, specific documentation requirements, the requirement to provide certain information to the FHTP for monitoring purposes as well as spontaneous information exchange with other jurisdictions concerned.

**Qualifying IP**

Many of the current IP regimes do not only apply to patents, but also apply to marketing-related IP such as trademarks. Under the nexus approach, the only IP assets that could qualify for tax benefits under an IP regime are patents and other IP assets that are functionally equivalent to patents, if those IP assets are both legally protected and subject to similar approval and registration processes. IP assets that are functionally equivalent to patents are:
• Patents defined broadly (i.e., utility models, IP assets that grant protection to plants and genetic material, orphan drug designations, and extensions of patent protection)
• Copyrighted software
• Other IP assets that are:
  − Non-obvious, useful and novel
  − Substantially similar to IP assets in the first two categories
  − Certified as such in a transparent certification process by a competent government agency that is independent from the tax administration

This category only applies to taxpayers that have no more than €50 million in global group-wide turnover and that themselves earn no more than €7.5 million per year in gross revenues from all IP assets. This third category of IP assets will be reviewed by 2020.

As a result, many current IP regimes will have to be amended in order for them not to be considered as harmful tax regimes.

**Tracking of expenditures and income**
Taxpayers that want to benefit from an IP regime will have to track expenditures in order to be able to substantiate the nexus between expenditures and income and to provide evidence of this link to tax administrations. In principle, this would be a link between expenditures, IP assets and IP income, and taxpayers would have to track to IP assets. However, where such tracking would be unrealistic and require arbitrary judgments, countries may also allow a product-based approach. Under this approach qualifying and overall expenditure would not be tracked in relation to specific IP assets but in relation to specific products to which IP assets contribute. This would require taxpayers to include all qualifying expenditure linked to the development of all IP assets that contributed to the product in “qualifying expenditures” and to include all overall expenditures linked to the development of all IP assets that contributed to the product in “overall expenditures.” However, in certain cases (the Final Report gives the example of medicines that are produced in different colors, dosages or sizes) tracking on an individual product-basis also would not be appropriate. In those cases tracking could be in relation to product families. The Final Report contains a list of mandatory documentation requirements, including, but not limited to, information on how the expenditure was tracked.

**Grandfathering for existing IP regimes**
Many existing IP regimes, including all the 16 regimes reviewed by the FHTP, do not meet the requirements resulting from the modified nexus approach. The Final Report contains the following guidance on grandfathering.

No new entrants should be permitted to any existing IP regime after 30 June 2016. If a new regime consistent with the nexus approach takes effect before 30 June 2016, no new entrants should be permitted after the new regime has taken effect. “New entrants” includes both taxpayers not previously benefiting from the regime and new IP assets owned by taxpayers already benefiting from the regime. Jurisdictions are permitted to allow taxpayers to benefit from the existing regime until a specified abolition date, which may not be later than five years after the date the regime is closed to new entrants, which means that the latest possible date is 30 June 2021. Legislative processes to implement a new IP regime must begin in 2015.

The OECD believes there is a risk that new entrants will seek to structure into existing regimes with a view to benefiting from grandfathering. Therefore, enhanced transparency requirements will apply to new entrants into an IP regime after 6 February 2015. This will include spontaneous exchange of information on the identity of new entrants, regardless of whether a ruling is provided. In addition, the IP regime should not be granted in respect of IP acquired directly or indirectly from related parties after 1 January 2016 (unless such assets already benefitted from an IP regime prior to such transaction). An exception would apply to acquisitions from related parties if this acquisition is part of a domestic or international business restructuring intended to transfer IP assets to regimes that are being modified to comply with the nexus approach. No definition of “restructuring” is given.
Substantial activity in the context of regimes other than IP regimes

Substantial activity is not only required for IP regimes but for all preferential regimes. When applied to other regimes, the nexus approach also should establish a link between the income qualifying for benefits and the core activities necessary to earn the income. The core activities at issue in non-IP regimes are geographically mobile financial and other service activities (as these are the exclusive focus of the FHTP).

The Harmful Tax Practices Report lists types of activities that could be used to establish a link with different types of financial and other service activities, namely headquarters regimes, distribution and service centers, financing or leasing, fund management, banking and insurance and shipping. With respect to holding activities, the Harmful Tax Practices Report states that there may not in fact be much substance required but many of the concerns raised by holding regimes may be dealt with through existing factors that indicate that a regime is harmful or other work carried on by the OECD (e.g., through Actions 2 and 6). However, the substantial activity factor requires, at a minimum, that all corporate law filing requirements are met and that the holding company has the substance necessary to engage in the activities of holding and managing equity participations, which precludes letter box companies.

Spontaneous exchange of information on tax rulings

Improving transparency is the second priority under Action 5. The FHTP was specifically asked to look into compulsory spontaneous exchange of information on rulings. Lack of transparency is also one of the factors in considering whether a regime is harmful.

The FHTP applied a three-step approach:

i. The first step was the development of a framework for compulsory spontaneous exchange of information on rulings related to preferential regimes. This framework was set out in the 2014 Progress Report but was significantly expanded under the Final Report.

ii. In the second step, the FHTP considered whether transparency can be further improved and considered the ruling systems of member and associated countries. This resulted in expanding the framework to cover not only rulings that relate to preferential regimes.

iii. In the third step, the FHTP developed general best practices for the design and operation of ruling regimes.

The framework in the Final Report differs from that included in the 2014 Progress Report. The most significant difference is the expansion in scope. While the 2014 Progress Report only referred to rulings on preferential regimes, the Final Report foresees information exchange on taxpayer-specific rulings that fall in one of six categories. The Final Report defines rulings as “any advice, information or undertaking provided by a tax authority to a specific taxpayer or group of taxpayers concerning their tax situation and on which they are entitled to rely.” Information exchange only applies to taxpayer-specific rulings. These are rulings that apply to a specific taxpayer in response to a ruling request and can be given both pre-transaction and post-transaction. This includes rulings given informally but not statements or agreements reached as a result of an audit carried out after the filing of tax returns or accounts. However, rulings or agreements given as a result of an audit are in scope if they concern the treatment of future profits and fall within any of the six categories.

The six categories of rulings covered by the exchange of information requirement are:

i. Rulings on preferential regimes: This category concerns rulings that are within the scope of work of the FHTP (i.e., rulings concerning geographically mobile activities, such as financial and other service activities, including intangibles), are preferential and meet the low or no effective tax rate factor described above. Rulings would not have to have been reviewed by the FHTP or found to be potentially or actually harmful. Countries would therefore have to self-assess whether a regime is preferential. This
includes specifically regimes in the following areas: shipping, banking, insurance, financing and leasing, fund management, headquarters, distribution center, service center, IP (even if the regime is consistent with the nexus approach outlined above) and holding company regimes.

ii. Unilateral APAs or other cross-border unilateral rulings in respect of transfer pricing (i.e., unilateral tax rulings covering transfer pricing or the application of transfer pricing methods, falling short of an APA).

iii. Cross-border rulings providing for a unilateral downward adjustment of taxable profits that is not directly reflected in the taxpayer’s financial/commercial accounts. The Final Report gives the example of excess profit rulings, informal capital rulings and similar rulings that recognize the contribution of capital or an asset and provide for an adjustment that reduces the taxable profits (e.g., through a deemed interest deduction on an interest free loan). An agreement was reached that information on cases of informal capital contribution or excess profit regimes will be exchanged even if a country does not require a ruling to benefit from the regime.

iv. PE rulings: Rulings that (i) explicitly determine or decide on the existence or absence of a PE (either inside or outside of the country giving the ruling) or (ii) provide for how much profit will be attributed to a PE.

v. Related party conduit rulings: Rulings covering “arrangements involving cross-border flows of funds or income through an entity in the country giving the ruling, whether those funds or income flow to another country directly or indirectly (i.e., through another domestic entity first).”

vi. In addition, information exchange would apply to any other type of ruling agreed by the FHTP that in the absence of spontaneous exchange of information gives rise to BEPS concerns. This category gives the FHTP flexibility to extend the obligation to exchange information to additional categories of rulings in the future.

The information exchange requirement would not relate to the ruling itself, but to certain information as contained in a template included in the Final Report. The tax authorities of the receiving country could then determine whether to request the ruling itself, which would then have to be exchanged in a second step. Information would have to be exchanged with any affected country. Which country is considered as affected varies depending on the category of ruling concerned, but includes in all cases the residence country of the ultimate parent company and the immediate parent company. In most cases information also will have to be exchanged with the countries of residence of related parties (as defined in the Final Report) with which the taxpayer enters into a transaction that is covered by the ruling. The framework also deals with questions of confidentiality.

The 2014 Progress Report anticipated that the framework set out in that Final Report would apply as from autumn 2014. However, the Final Report indicates framework has not been applied yet due to the increase in volume of information that will need to be exchanged as a result of the significant expansion of rulings covered. The Final Report therefore provides for new key dates:

- Information on rulings issued on or after 1 April 2016 will have to be exchanged at the latest within three months after the ruling has become available to the competent authority of the country granting the ruling.
- The obligation to exchange information also applies to rulings that were issued on or after 1 January 2010 and were still in effect as from 1 January 2014, including rulings modified in this period. The process to exchange information on these rulings should be completed by the end of 2016.

The Final Report makes it clear that countries will not be able to invoke the lack of reciprocity as an argument for not spontaneously exchanging information with an affected country where the affected country does not grant, and therefore cannot exchange, rulings that are subject to the obligation to spontaneously exchange information. However, information exchange may be
suspended or limited in scope if appropriate safeguards to ensure confidentiality are not in place or if there has been a breach in confidentiality and the situation has not been appropriately resolved.

The Final Report also sets out best practices as regards the process of granting a ruling, the term of rulings, subsequent audit/checking procedures as well as publication and exchange of information. These apply to taxpayer-specific rulings as well as general rulings, i.e., rulings that apply to groups or types of taxpayers or may be given in relation to a defined set of circumstances or activities.

The FHTP will monitor and review compliance with the obligation to spontaneously exchange information under Action 5. This will involve an annual review by the FHTP starting at the beginning of 2017. To that end, countries that provide taxpayer-specific rulings that fall within the framework will be expected to provide certain statistical information on an annual basis.

**Progress report on review of member country and associated country tax regimes**

In 2010 the FHTP started a review process of preferential tax regimes in member countries and associated countries, which covers 43 regimes. As the review commenced in 2010, i.e., before the BEPS Action Plan, the review is generally based on the factors set out in the 1998 Report, under which “substantial activity” was not yet a key factor. This was done to ensure consistency in the approach. Only IP regimes were considered in light of the substantial activity requirement. As mentioned above, the FHTP concluded that all sixteen IP regimes that were reviewed are inconsistent with the nexus approach. Of the remaining 27 regimes other than IP regimes, none was considered as actually harmful. However, the review of four regimes has not yet been concluded and four regimes are in the process of being eliminated.

**Next steps**

In addition to monitoring the application of the transparency framework (i.e., the framework for spontaneous exchange of information on rulings), the FHTP will continue to monitor preferential regimes.

With respect to preferential IP regimes, monitoring will specifically cover the legislative processes undertaken by countries to update IP regimes that do not meet the nexus approach, the application of the nexus ratio as rebuttable presumption (if countries decide to apply this option) as well as the granting of IP regimes to “other IP assets” as defined above.

To ensure a level playing field and avoid the risk of harmful tax practices being simply displaced to third countries, the FHTP will engage with other non-OECD member countries on the basis of the framework developed in the Final Report.

Action 5 also required the FHTP to consider revisions or additions to the existing framework to evaluate harmful tax practices. The FHTP established two areas that could benefit from further consideration, viz., “artificial definition of the tax base” and ring-fencing. However, the OECD and G20 countries involved in the FHTP considered it too early to accurately define areas in which the existing criteria may fall short because it is not yet possible to evaluate the impact of the elaboration of the substantial activity criterion and increased transparency.

**Implications**

According to the OECD, the work on harmful tax practices is not intended to promote the harmonization of taxes, tax structures or tax rates. Rather, it is about reducing the role of taxation on the location of mobile financial and service activities, including intangibles. The OECD indicates the desire to create a “level playing field” in which tax competition can take place by having countries agree to a set of common criteria and by promoting a co-operative framework. To this end, the OECD notes the importance of engaging also with non-OECD countries so that any such level playing field will not be limited to OECD member countries.

Even though the OECD has been reviewing preferential tax regimes of its member countries for more than a decade, the new focus on substantial activity may result in more regimes being considered potentially harmful than was the case in the past and, as a result, may trigger certain amendments being made to some tax regimes. All sixteen IP regimes reviewed will have
to be amended to bring them in line with the new nexus approach and countries may decide to apply grandfathering rules to existing regimes. In the case of EU countries, consideration will need to be given to the matter of how the substantial activity requirement could be defined without violating EU law.

Finally, the framework for spontaneous exchange of rulings is a significant step in the OECD’s push for more transparency and information exchange. Member countries will not only have to adapt their laws to be able to implement the framework, but also will have to adapt their systems to be able to process the information. Despite these legal and administrative issues, the OECD seems determined to move this forward as quickly as possible by prescribing that member countries start exchanging information as from April 2016. To underscore this, all preferential regimes will be reviewed on the basis of this requirement as well. However, exchange of information provisions may raise constitutional law and privacy concerns in some countries, which have not been raised in the project.

With the development of the nexus approach to define substantial activity as well as the framework for exchange of information on rulings not only covering preferential regimes but covering broader categories of cross-border transactions, the OECD’s work is expected to have significant impact not only on the design of preferential tax regimes but on taxpayers operating internationally in general, potentially leading to an increase in challenges by tax authorities and increased controversy.

Webcasts on BEPS outcomes

EY is hosting a series of eight tax webcasts that will provide a comprehensive review of the final BEPS reports and the outlook for country action:

- OECD BEPS Project Outcomes: Highlights and Next Steps - 15 October, 10am EDT
- New Reporting under BEPS Action 13 - 20 October, 10am EDT
- Digital Economy Developments and BEPS Action 1 - 27 October, 12 noon EDT
- Permanent Establishment Developments and BEPS Action 7 - 5 November, 10am EST
- Transfer Pricing and BEPS Actions 8-10 - 12 November, 10am EST
- Anti-abuse Measures under BEPS Actions 3, 5, 6 and 12 - 19 November, 10am EST
- Financial Payments and BEPS Actions 2 and 4 - 3 December, 10am EST
- Dispute Resolution and BEPS Action 14 - 10 December, 10am EST

For more information and to register for the webcast series, click here.

Endnotes


2. Belgium, China, Colombia, France, Hungary, Israel, Italy, Luxembourg, Netherlands, Portugal, Spain, Spain (Basque Country), Spain (Navarra), Switzerland (Canton of Nidwalden), Turkey and the UK.
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