OECD/G20 Base Erosion and Profit Shifting Project

Harmful Tax Practices - 2017 Progress Report on Preferential Regimes

INCLUSIVE FRAMEWORK ON BEPS: ACTION 5

OECD

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Please cite this publication as:
OECD (2017), *Harmful Tax Practices - 2017 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action* 5, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
http://dx.doi.org/10.1787/9789264283954-en

ISBN 978-92-64-28393-0 (print)
ISBN 978-92-64-28395-4 (PDF)

Series: OECD/G20 Base Erosion and Profit Shifting Project
ISSN 2313-2604 (print)
ISSN 2313-2612 (online)

Revised version, November 2017
Details of revisions available at:
http://www.oecd.org/about/publishing/corrigendum-harmful-tax-practices-2017-progress-report.pdf

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Corrigenda to OECD publications may be found on line at: *www.oecd.org/about/publishing/corrigenda.htm*.

Foreword

The integration of national economies and markets has increased substantially in recent years, putting a strain on the international tax rules, which were designed more than a century ago. Weaknesses in the current rules create opportunities for base erosion and profit shifting (BEPS), requiring bold moves by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created.

Following the release of the report *Addressing Base Erosion and Profit Shifting* in February 2013, OECD and G20 countries adopted a 15-point Action Plan to address BEPS in September 2013. The Action Plan identified 15 actions along three key pillars: introducing coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in the existing international standards, and improving transparency as well as certainty.

After two years of work, measures in response to the 15 actions were delivered to G20 Leaders in Antalya in November 2015. All the different outputs, including those delivered in an interim form in 2014, were consolidated into a comprehensive package. The BEPS package of measures represents the first substantial renovation of the international tax rules in almost a century. Once the new measures become applicable, it is expected that profits will be reported where the economic activities that generate them are carried out and where value is created. BEPS planning strategies that rely on outdated rules or on poorly co-ordinated domestic measures will be rendered ineffective.

Implementation is now the focus of this work. The BEPS package is designed to be implemented via changes in domestic law and practices, and via treaty provisions. With the negotiation for a multilateral instrument (MLI) having been finalised in 2016 to facilitate the implementation of the treaty related measures, 67 countries signed the MLI on 7 June 2017, paving the way for swift implementation of the treaty related measures. OECD and G20 countries also agreed to continue to work together to ensure a consistent and co-ordinated implementation of the BEPS recommendations and to make the project more inclusive. Globalisation requires that global solutions and a global dialogue be established which go beyond OECD and G20 countries.

A better understanding of how the BEPS recommendations are implemented in practice could reduce misunderstandings and disputes between governments. Greater focus on implementation and tax administration should therefore be mutually beneficial to governments and business. Proposed improvements to data and analysis will help support ongoing evaluation of the quantitative impact of BEPS, as well as evaluating the impact of the countermeasures developed under the BEPS Project.

As a result, the OECD established an Inclusive Framework on BEPS, bringing all interested and committed countries and jurisdictions on an equal footing in the Committee

on Fiscal Affairs and all its subsidiary bodies. The Inclusive Framework, which already has more than 100 members, will monitor and peer review the implementation of the minimum standards as well as complete the work on standard setting to address BEPS issues. In addition to BEPS Members, other international organisations and regional tax bodies are involved in the work of the Inclusive Framework, which also consults business and the civil society on its different work streams.

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Abbreviations and acronyms

BEPS	Base Erosion and Profit Shifting
CbC	Country-by-Country
FHTP	Forum on Harmful Tax Practices
IMO	International Maritime Organisation
IP	Intellectual Property
MNE	Multinational Entreprise
OECD	Organisation for Economic Co-operation and Development
R&D	Research and Development

Executive summary

The Inclusive Framework on BEPS has fostered rapid change in the international tax rules. This report presents the results achieved by jurisdictions around the world in implementing one of the four BEPS minimum standards, Action 5 Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance.

The key to this minimum standard is the level playing field. Given the extensive membership of the Inclusive Framework, and the ability to review any non-members which are identified as "jurisdictions of relevance," the standard on harmful tax practices is now a truly global standard.

The outcomes of the work on Action 5 have tangible impacts on tax planning. For example, all preferential regimes that offer benefits to income from intellectual property are now held to the same standard and make the granting of tax benefits contingent on the taxpayer carrying out the underlying research and development activities – in other words, aligning taxation with value creation.

In addition, the review of preferential regimes in the scope of the Action 5 work has identified features that can pose an unfair risk to the tax base of other jurisdictions, such as ring-fencing, a lack of transparency or allowing tax benefits irrespective of whether substantial activities are carried out, and these features are being addressed. Not only will this level the playing field but it should also have a positive effect on the host jurisdictions, for example where the regime will now require that the taxpayer conduct substantial activities in the jurisdiction rather than purely tax driven operations.

This progress report serves to demonstrate to the public the swift progress being made, to affirm the actions of Inclusive Framework members that have made significant commitments to change their tax rules, and to maintain the momentum that led to the creation of the Inclusive Framework.

Introduction

1. The Forum on Harmful Tax Practices (FHTP) is the body that has the mandate to monitor and review tax practices of jurisdictions around the world, focussing on the features of preferential tax regimes. Under the BEPS Project, the FHTP revamped its work, reviewing preferential regimes of all OECD and G20 members, with a priority on enhancing transparency and requiring substantial activities in preferential regimes.

2. The report on *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report* (BEPS Action 5 Report, OECD, 2015) contained the results of the review of preferential regimes of OECD members which had not been previously reviewed, and the review of preferential regimes of non-OECD/G20 countries which was undertaken for the first time.

3. With the release of the final BEPS Reports in 2015, it was agreed that BEPS Action 5 was one of the four BEPS minimum standards. Shortly thereafter, the Inclusive Framework on BEPS was created. At present, 102 jurisdictions have committed to implementing the BEPS minimum standards, including Action 5.

4. Under the auspices of the Inclusive Framework, the FHTP has the task of reviewing compliance with the BEPS Action 5 minimum standard. There are two aspects to this: whether preferential tax regimes have harmful features; and the compulsory spontaneous exchange of information on tax rulings (the "transparency framework"). The FHTP has commenced the review of the implementation of the transparency framework, the results of which are currently scheduled to be published separately by early 2018.

5. Since the publication of the final BEPS Action 5 Report (OECD, 2015), the FHTP has reviewed 164 preferential regimes. It is therefore timely to report on the results of the review of these preferential regimes. Doing so provides accountability and transparency to the FHTP's work. It also provides clarity to taxpayers on the status of preferential regimes in jurisdictions in which they operate.

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Chapter 1

The standards for preferential regimes

6. The BEPS Action 5 Report (OECD, 2015) contains the minimum standard on preferential tax regimes, which incorporates the work undertaken earlier by the OECD and published in the 1998 Report "*Harmful Tax Competition: An Emerging Global Issue"* (the "1998 Report", OECD, 1998). The 1998 Report (OECD, 1998) established the FHTP and launched the work of reviewing preferential tax regimes. The FHTP's review process is intended to identify features of preferential tax regimes that can facilitate base erosion and profit shifting, and therefore have the potential to unfairly impact the tax base of other jurisdictions. The 1998 Report (OECD, 1998) set out the scope of preferential regimes to be assessed, and defined the criteria for the assessment.

7. The criteria continue to be applied by the FHTP to assess specific tax regimes. To be within the scope of the work, the regime must apply to income from geographically mobile activities, such as financial and other service activities, including the provision of intangibles.[1]

8. The Action 5 Report (OECD, 2015) placed a renewed focus on requiring substantial activity for any preferential regime. This was undertaken with respect to regimes benefiting income from intellectual property (IP regimes), for which the "nexus approach" was developed. The nexus approach requires a link between the income benefiting from the IP regime and the extent to which the taxpayer has undertaken the underlying research and development that generated the intellectual property. The Action 5 Report (OECD, 2015) also contained more general guidance for the application of the substantial activities criterion to non-IP regimes, and further detail on the FHTP's approach is set out in Annex D.[2]

9. The regimes that have been reviewed by the FHTP in 2016 and 2017, and which are included in this Progress Report, are those that have been brought to the FHTP's attention. This is done primarily through the jurisdiction self-identifying the preferential tax regimes that it offers. This process is supplemented by the ability of a peer jurisdiction to alert the FHTP to a regime.

10. Some preferential regimes with harmful features may be offered by jurisdictions which are not members of the Inclusive Framework. In order to ensure a level playing field, such jurisdictions are able to be identified by the members of the Inclusive Framework as being relevant to the work. These are "jurisdictions of relevance," and the jurisdictions which to date have been identified as such are also included in the results below.

11. The regimes have generally been reviewed using a thematic approach, whereby regimes of a similar nature are reviewed together. The categories of regimes used are those that the FHTP has observed in the course of its work. They are presented thematically below: IP regimes, headquarters regimes, financing and leasing regimes, banking and insurance regimes, distribution and service centre regimes, shipping regimes, holding

company regimes, fund management regimes and miscellaneous regimes. In addition, the FHTP reviewed regimes which were brought forward under its "fast-track" procedure. This procedure gave the FHTP the flexibility to review a regime as a priority, either on the request of the jurisdiction offering the regime or at the request of another jurisdiction.

12. The review process involves each jurisdiction which offers a relevant regime completing a standardised self-review questionnaire and submitting the relevant legislation to the FHTP. Each regime is then discussed at the periodic meetings of delegates of the FHTP, which includes a dialogue with the jurisdiction in order to provide any clarifying information. Decisions are reached on a consensus basis, although it is possible where necessary to use a "consensus minus one" basis of decision making in relation to the peer review process.

Notes

1. Harmful Tax Competition: An Emerging Global Issue (OECD, 1998), paragraph 6.

2. Every regime has different features, and consideration of how the substantial activities requirement applies must take place in the context of the category of regime being considered. As such, the degree of substantial activities that may be appropriate for one type of regime will not necessarily be adequate in the context of another type of regime. For example, this is relevant in the case of shipping regimes, given the particularities of the shipping industry and related taxation frameworks as already recognised for instance in the 2000 Progress Report and the 2004 Consolidated Application Note. Thus, decisions on one type of regime do therefore not necessarily have an implication for decisions on other regimes.

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Chapter 2

Update on the status of regimes

13. In all of the following tables, the meaning of the relevant terms is as follows: where the results indicate a regime is "harmful", this means the regime has harmful features and economic effects. Where the results indicate a regime is "potentially harmful," this means the features of the regime implicates one or more of the criteria, but that an assessment of the economic effects has not yet taken place to make a determination as to whether the regime is "harmful." A regime which is in the process of being eliminated is treated as "abolished" if no new entrants are permitted into the regime, a definite date for complete abolition of the regime has been announced, and the regime is transparent and has effective exchange of information (see paragraph 6 of Annex B). An "amended" regime has had its harmful features removed and is therefore not harmful. Where a regime is "in the process of being eliminated," as well as where a regime is "in the process of being amended," this reflects that the jurisdiction has communicated to the FHTP its government commitment to abolish or amend the regime in light of the discussions by the FHTP about the features of the regime that are of concern, and that the FHTP could reconsider the description of these regimes if insufficient progress was being made (see also paragraph 7 of Annex B).

Regimes listed in the 2015 BEPS Action 5 Report

14. This paragraph presents an update on the status of regimes listed in the 2015 BEPS Action 5 Report (OECD, 2015).

IP regimes listed in the 2015 BEPS Action 5 Report

	Jurisdiction	Regime[1]	Status
1	Belgium	Patent income deduction	Not harmful
2	Colombia	Software regime	Abolished
3	China (People's Republic of)	Reduced rate for high & new tech enterprises	Not harmful[2]
4	France	Reduced rate for long term capital gains and profits from the licensing of IP rights	Harmful[3]
5	Hungary	IP Regime for royalties and capital gains	Not harmful
6	Israel	Amended preferred enterprise regime	Not harmful
7	Italy	Taxation of income from intangible assets	Not harmful except for the extension to new entrants for trademarks[4] between 1 July 2016 and 31 December 2016, which is harmful
8	Luxembourg	Partial exemption for income/gains derived from certain IP rights	Abolished
9	Netherlands	Innovation box	Not harmful

IP regimes listed in the 2015 BEPS Action 5 Report *(continued)*

	Jurisdiction	Regime[1]	Status
10	Portugal	Partial exemption for income from certain intangible property	Not harmful
11	Spain	Partial exemption for income from certain intangible assets (Federal regime)	In the process of being amended
12	Spain	Partial exemption for income from certain intangible assets (Basque country)	In the process of being amended
13	Spain	Partial exemption for income from certain intangible assets (Navarra)	In the process of being amended
14	Switzerland – Canton of Nidwalden	Licence box	Not harmful
15	Turkey	Technology development zones regime	Potentially harmful[5]
16	United Kingdom	Patent box	Not harmful

1. See table 6.1 of the 2015 BEPS Action 5 Report.
2. While the regime did not technically comply with the nexus approach, it was considered functionally equivalent and therefore evaluated as not harmful, given its distinct features and safeguards and the willingness of China to provide additional information.
3. The regime is not consistent with the nexus approach.
4. The Italian IP regime did not and does not include in the eligible assets any marketing related assets other than trademarks.
5. The regime is not consistent with the nexus approach as regards qualifying IP assets and grandfathering provisions. A reassessment will take place in 2018 as Turkey is considering amendments to the definition of qualifying IP assets.

Non-IP regimes listed in the 2015 BEPS Action 5 Report

	Jurisdiction	Regime[1]	Status
1	Indonesia	Public / listed company regime	Out of scope
2	Indonesia	Investment allowance regime	Out of scope
3	Indonesia	Special economic zone regime	Out of scope
4	Indonesia	Tax holiday regime	Out of scope
5	Switzerland – cantonal level	Auxiliary company regime (previously referred to as domiciliary company regime)	In the process of being eliminated[2]
6	Switzerland – cantonal level	Mixed company regime	In the process of being eliminated[3]
7	Switzerland – cantonal level	Holding company regime	In the process of being eliminated[4]
8	Switzerland – federal level	Commissionaire ruling regime	In the process of being eliminated[5]

1. See table 6.2 of the 2015 BEPS Action 5 Report.
2. The tax reform bill, approved in June 2016 by the Federal Parliament was rejected by the Swiss voters on 12 February 2017. The Swiss Government immediately initiated steps for a new proposal to abolish the regimes. Subject to the Swiss parliamentary/constitutional approval process, the intention is for the new Federal legislation to become effective by 1 January 2021.
3. See footnote 2.
4. See footnote 2.
5. See footnote 2.

Regimes reviewed since October 2015

15. The following tables present the results of the review of preferential regimes reviewed since October 2015, as at 4 October 2017. The results are presented according to the categories of regime.

IP regimes reviewed since October 2015

	Jurisdiction	Regime	Status
IP regimes of OECD and G20 countries			
1	India	Tax on income from patent (new IP regime)	Not harmful
2	Ireland	Knowledge development box (new IP regime)	Not harmful
3	Israel	Preferred technological enterprise regime	Not harmful
4	Korea	Special taxation for transfer, acquisition, etc. of technology	Not harmful[1]
5	Turkey	5/B regime (new IP regime)	Not harmful
IP regimes of new Inclusive Framework members			
1	Andorra	Companies involved in the international exploitation of intangible assets	In the process of being amended[2]
2	Liechtenstein	IP box	Abolished
3	Malta	Patent box	Abolished
4	Panama	City of knowledge technical zone	In the process of being amended
5	San Marino	IP regime provided by law no. 102/2004	Abolished
6	San Marino	New companies regime provided by art. 73, law no. 166/2013	In the process of being amended
7	San Marino	Regime for high-tech start-up companies under law no. 71/2013 and delegated decree no. 116/2014	In the process of being amended
8	Uruguay	Benefits under law 16.906 for biotechnology	In the process of being amended
9	Uruguay	Benefits under lit S art. 52 for biotechnology and for software	In the process of being amended
IP regimes of new Inclusive Framework members that are also reviewed as non-IP regimes			
1	Barbados	International societies with restricted liability	In the process of being amended
2	Barbados	International business companies	In the process of being amended
3	Belize	International business companies	In the process of being amended
4	Macau (China)	Macau offshore institution	In the process of being eliminated/ amended
5	Curaçao	Tax exempt entity	In the process of being amended
6	Curaçao	Export facility	In the process of being amended
7	Lithuania	Free economic zone taxation regime	Disadvantaged area regime[3]
8	Malaysia	Principal hub	In the process of being amended
9	Malaysia	Biotechnology industry	In the process of being amended
10	Malaysia	MSC Malaysia	In the process of being amended
11	Malaysia	Pioneer status	In the process of being amended
12	Mauritius	Global business license 1	In the process of being amended
13	Mauritius	Global business license 2	In the process of being amended
14	Seychelles	International business companies	In the process of being amended
15	Seychelles	Companies special license	In the process of being amended
16	Seychelles	International trade zone	In the process of being amended
17	Singapore	Development and expansion incentive – services	Abolished[4]
18	Singapore	Pioneer service company	Abolished[5]

IP regimes reviewed since October 2015 *(continued)*

	Jurisdiction	Regime	Status
19	Thailand	International headquarters	In the process of being amended
20	Thailand	Regional operating headquarters	In the process of being amended
21	Uruguay	Free zones	In the process of being amended
22	Viet Nam	Export processing zone	Under review

1. Subject to final adoption of new legislation.
2. On 30 June 2017, the legislative amendment for this regime entered into the parliamentary process.
3. Disadvantaged areas regimes which provide incidental benefits to IP income are acceptable under paragraph 150 of the Action 5 report.
4. Subject to final adoption of new legislation.
5. Subject to final adoption of new legislation.

Headquarters regimes

	Jurisdiction	Regime	Status
1	Andorra	Holding company regime	In the process of being amended[1]
2	Barbados	International business companies[2]	In the process of being amended
3	Chile	Business platform regime	Potentially harmful but not actually harmful[3]
4	Kenya	Special economic zone[4]	Under review
5	Malaysia	Principal hub[5]	In the process of being amended
6	Mauritius	Global business license 1	In the process of being amended
7	Mauritius	Global business license 2	In the process of being amended
8	Mauritius	Global headquarters administration regime	Not harmful
9	Panama	Multinational headquarters	In the process of being amended
10	Philippines	Regional or area headquarters	Out of scope
11	Philippines	Regional operating headquarters	Under review
12	Seychelles	Companies special license[6]	In the process of being amended
13	Singapore	Development and expansion incentive – services	Not harmful
14	Singapore	Pioneer service company	Not harmful
15	Thailand	International headquarters	In the process of being amended
16	Thailand	Regional operating headquarters	In the process of being amended
17	Turkey	Regional headquarters / regional management centre	Out of scope

1. On 30 June 2017, the legislative amendment for this regime entered into the parliamentary process.
2. Also reviewed as a financing and leasing regime.
3. Decision already concluded in 2009. This regime has potentially harmful features because of ring-fencing.
4. Also reviewed as a distribution and service centre regime.
5. Also reviewed as a financing and leasing regime.
6. Also reviewed as a financing and leasing regime.

Financing and leasing regimes

	Jurisdiction	Regime	Status
1	Andorra	Intercompany and financing regime	In the process of being eliminated[1]
2	Barbados	International business companies[2]	In the process of being amended
3	Barbados	International financial services	Potentially harmful[3]
4	Barbados	International trusts[4]	In the process of being amended
5	Belize	International business companies	In the process of being amended
6	Botswana	International financial services company	In the process of being amended
9	Hong Kong (China)	Profits tax concession for corporate treasury centres	In the process of being amended
10	Hong Kong (China)	Profits tax concessions for aircraft lessors and aircraft leasing managers	Not harmful
7	Curaçao	Tax exempt entity	In the process of being amended
8	Georgia	International financial company	Potentially harmful but not actually harmful[5]
11	Malaysia	Treasury management centre	Abolished
12	Malaysia	Labuan leasing	In the process of being amended
13	Malaysia	Principal hub[6]	In the process of being amended
14	Mauritius	Global treasury activities	Not harmful
15	Montserrat	International business companies	Under review
16	San Marino	Financing regime provided by law no. 102/2004	Abolished
17	Seychelles	International business companies	In the process of being amended
18	Seychelles	Companies special license[7]	In the process of being amended
19	Singapore	Aircraft leasing scheme	Not harmful
20	Singapore	Finance and treasury centre	Not harmful
21	Sint Maarten	Tax exempt company	Under review
22	Thailand	Treasury centre regime	In the process of being amended

1. On 30 June 2017, the legislative amendment for this regime entered into the parliamentary process.
2. Also reviewed as a headquarters regime.
3. This regime has potentially harmful features on account of ring-fencing and substantial activities, based on documents provided by Barbados before 11 September 2017.
4. Also reviewed as a holding company regime.
5. This regime has potentially harmful features on account of ring-fencing.
6. Also reviewed as a headquarters regime.
7. Also reviewed as a headquarters regime.

Banking and insurance regimes

	Jurisdiction	Regime	Status
1	Barbados	Exempt insurance	In the process of being amended
2	Barbados	Qualifying insurance companies	In the process of being amended
3	Hong Kong (China)	Profits tax concession for professional reinsurers	In the process of being amended
4	Hong Kong (China)	Profits tax concession for captive insurers	In the process of being amended
5	Macau (China)	Macau offshore institution	In the process of being eliminated/amended
6	Malaysia	Inward re-insurance and offshore insurance regime	In the process of being amended
7	Malaysia	Labuan financial services	In the process of being amended

Banking and insurance regimes *(continued)*

	Jurisdiction	Regime	Status
8	Mauritius	Captive insurance	In the process of being amended
9	Mauritius	Banks holding a banking licence under the Banking Act 2004 ("Segment B banking")	In the process of being amended
10	Mauritius	Investment banking	Not harmful
11	Nigeria	Free trade zones[1]	Under review
12	Seychelles	Non-domestic insurance business	In the process of being amended
13	Seychelles	Offshore banking	In the process of being amended
14	Seychelles	Fund administration business	In the process of being amended
15	Seychelles	Securities businesses under the securities act	In the process of being amended
16	Seychelles	Reinsurance business	Potentially harmful but not actually harmful[2]
17	Singapore	Insurance business development	Amended[3]
18	Singapore	Financial sector incentive	Not harmful
19	Thailand	International banking facilities	In the process of being eliminated/amended

1. Also reviewed as a distribution and service centre regime.
2. This regime has potentially harmful features on account of ring-fencing.
3. Subject to final adoption of new legislation.

Distribution centre and service centre regimes

	Jurisdiction	Regime	Status
1	Andorra	Companies involved in international trade	In the process of being eliminated[1]
2	Barbados	Fiscal incentives act	Out of scope
3	Costa Rica	Free trade zone	In the process of being amended
4	Curaçao	Export facility	In the process of being amended
5	Curaçao	E-Zone	In the process of being amended
6	Georgia	Free industrial zone	Out of scope
7	Georgia	Special trade company	Out of scope
8	Georgia	Virtual zone person	Potentially harmful but not actually harmful[2]
9	Jordan	Development zones and free trade zones	Potentially harmful[3]
10	Kenya	Special economic zone[4]	Under review
11	Kenya	Export processing zone	Under review
12	Korea	Foreign investment zone	Out of scope
13	Korea	Free economic zone / free trade zone	Out of scope
14	Lithuania	Free economic zone taxation regime	Not harmful
15	Malaysia	Approved service projects	Out of scope
16	Malaysia	Malaysian international trading company	Out of scope
17	Malaysia	Special economic regions	In the process of being amended
18	Malaysia	Green technology services	Not harmful
19	Mauritius	Freeport zone	In the process of being amended
20	Nigeria	Free trade zones[5]	Under review
21	Panama	Colon free zone	Out of scope
22	Panama	Panama-Pacifico special economic zone	In the process of being amended

Distribution centre and service centre regimes *(continued)*

	Jurisdiction	Regime	Status
23	Peru	Special economic zone 1 (Ceticos / ZED)	Out of scope
24	Peru	Special economic zone 2 (Zofratacna)	Not harmful
25	Seychelles	International trade zone	In the process of being amended
26	Singapore	Global trader programme	Not harmful
27	Thailand	International trade centre	In the process of being eliminated/amended
28	Trinidad and Tobago	Free trade zones	In the process of being eliminated[6]
29	Uruguay	Free zones	In the process of being amended
30	Uruguay	Shared service centre	In the process of being amended
31	Viet Nam	Export processing zone	Under review

1. On 30 June 2017, the legislative amendment for this regime entered into the parliamentary process.
2. This regime has potentially harmful features on account of ring-fencing and a lack of substantial activities.
3. This regime has potentially harmful features on account of ring-fencing.
4. Also reviewed as a headquarters regime.
5. Also reviewed as a banking and insurance regime.
6. A Cabinet decision to repeal the regime was made on 16 March 2017 following recommendations made in the Special Economic Zones Policy for Trinidad and Tobago prepared by the Ministry of Trade and Industry.

Shipping regimes

	Jurisdiction	Regime[1]	Status
1	Barbados	Shipping regime	Under review
2	Hong Kong (China)	Profits tax exemptions for ship operators	Not harmful
3	Liberia	Shipping regime	Not harmful
4	Malta	Tonnage tax system	Not harmful
5	Mauritius	Shipping regime	Not harmful
6	Panama	Shipping regime	Not harmful
7	Singapore	Maritime sector incentive	Not harmful

1. The determination of substantial activity in the context of shipping regimes recognises that significant core income generating activities within shipping are performed in transit outside of the jurisdiction of the shipping regime, and that the value creation attributable to the core income generating activities that occur from a fixed location is more limited than for other types of regimes for mobile business income. The determination further considers whether the regime was designed to ensure that the qualifying taxpayer handles all corporate law and regulatory compliance of the shipping company with any additional obligations within the jurisdiction such as ship registration including compliance with International Maritime Organisation ("IMO") regulations, customs and manning requirements (noting the various regulatory requirements for shipping identified in the Consolidated Application Note) (OECD, 2004) consistent with the IMO definition.

Holding company regimes

	Jurisdiction	Regime	Status
1	Barbados	International societies with restricted liability	In the process of being amended
2	Barbados	International trusts[1]	In the process of being amended

1. Also reviewed as a financing and leasing regime.

Fund management regimes

	Jurisdiction	Regime	Status
1	Malaysia	Foreign fund management	Not harmful

Miscellaneous regimes

	Jurisdiction	Regime	Status
1	Barbados	Credit for foreign currency earnings / Credit for overseas project or services	Potentially harmful[1]
2	Malaysia	Biotechnology industry	In the process of being amended
3	Malaysia	MSC Malaysia	In the process of being amended
4	Malaysia	Pioneer status	In the process of being amended
5	Singapore	DEI-Legal services	Abolished
6	Singapore	International growth scheme	Abolished
7	Uruguay	Tax system according to the source principle	Out of scope
8	Uruguay	Investment law incentives under law 16.096	Out of scope
9	Uruguay	Financial company reorganisation	Abolished

1. This regime has potentially harmful features on account of ring-fencing. Additional information on ring-fencing within the regime was received from Barbados after 11 September 2017 and this will be further considered by the FHTP.

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Chapter 3

Next steps

16. Jurisdictions which have regimes that are in the process of being amended, in the process of being eliminated, or are found to be harmful are expected to either abolish or amend their regimes in line with the Action 5 standard. For regimes reviewed after October 2015, see Annex B for further detail, including the timelines for doing so.

17. For IP regimes of new members of the Inclusive Framework, no new entrants are permitted after 30 June 2018 and grandfathering of existing entrants can be provided only until 30 June 2021. See Annex A for further detail.

18. The FHTP will continue its work in 2018. This will include:

- Monitoring and reviewing the implementation of commitments to eliminate or amend a regime to ensure consistency with the Action 5 standard;
- Monitoring progress where regimes are in the process of being eliminated;
- Monitoring progress on the elimination or amendment of IP regimes of new Inclusive Framework members, which will be reviewed in 2019;
- Monitoring economic data on potentially harmful but not actually harmful regimes and reconsidering the conclusion where the economic data indicates this is warranted, as per the agreed process which is included in Annex C;
- Monitoring IP regimes which grant benefits to the third category of assets or permit use of the rebuttable presumption approach to ensure consistency with the "nexus approach," as per the agreed process in Annex C;
- Monitoring regimes which are treated as "disadvantaged area" regimes to ensure they continue to not pose any BEPS risks, as per the agreed process in Annex C;
- Commencing the monitoring of substantial activities in non-IP regimes, as outlined in Annex D;
- Reviewing any newly introduced regimes; and
- Identifying any additional "jurisdictions of relevance" for the work on preferential regimes.

19. In addition, the FHTP is considering possible revisions or additions to the existing criteria used to assess preferential regimes, as mandated by the Action 5 Report (OECD, 2015). Such work could include providing clearer guidance on the interaction of the existing criteria, clarifying the application of the ring-fencing criterion, combining certain existing criteria, further considering the particular characteristics of shipping regimes, determining the continued relevance of certain existing criteria, and considering outputs from other BEPS Actions and the Global Forum on Transparency and Exchange of Information for Tax Purposes when assessing the existing criteria.

Annex A

Timelines for implementing the nexus approach

Event	Agreed timeline for OECD / G20 jurisdictions	Adjusted timeline for new Inclusive Framework members	Adjusted timeline for developing countries, where needed
Enhanced transparency for new entrants to existing IP regimes (if not already covered by transparency framework)[1]	6 February 2015	Publication date (October 2017)	Publication date (October 2017)
Start legislative process to amend existing IP regimes (otherwise not eligible for grandfathering)[2]	31 December 2015	31 December 2017	31 December 2017
Cut-off date for new entrants to an existing IP regime	30 June 2016	As soon as possible and no later than 30 June 2018	As soon as possible and no later than 30 June 2018
Cut-off date for certain acquired assets to benefit from grandfathered IP regimes[3]	31 December 2016 (for assets acquired after 1 January 2016)	30 June 2018 (for assets acquired after publication date)	30 June 2018 (for assets acquired after 1 January 2018)
The latest abolition date (i.e. end of grandfathering) for existing IP regimes	30 June 2021	30 June 2021	30 June 2021

1. This provision reflects the safeguard described in paragraph 66 of the Action 5 Report (OECD, 2015), first bullet. It sets a date as of which new entrants are subject to enhanced transparency. The policy rationale here is that once the FHTP has found that a regime does not meet the Action 5 standards, countries with such regimes should provide additional transparency on any taxpayers or assets joining the regime after such date and before their abolition. This should minimise the risk that taxpayers rush to use such regime simply with a view to benefit from any grandfathering.
2. This provision reflects the eligibility requirement for grandfathering contained in paragraph 63 of the Action 5 Report (OECD, 2015). It is intended to ensure that jurisdictions initiate action in a timely manner to comply with the nexus approach.
3. This provision reflects the safeguard described in paragraph 66 of the Action 5 Report (OECD, 2015), second bullet. While grandfathering is generally available until 30 June 2021, this safeguard limits grandfathering to a much earlier date for IP assets that are acquired after a certain date close to the close-off date for new entrants. The purpose of this safeguard is to protect against taxpayers that would not otherwise benefit from a grandfathered regime from using related-party acquisitions to shift IP assets into existing regimes in order to take advantage of the grandfathering provision. The safeguard does not apply if the acquired IP asset was already benefiting from an existing "back-end" IP regime or was acquired from an unrelated party.

Annex B

Guidance on closing off of regimes and grandfathering for non-IP regimes

Introduction

1. When a regime is going to be abolished or substantially amended, there is a need to close off that existing regime. Closing off an existing regime means that no new entrants are permitted to enter the regime, and that the scope of benefits in the existing regime cannot be substantially expanded for existing beneficiaries (such as making sure that existing beneficiaries are not able to bring new activities or assets under the regime).

2. When a regime is going to be abolished or substantially amended, it may also be grandfathered. Grandfathering in the context of the FHTP's work refers to a transitional period during which taxpayers can benefit from a regime which may have harmful features. This transitional period can apply to both amendments and abolition of regimes. Jurisdictions may offer a grandfathering period in order to balance the expectations of taxpayers benefiting from the regime with the need to adapt to the agreed criteria, as well as to the decisions taken by the Forum.

3. This Annex covers the historical approach of the FHTP to closing off regimes and grandfathering, the particular approach taken in the BEPS Action 5 Report (OECD, 2015) with respect to IP regimes, and the approach to these issues for non-IP regimes that are being reviewed in 2017 and thereafter.

FHTP's historical approach to grandfathering and closing off regimes

Grandfathering under the 1998 Report

4. Grandfathering was addressed in the 1998 Report (OECD, 1998), in the context of setting out the expectations on jurisdictions to tackle harmful regimes, where it was provided that jurisdictions should

> Remove, before the end of five years starting from the date on which the Guidelines are approved by the OECD Council, the harmful features of their preferential tax regimes (…). However, in respect of taxpayers who are benefiting from such regimes on 31 December 2000, the benefits that they derive will be removed at the latest on 31 December 2005. This will ensure that such particular tax benefits have been entirely removed after that date.[1]

5. In practice, most of the regimes reviewed by the FHTP during its early years and which were abolished were either terminated without grandfathering or included grandfathering within this maximum five-year period. There were three regimes reviewed in the first round whose grandfathering periods extended longer, to the end of 2010.[2] In

meetings subsequent to the FHTP reaching its conclusions on these regimes, the countries' delegates provided follow-up information on the grandfathering allowed under the abolished regimes.

Closing off regimes under the 2004 Progress Report

6. The FHTP agreed in 2004 on the conditions to be met for a regime to be considered closed off and therefore abolished. According to paragraph 12 of the 2004 Progress Report (OECD, 2004), a regime will be treated as abolished if:

i. no new entrants are permitted into the regime;

ii. a definite date for complete abolition of the regime has been announced; and

iii. the regime is transparent and has effective exchange of information.

7. In Table 6.2 of the 2015 Action 5 report (OECD, 2015), several regimes were described as being "in the process of being eliminated." These regimes did not meet the conditions set out in the 2004 Progress Report (OECD, 2004). This classification requires that the jurisdiction offering the regime report back to the FHTP on the progress of the elimination, and that the FHTP could reconsider the description of these regimes if insufficient progress was being made.

Closing off and grandfathering for IP regimes under the 2015 BEPS Action 5 Report

8. Specific requirements for closing off and grandfathering were set out in paragraphs 63 to 66 of the 2015 BEPS Action 5 Report (OECD, 2015) for IP regimes of existing FHTP members. The following criteria were agreed:

- No new entrants in existing, non-nexus consistent IP regimes after 30 June 2016;
- New entrants include both new taxpayers and new IP assets owned by taxpayers already benefiting from the regime, but they must fully meet all substantive requirements and have been officially approved as eligible to benefit from the regime;
- Grandfathering of existing entrants is allowed for a maximum of five years from the close off date (i.e. up until 30 June 2021 at the latest);
- Safeguards consisting of enhanced transparency from 6 February 2015 for new entrants entering the regime by requiring spontaneous exchange of information on their identity; and
- Safeguards to avoid using related-party acquisitions to shift IP assets into existing regimes not consistent with the nexus approach in order to take advantage of the grandfathering provision.

9. These requirements are also being applied to the IP regimes of new FHTP members, although with some adjustments to the dates.

Approach for non-IP regimes being reviewed in 2017 and thereafter

10. The following guidance would apply in respect of regimes where the FHTP has reached a conclusion that the regime is actually harmful. It would also apply where the FHTP has not reached a definitive conclusion but the jurisdiction decides to abolish or amend the regime in light of the preliminary discussions by the FHTP which have provided a signal about the features of the regime that are of concern.

11. The approach presented below (and summarised in the diagram below) is intended to draw on the experiences of the FHTP, while taking into account the context of a large number of regimes to be reviewed in 2017 and thereafter. In considering this issue, the level playing field is a key concern. The timelines therefore seek to be in keeping with the ambitious approach taken in the BEPS Action 5 Report (OECD, 2015) in respect of IP regimes, while also acknowledging that there may be circumstances where additional time is needed.

12. Considering the wide scope of non-IP regimes to be reviewed, as well as the different possible harmful features that may exist, the approach for closing off and grandfathering non-IP regimes should vary, as addressed below. This is because the length of time for closing off a regime and the availability of a grandfathering period should reflect the nature of, and the difficulty of remedying, the harmful features.

13. The key factors that can lead a preferential regime which meets the gateway criterion (low or zero tax) to be considered harmful are:

- Ring-fencing
- Lack of transparency
- Lack of effective exchange of information

14. The substantial activities factor, which has been elevated in importance, should also be considered in this respect. The remaining seven other factors are also to be considered, where relevant. However, in many cases they can be seen as an elaboration of the key factors and thus a discussion of the key factors should be sufficient to handle the vast majority of harmful regimes. Any remaining situations not covered by this approach can be addressed on an ad hoc basis, using principles similar to those in this Annex.

Ring-fenced regimes

15. Jurisdictions with regimes being reviewed in 2017 that are ring-fenced can eliminate the ring-fencing by extending the regime to domestic taxpayers/transactions or by closing the regime. In either case, jurisdictions should address the harmful aspects of their regime as soon as possible and by no later than 12 months, or where necessary because of the legislative process, by 31 December of the following calendar year. The timing for this determination would start with the date on which the decision of the FHTP is made public (including a provisional decision such as "in the process of being eliminated").

16. The conditions for determining whether a regime has been abolished would remain the same as set out in the 2004 Progress Report (OECD, 2004). In addition, and drawing from the experience with the nexus approach, where a regime provides benefits for income from specific assets or projects, the closure of a regime to new entrants would include closing it to both new taxpayers and to new assets or activities of existing taxpayers.

17. Where a ring-fenced regime is abolished, and in appropriate cases where a regime is amended (e.g. where existing entrants have a time-limited agreement as to conditions for participating in the regime), grandfathering may be provided. The end date of the grandfathering period for regimes being reviewed in 2017 are consistent with the approach taken in the Action 5 Report (OECD, 2015) for IP regimes. Accordingly, any grandfathering associated with such regimes should end by 30 June 2021.

18. Jurisdictions which joined the Inclusive Framework from June 2016 facing unavoidable litigation exposure resulting from abrogation of prior commitments by the jurisdiction related to pre-existing regimes which compel them to provide grandfathering past this date should provide

the FHTP with documentation on the material litigation risk, including its probability of success on the basis of the current legal framework and its significance in the context of the jurisdiction, e.g. a constitutional issue or another serious legal constraint. In such exceptional cases, the FHTP may determine, based on the circumstances of the case, that benefits may continue beyond 30 June 2021, with the expectation that in most cases no benefits would continue beyond 30 June 2027. In addition, they should spontaneously exchange information on the taxpayers benefitting from such grandfathering, using the framework for spontaneous exchanges on rulings on preferential regimes set out in the Action 5 Report to determine with which jurisdictions to exchange the information, even where the regime is not operated via a ruling.

19. Where a jurisdiction provides for grandfathering, entrants into the regime subsequent to the publication of the FHTP's decision and prior to the date of the regime's abolition should not benefit from grandfathering beyond the date on which such abolition takes effect. It is suggested that jurisdictions which are having FHTP decisions published should be prepared to take the necessary domestic steps (e.g. issuing a press release) to ensure that possible future entrants to the regime are aware that they will not be able to avail themselves of grandfathering upon a subsequent closure of the regime.

Lack of substantial activity in the operation of a regime

20. Jurisdictions with regimes being reviewed in 2017 that lack a requirement for substantial activity can introduce such a requirement or close the regime. In either case, jurisdictions should address the harmful aspects of their regime as soon as possible and no later than 12 months, or where necessary because of the legislative process, by 31 December of the following calendar year, from the time of publication of such a decision by the FHTP.

21. The conditions for determining whether a regime has been abolished would remain the same as set out in the 2004 Progress Report (OECD, 2004). In addition, and drawing from the experience with the nexus approach, where a regime provides benefits for income from specific assets or projects, the closure of a regime to new entrants would include closing it to both new taxpayers and to new assets or activities of existing taxpayers.

22. Where a regime that lacks substantial activity is abolished or amended, grandfathering may be provided, using the same time frames (and the same considerations for constitutional or similar constraints, and for regimes which are in the process of being eliminated) as discussed for ring-fenced regimes.

Lack of transparency in the operation of a regime

23. Jurisdictions with regimes being reviewed in 2017 that lack transparency can address the issue by making the regime transparent or by closing the regime. In either case, jurisdictions should address the harmful aspects of their regime as soon as possible and no later than 12 months, or where necessary because of the legislative process, by 31 December of the following calendar year, from the time of publication of such a decision by the FHTP.

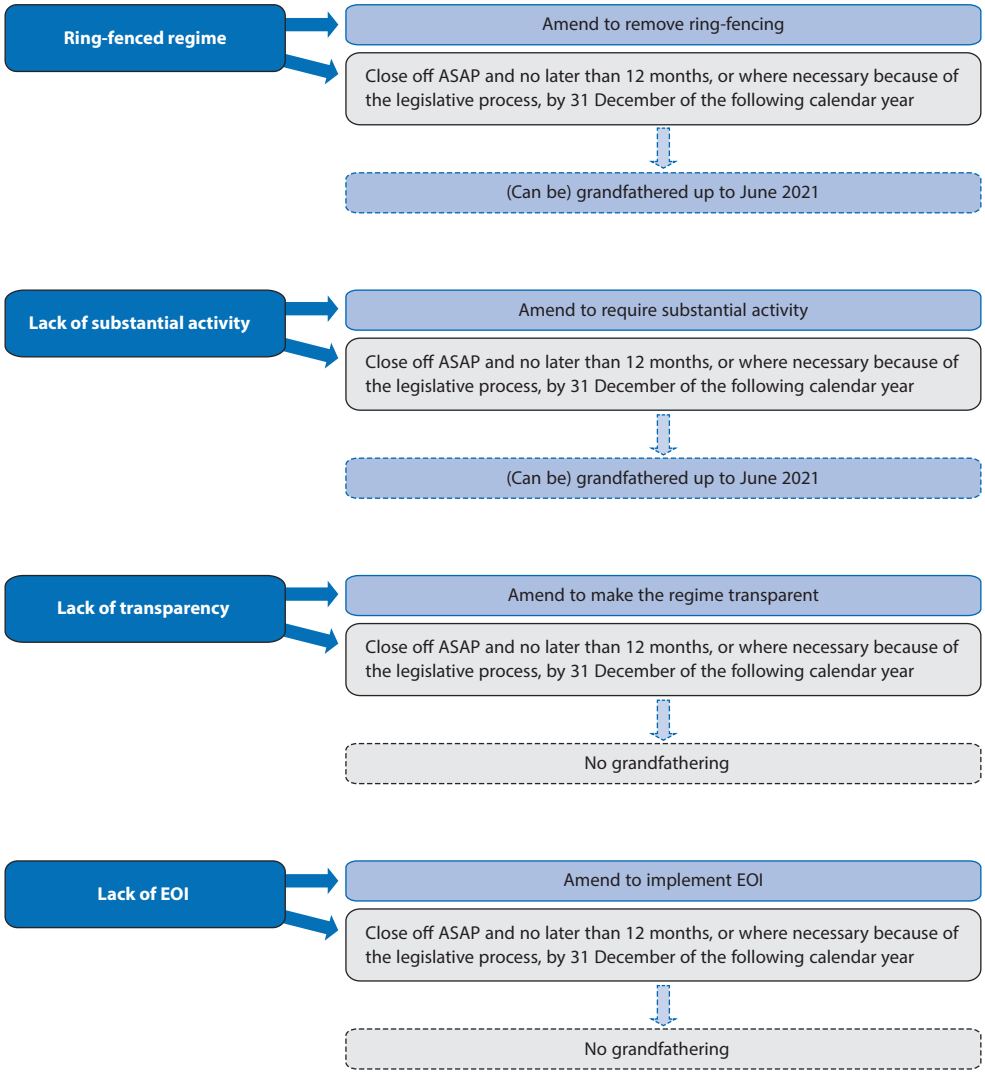
24. Where a regime is made transparent, grandfathering is not a concern. Where a non-transparent regime is to be abolished, no grandfathering can be provided (consistent with the approach described in the 2004 Progress Report [OECD, 2004]).

Lack of exchange of information in relation to taxpayers benefiting from a preferential regime

25. Jurisdictions with regimes being reviewed in 2017 and thereafter that lack effective exchange of information in relation to taxpayers benefiting from the regime can address the issue by implementing effective exchange of information or by abolishing the regime. In either case, jurisdictions should address the harmful aspects of their regime as soon as possible and no later than 12 months, or where necessary because of the legislative process, by 31 December of the following calendar year, from the time of publication of such a decision by the FHTP.

26. Where effective exchange of information is implemented for a regime, grandfathering is not a concern. Where a regime is abolished, no grandfathering can be provided (consistent with the approach described in the 2004 Progress Report [OECD, 2004]).

Figure **B.1. Summary of guidance for closing off and grandfathering non-IP regimes**



Additional monitoring

27. Monitoring in addition to that set out above is warranted with respect to any grandfathered non-IP regimes reviewed in 2017 and thereafter. For such a grandfathered regime, the jurisdiction should provide the FHTP annually with data on the number of taxpayers and amount of income benefitting from the grandfathering.

Notes

1. See Box III following paragraph 148 of the 1998 Report.
2. Belgium: Coordination centres, Netherlands: Risk reserves for International Group Financing, Portugal: Madeira International business centres.

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Annex C

Monitoring data on preferential regimes

Introduction

1. At its March 2017 meeting, the FHTP undertook its first reviews of preferential regimes of new Inclusive Framework members. In the course of that review process, FHTP delegates agreed that more formal guidance would be beneficial in order to standardise the process for monitoring regimes that have been determined by the FHTP to be "potentially harmful but not actually harmful."

2. This Annex sets out the standardised monitoring process. It first explains the policy objective of such monitoring, then sets out the data to be provided by the monitored jurisdiction and the mode of periodically providing such data.

3. In addition, the Action 5 Report (OECD, 2015) contemplates monitoring data on certain features of IP regimes as well as on disadvantaged area regimes. In order to have a coherent approach to all forms of monitoring, this Annex also sets the process for monitoring certain features of IP regimes and disadvantaged areas regimes.

Policy objectives of monitoring potentially harmful but not actually harmful regimes

4. In accordance with the framework for reviewing regimes a regime can be determined to be potentially harmful but not actually harmful.

5. Where a regime is found to be "potentially harmful but not actually harmful" that finding is based on a two-step process. First, the legal framework governing the regime is reviewed, leading to a decision that the way in which the regime is designed makes it possible for the regime to negatively affect the tax base of other jurisdictions, for example by being designed as a low-tax and ring-fenced regime. The second step is that the regime is assessed as not having a negative impact in practice. This finding is based on a review of historical economic data about the operation of the regime in practice, such as the number of taxpayers and the amount of income benefiting from the regime.

6. However, this statistical data may change. For example, a regime may have been used by only a small number of taxpayers in previous years, supporting a conclusion that the regime was not actually harmful, but a larger number of taxpayers or a larger amount of income may subsequently benefit from the regime.

7. As such, a finding by the FHTP that a regime is "potentially harmful but not actually harmful" should not be regarded as a final conclusion. Instead, in order to maintain the level playing field and the integrity of the FHTP's work, the FHTP will need to have

reliable and regular data that allows it to revisit its conclusion on the regime if the facts about the economic impact of the regime have changed. To achieve this, jurisdictions that maintain regimes that have been found to be "potentially harmful but not actually harmful" will need to facilitate the FHTP's work to monitor these regimes.

Approach to a standardised monitoring process

8. To date, relatively few regimes have been determined to be potentially harmful but not actually harmful. As such, the FHTP has used an ad hoc approach to monitoring such regimes. However, with its enlarged membership under the Inclusive Framework, it is timely to set clear guidelines as to the expectations for such monitoring. Having a standardised approach will also facilitate the accurate collection of the relevant data by the monitored jurisdiction, and ensure greater consistency and comparability of data in the monitoring process.

9. There are two aspects to the monitoring: the data that should be collected; and the mode for making that data available to the FHTP.

Identifying the data that should be collected

10. The data that should be collected should include all of the following:

- The number of taxpayers benefiting from the regime each year (being the tax year or other 12 month period, as is most practicable for the jurisdiction); and
- The total amount of gross income for each tax year in respect of which the preference applied.

11. In order to put the data into perspective, a time series (covering the most recent five years) should be provided, if available.

12. Where the regime continues to be used by only a small number of taxpayers (which has historically been the case where the FHTP has made a finding that a regime is potentially harmful but not actually harmful), the collection of this data should not be unduly burdensome.

Mode for making that data available to the FHTP

13. This data will be collected and provided to the FHTP on an annual basis. This should coincide with the frequency of income tax periods and reporting obligations and also allow the FHTP to have data on a regular basis to monitor any significant changes. The straightforward nature of the information to be provided means that annual monitoring should not be unduly burdensome.

14. The format for providing this data would be by way of a short questionnaire covering the above data points in paragraph 10. This would be completed in advance of the first FHTP meeting of each year by jurisdictions offering regimes that have been determined by the FHTP to be "potentially harmful but not actually harmful". The Secretariat would compile the received questionnaires and distribute the compilation for discussion at the first FHTP meeting of each year.

Possible outcomes of monitoring process

15. The above data points are intended to be used as a screening process to determine whether the conclusion that a regime is potentially harmful but not actually harmful should be reconsidered. At the first meeting of the FHTP where the monitoring data is provided, the FHTP would then have the opportunity to ask any questions of a monitored jurisdiction. If the data confirms that the regime continues to be used by a very small number of taxpayers and with a very small amount of income benefiting from the regime, the FHTP should continue to treat the regime as "potentially harmful but not actually harmful."

16. However, if the monitoring data suggests an increase in use of the regime, the FHTP should consider whether the regime is actually harmful. In order to be able to make such determination, the FHTP should agree on what additional data would be needed, such as the type of taxpayers benefiting from the regime, the source of income benefiting from the regime, the amount of expenditure in the host jurisdiction (such as equipment and employees if available).

17. This additional data can be decided on a case-by-case basis, but would take into account the guidance at paragraphs 80-84 of the 1998 Report (OECD, 1998) on assessing the economic effects of a preferential tax regime in terms of its potential harmfulness. Such a further refinement of data collection could provide more precise information.

18. This approach of requiring data at a more general level for the annual screening process while requiring additional data before the FHTP decides whether a regime is actually harmful seeks to balance the burdens on jurisdictions to provide data each year, as well as giving a jurisdiction the full opportunity to present its case and ensuring the FHTP has sufficient detail to make decisions.

19. This additional data should be provided in advance of the immediately subsequent FHTP meeting. At that same immediately subsequent FHTP meeting, the FHTP would consider the additional data and would decide whether the regime is actually harmful.

20. The decision on the regime would be made on the basis of consensus minus one.

Approach to monitoring specific aspects of IP regimes

21. The Action 5 Report (OECD, 2015) mandates certain monitoring in respect of intellectual property (IP) regimes that are "nexus compliant." This applies to the granting of benefits to the third category of IP assets and the use of the rebuttable presumption.

22. The nexus approach includes the possibilities of the rebuttable presumption and granting benefits to the third category of IP assets in order to provide flexibility to jurisdictions, and these possibilities were designed to apply in limited circumstances. As such, additional safeguards are associated with these options to ensure that they are used appropriately, including obligations on the jurisdiction to provide certain information to the FHTP for monitoring purposes, and certain requirements to exchange information spontaneously with relevant other jurisdictions.

23. Since the nexus compliant regimes have been recently introduced by FHTP members, the monitoring process has not yet begun. It is timely therefore to outline the process for this monitoring. As above for monitoring of non-IP regimes, there are two aspects of the approach: the data that should be collected; and the mode for making that data available to the FHTP.

Identifying the data that should be collected

24. The Action 5 Report (OECD, 2015) sets out the detail of the information that is to be reported, as follows.

25. ***The granting of benefits to the third category of IP assets***. Paragraph 37 of the Action 5 Report (OECD, 2015) requires that the following information be notified to the FHTP:

- The fact that the jurisdiction allows benefits to be provided to the third category of IP assets, and the applicable legal and administrative framework (this information is provided in the course of the review of the regime for compliance with the nexus approach);
- The number of IP assets for each type of IP asset included in the third category;
- The number of taxpayers benefiting from the third category; and
- The aggregate amount of IP income arising from the third category of IP assets that qualifies for the IP regime.

26. ***The use of the rebuttable presumption.*** Paragraph 69 of the Action 5 Report (OECD, 2015) requires that the following information be notified to the FHTP:

- The circumstances in which the jurisdiction allows the rebuttable presumption, and the legal and administrative framework for permitting taxpayers to rebut the nexus ratio (this information is provided in the course of the review of the regime for compliance with the nexus approach);
- The overall number of taxpayers benefiting from the IP regime;
- The number of cases in which a taxpayer rebuts the presumption;
- The number of such cases in which the jurisdiction spontaneously exchanged information (this information is collected in the peer review of the transparency framework);
- The aggregate amount of income receiving benefits under the IP regime (differentiated between income benefiting from the nexus ratio and income benefiting from the use of the rebuttable presumption); and
- A list of the exceptional circumstances, described in generic terms and without disclosing the identity of the taxpayer, that permitted taxpayers to rebut the nexus ratio in each case.

27. In order to put the data into perspective, a time series (covering the most recent five years) should be provided, if available. As IP regimes with the above features were introduced only after the 2015 BEPS Action 5 Report (OECD, 2015), data should be provided for the most recent years for which data is available.

Mode for making that data available to the FHTP

28. The Action 5 report (OECD, 2015) explicitly provides that the data on the rebuttable presumption should be provided on an annual basis. For simplicity, the data on the third category of assets will likewise be reported on an annual basis. This should coincide with the frequency of income tax periods and reporting obligations and also allow the FHTP to have regular data to monitor any significant changes.

29. As is the approach taken for the monitoring of non-IP regimes, the format for providing this data would be by way of a short questionnaire covering the above data

points. This would be completed in advance of the first FHTP meeting of each year by the relevant jurisdictions with IP regimes offering the rebuttable presumption or the third category of IP assets. The Secretariat would compile the received questionnaires and distribute the compilation for discussion at the first FHTP meeting of each year.

Possible outcomes of monitoring process

30. At the first meeting where the monitoring data is presented, the FHTP would then have the opportunity to ask any questions relating to the third category of assets or the rebuttable presumption of a jurisdiction offering an IP regime with one or both of these elements.

31. It is possible that such monitoring data could give rise to a need to reconsider whether the regime is nexus compliant. For example, if the monitoring data indicates that a relatively large number of taxpayers are using the rebuttable presumption, the FHTP may need to examine the circumstances where the jurisdiction allowed taxpayers to benefit from the use of this approach. Before reaching such a determination, the FHTP should agree on what, if any, additional data would be needed to effectively evaluate the regime for compliance with the nexus approach. This additional data can be decided on a case-by-case basis.

32. Any such additional data should be provided in advance of the immediately subsequent FHTP meeting. At that subsequent FHTP meeting, the FHTP would consider the additional data and at that same meeting decide whether the regime is not nexus-compliant. Any decisions by the FHTP about whether a regime is not nexus compliant would be made on the basis of consensus minus one.

Approach to monitoring disadvantaged area regimes

33. Certain jurisdictions have introduced tax incentive regimes designed to encourage development in disadvantaged areas and which, whilst they do not specifically provide a preferential treatment for income from IP, they may include (or do not specifically exclude) such income. The Action 5 Report (OECD, 2015) considered that such regimes do not pose a high risk of BEPS, provided they meet certain conditions, but should be monitored by the FHTP.

34. At its July 2016 meeting, the FHTP discussed the content of the monitoring that should be undertaken with respect to disadvantaged areas. A questionnaire for such monitoring was agreed.

35. For coherence with the above monitoring processes, the questionnaire will be completed in advance of the first FHTP meeting of each year by the relevant jurisdictions with regimes for disadvantaged areas. The Secretariat would compile the received questionnaires and distribute the compilation for discussion at the first FHTP meeting of each year. The FHTP would then have the opportunity to ask any questions of a jurisdiction offering such regime.

36. If the FHTP finds an indication of adverse economic effects from a regime, the FHTP will agree what additional data would be necessary to inform a decision as to whether the regime should be treated as an IP regime and assessed against the nexus approach. This additional data can be decided on a case-by-case basis. Such additional data should be provided at the immediately subsequent FHTP meeting. The FHTP will then consider the additional data and conduct further review on such regime as agreed on a consensus minus one basis.

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Annex D

Substantial activities in regimes other than IP regimes

Introduction

1. The 2015 Report on Action 5 (OECD, 2015a) contained detailed guidance on the application of the substantial activities criterion to IP regimes as well as more general guidance for the application of the substantial activities criterion to non-IP regimes. In part this recognised that applying the substantial activities criterion to non-IP regimes is a relatively more straightforward and simpler exercise as the value creation is primarily driven by the services provided rather than a separate IP asset that can be shifted.

2. The general guidance in the report for how to assess substantial activities in the context of regimes other than IP regimes is consistent with the nexus approach, which permits IP regimes to provide benefits to taxpayers only to the extent that those taxpayers themselves undertook the R&D activities (or, for IP regimes outside the European Union, to the extent that the R&D activities took place within the jurisdiction providing the benefits). The report stated that "the same principle can also be applied so that [regimes other than IP regimes] would only be found to meet the substantial activity requirement if they also granted benefits only to qualifying taxpayers to the extent those taxpayers undertook the core income generating activities required to produce the type of business income covered by the preferential regime." [1]

3. The remainder of this annex has two sections. Section 2 considers how outputs from other Actions affect the need for a substantial activities requirement in the context of non-IP regimes. Section 2 concludes that Actions 8-10 and Action 13 give jurisdictions better tools to prevent profit-shifting to preferential regimes that may have little substance. However, while such other actions already provide a certain level of protection, they do not eliminate the need for a substantial activities requirement as specifically recognised in the Report. Section 3 contains a two-step approach to implementing the substantial activities requirement in the context of non-IP regimes.

Substantial activities under other Actions

4. In the context of certain holding company regimes, the Report suggested that concerns about a lack of substantial activities might already be addressed in other work or under other existing factors.[2] Along with the other work mentioned in the Report (OECD, 2015a) on Action 5, the Reports on Actions 8-10 (OECD, 2015b) and Action 13 (OECD, 2015c) also address many concerns about a lack of substantial activities in non-IP regimes.

- **Transfer pricing** – The outputs from Actions 8-10 set out updated guidance on transfer pricing, which ensures transfer pricing outcomes are better aligned with value

creation. The effect of this new guidance is that it will be less likely for significant income to be allocated to an entity which lacks substantial activities and which was established in a jurisdiction merely to receive benefits under a non-IP regime.

- **Country-by-country reporting** – Action 13 established a minimum standard on country-by-country (CbC) reporting. This minimum standard reflects a commitment to implement the common template for CbC reporting. The effect of CbC reporting is that jurisdictions will have relevant information necessary to determine whether resident companies have related entities which lack substantial activities and which are established in a jurisdiction merely to receive benefits under a non-IP regime. In particular, CbC reporting will provide jurisdictions with country-by-country breakdowns of related party revenues, profits before income tax, income tax paid and accrued, number of employees, tangible assets, and other indicators of economic activities within large MNE groups.

5. Actions 8-10 and Action 13 do not eliminate the need for a substantial activities requirement, but they complement the substantial activities requirement by giving jurisdictions better tools to protect against profit-shifting to preferential regimes with little substance. The need for a robust substantial activities requirement for non-IP regimes therefore needs to be seen in light of the overall BEPS Action Plan.

Possible substantial activities analysis for preferential regimes other than IP regimes

6. Although the Actions discussed above may limit the need for a substantial activities requirement in non-IP regimes, they do not eliminate this need. Jurisdictions with such regimes must therefore implement the principles set out in the Action 5 Report (OECD, 2015a) to ensure that preferential regimes other than IP regimes require substantial activities in order to provide benefits. This section sets forth a two-step approach for the implementation of substantial activities in non-IP regimes under which (1) jurisdictions would require activities and establish mechanisms to review compliance with this requirement, and (2) the FHTP would monitor compliance.

Requiring substantial activities

7. In order to comply with the principles set out in the Action 5 Report (OECD, 2015a), non-IP regimes must be designed to ensure that benefits are available only when the core income generating activities are undertaken by the qualifying taxpayer (or, for regimes outside the European Union, when the core income generating activities are undertaken in the jurisdiction providing benefits).[3] Jurisdictions offering non-IP regimes that are in scope of the FHTP work therefore need to design the regime in a way that ensures that core activities relevant to the regime type are undertaken by the taxpayer wishing to benefit from the regime.

8. Core income generating activities presuppose having an adequate number of full-time employees with necessary qualifications and incurring an adequate amount of operating expenditures to undertake such activities. As set out in the Action 5 Report (OECD, 2015a), such activities could include the following.

- **Headquarters regimes –** The core income generating activities in a headquarters company could include taking relevant management decisions; incurring expenditures on behalf of group entities; and co-ordinating group activities.

- **Distribution and service centre regimes** – The core income generating activities in a distribution or service centre company could include activities such as transporting and storing goods; managing stocks and taking orders; and providing consulting or other administrative services.
- **Financing and leasing regimes** – The core income generating activities in a financing or leasing company could include agreeing funding terms; identifying and acquiring assets to be leased (in the case of leasing); setting the terms and duration of any financing or leasing; monitoring and revising any agreements; and managing any risks.
- **Fund management regimes** – The core income generating activities for a fund manager could include taking decisions on the holding and selling of investments; calculating risks and reserves; taking decisions on currency or interest fluctuations and hedging positions; and preparing relevant regulatory or other reports for government authorities and investors.
- **Banking regimes** – The core income generating activities for banking companies could include raising funds; managing risk including credit, currency and interest risk; taking hedging positions; providing loans, credit or other financial services to customers; managing regulatory capital; and preparing regulatory reports and returns.
- **Insurance regimes** – The core income generating activities for insurance companies could include predicting and calculating risk, insuring or re-insuring against risk, and providing client services.
- **Shipping regimes** – The core income generating activities for shipping companies could include managing the crew (including hiring, paying, and overseeing crewmembers); hauling and maintaining ships; overseeing and tracking deliveries; determining what goods to order and when to deliver them; and organising and overseeing voyages.
- **Holding company regimes** – For holding companies that hold a variety of assets and earn different types of income (e.g. interest, rents, and royalties), the core income generating activities would be those activities that are associated with the income that the holding companies earn, as determined by the discussion above. (For example, a holding company that receives benefits for banking income would be required to have the core income generating activities associated with banking companies.) For pure equity holding companies, which only hold equity participations and earn only dividends and capital gains, the Action 5 Report makes clear that there is less concern of such regimes being used for BEPS. The Report states that such holding companies must respect all applicable corporate law filing requirements in order to meet the substantial activities requirement, and suggests that they should have the people and the premises for holding and managing equity participations. Beyond this, because such regimes are provided in part to avoid double taxation, there should be no expectation of a correlation between income-generating activities and benefits. In other words, holding company regimes, including participation exemptions, are particular as the tax exemption / tax benefit is based on policy considerations other than notions of value creation.

9. For "internal" income shifting (i.e. the shifting of income from other domestic sources into the regime to avoid the otherwise applicable higher domestic tax rate), jurisdictions can be expected to already be addressing such problems in order to protect their own revenue

bases. For "external" income shifting (i.e. shifting income from foreign sources into the regime to avoid the otherwise applicable higher foreign tax rate), jurisdictions may not have the same built-in incentive to take action. Along with articulating the core income generating activities that are required for a taxpayer to benefit from a regime, jurisdictions providing benefits must therefore also have a transparent mechanism to review taxpayer compliance and to deny benefits if these core income generating activities are not undertaken by the taxpayer or do not occur within the jurisdiction. Jurisdictions must demonstrate that this mechanism ensures that taxpayers comply.

10. As part of this mechanism, jurisdictions would be expected to gather and maintain information on the identity (and hence the number) of taxpayers benefitting from the regime. Furthermore, they should gather information on the type and level of activity performed. Such information includes information on whether the taxpayer performs the core activities for which the regime is designed, the level of core activities undertaken, and the number of qualified full-time employees and amount of operating expenditures associated with the core activities. Finally, the jurisdiction should gather information on the amount of net income for which each taxpayer receives benefits under the regime because, for instance, a disproportionately large net income relative to benefitting core activities may indicate that other non-benefitting activities/value drivers may be responsible for the reported net income. In this regard, special considerations would need to apply for holding companies and non-income based taxes such as tonnage tax regimes.

11. Pure equity holding company regimes would not require this type of information gathering. The nature of such regimes is that they are typically granted through statutory exemptions, making it difficult to gather information on their activities through the tax return. This reflects the point, discussed above, that holding company regimes, including participation exemptions, are particular as the tax exemption/tax benefit is based on policy considerations other than notions of value creation.

12. For regimes which do not have income reporting because they implement a non-income based tax in place of income tax or where such data is not collected as part of the tax return or is not otherwise easily obtainable, such as certain tonnage tax regimes, accounting profits or other similar statistics can be reported instead of the amount of net income benefitting from the regime.

13. The following are examples of the application of the substantial activities factor to non-IP regimes:[4]

- **Example 1: Financing and leasing regime.** A regime requires benefitting taxpayers to undertake the leasing activities and operations in the jurisdiction, including identifying and acquiring the assets to be leased, negotiating the leasing terms, and managing the leases. The regime further requires that benefitting taxpayers incur at least EUR 5 million in annual business spending and employ an adequate number of qualified full-time employees to undertake the core activities (and at least three such employees) in the jurisdiction. The jurisdiction requires the taxpayer to report information annually on the income benefitting from the regime, as well as the type and level of activity performed to generate the income. Taxpayers which do not meet the requirements are denied the regime's benefits. This regime demonstrates that the core income generating activities occur in the jurisdiction and has a robust follow-up mechanism to ensure compliance. It therefore satisfies the requirement for having substantial activities in the jurisdiction.
- **Example 2: Headquarters regime.** A regime requires taxpayers to carry on headquarters activities in the jurisdiction, such as strategic business planning and

development, supply chain management and co-ordination, and general management and administrative activities, including the control and provision of services to related group companies. The regime further requires taxpayers to incur at least EUR 3 million in annual business spending and employ an adequate number of qualified full-time employees, including managers and professionals, to undertake the core activities (and at least ten such employees) in the jurisdiction. The jurisdiction requires the taxpayer to report information annually on the income benefitting from the regime, as well as the type and level of activity performed to generate the income. Taxpayers which do not meet the requirements are denied the regime's benefits. This regime demonstrates that the core income generating activities occur in the jurisdiction and has a robust follow-up mechanism to ensure compliance. It therefore satisfies the requirement for having substantial activities in the jurisdiction.

FHTP monitoring

14. For non-IP regimes that have been subject to a substantial activities assessment, jurisdictions would need to establish monitoring procedures and notify the FHTP of how they define core income generating activities and how they review taxpayer compliance with the substantial activities requirement. The purpose of such monitoring is not to conduct a transfer pricing analysis but instead to confirm that the regime continues to operate consistently with the type and level of activities upon which the previous findings of the FHTP were based. Jurisdictions would also need to report on an annual basis [5] on:

- the number of taxpayers applying for the regime;
- the number of taxpayers benefitting from the regime;
- the type of core activities undertaken by taxpayers benefitting from the regime;
- the quantity of core activities undertaken by taxpayers benefitting from the regime (as measured by the number of full-time employees and the amount of operating expenditures associated with these activities);
- the aggregate amount of net income benefitting from the regime (as discussed above, for regimes which do not have income reporting because they implement a non-income based tax in place of income tax or where such data is not collected as part of the tax return or is not otherwise easily obtainable, accounting profits or other similar statistics can be reported instead); and
- the number of taxpayers, if any, that no longer qualify for benefits in whole or in part under the regime.

15. To balance the importance of monitoring substantial activities in preferential regimes against the administrative burden of collecting the required information, monitoring would be required only with respect to taxpayers that are members of multinational enterprise groups with annual revenues in the preceding year of EUR 750 million or more – that is, taxpayers which are constituent entities of MNE groups required to file CbC reports, as set out in the Action 13 Report (OECD, 2015b) and subsequent guidance on CbC reporting. Monitoring would also not be required if the small number of taxpayers benefitting from a regime means that provision of the above information would have the effect of disclosing the identity of the taxpayer, and jurisdictions could establish de minimis exceptions to the monitoring requirement to prevent such disclosure.

16. Pure equity holding company regimes would not be subject to this type of monitoring, for the reasons discussed above. Furthermore, monitoring of pure equity holding companies

is already accomplished through CbC reporting, which identifies such holding companies in an MNE group and allows determination of the key economic variables such as number of employees and tangible assets.

Notes

1. Action 5 Report (OECD, 2015a), para. 71.
2. For example, para. 87 of the Action 5 Report states that the ring-fencing factor addresses concerns about equity holding company regimes which provide benefits to income only from foreign companies and which income is not already taxed anywhere, or which otherwise target foreign investors.
3. Action 5 Report (OECD 2015), para. 71 and footnotes 16 and 19 to chapter 4.
4. These examples are for illustrative purposes only and are not intended to set minimum standards.
5. The monitoring described in the following bullet points would commence for fiscal years commencing in 2018. For earlier years, countries would be asked to report data points that they have available, and these would be collected together with other data points on monitoring.

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(23 2017 38 1 P) ISBN 978-92-64-28393-0 – 2017

OECD/G20 Base Erosion and Profit Shifting Project

Harmful Tax Practices - 2017 Progress Report on Preferential Regimes

INCLUSIVE FRAMEWORK ON BEPS: ACTION 5

Addressing base erosion and profit shifting is a key priority of governments around the globe. In 2013, OECD and G20 countries, working together on an equal footing, adopted a 15-point Action Plan to address BEPS. Beyond securing revenues by realigning taxation with economic activities and value creation, the OECD/G20 BEPS Project aims to create a single set of consensus-based international tax rules to address BEPS, and hence to protect tax bases while offering increased certainty and predictability to taxpayers. In 2015, the OECD and G20 established an Inclusive Framework on BEPS to allow interested countries and jurisdictions to work with OECD and G20 members to develop standards on BEPS related issues and reviewing and monitoring the implementation of the whole BEPS Package.Over 100 countries and jurisdictions have joined the Inclusive Framework.

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This progress report is an update to the 2015 BEPS Action 5 report and contains the results of the review of all Inclusive Framework members' preferential tax regimes that have been identified. The results are reported as at October 2017.

The report also contains guidance on preferential tax regimes, including timelines for amending regimes, how certain features of preferential regimes will be monitored, and guidance on the requirement that jurisdictions offering preferential regimes must require substantial activities to be undertaken in the regime.

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ISBN 978-92-64-28393-0
23 2017 38 1 P

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