OECD releases 2018 Progress Report on Preferential Regimes under BEPS Action 5

Executive summary

On 29 January 2019, the Organisation for Economic Co-operation and Development (OECD) released *Harmful Tax Practices – 2018 Progress Report on Preferential Regimes* (the 2018 Progress Report), approved by the Inclusive Framework on Base Erosion and Profit Shifting (BEPS). The purpose of this document is to provide an update to the 2017 Progress Report and to report the results of the review of all Inclusive Framework members' preferential tax regimes that have been identified.

In 2017, commitments were made in respect of more than 80 regimes to be made compliant with the BEPS Action 5 minimum standard. In 2018, jurisdictions have, in almost all cases, delivered on these commitments, while the total number of regimes reviewed since the start of the BEPS project is now 255. The 2018 results also show that all Intellectual Property (IP) regimes are, with one exception, either abolished or amended to comply with the nexus approach.

The 2018 Progress Report also contains annexes containing substantive updates on the Forum on Harmful Tax Practices (FHTP) framework, including the new standard for substantial activities requirements within no or only nominal tax jurisdictions, interpretive guidance on the application of existing factors for assessing regimes, and recommendations on the data points and process for carrying out the monitoring of the grandfathering for non-IP regimes.

Finally, the 2018 Progress Report sets out next steps for the FHTP in continuing to address harmful tax practices.

Detailed discussion

Background

On 5 October 2015, the OECD released its final report on Action 5, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance* (the Action 5 Report) under its BEPS Action Plan.[1] The Action 5 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.

The Action 5 Report is one of the four BEPS minimum standards. Each of the four BEPS minimum standards is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field. All members of the Inclusive Framework on BEPS commit to implementing the Action 5 minimum standard, and commit to participating in the peer review. To that end, on 1 February 2017, the OECD released the *Terms of Reference and Methodology for Peer Reviews* on the Action 5 standard for the exchange of information on tax rulings.[2]

Since the publication of the 2017 Progress Report in October 2017,[3] the FHTP has further continued its work on the review of preferential regimes in the scope of BEPS Action 5. This includes both IP regimes, such as patent boxes, and non-IP regimes. On 29 January 2019, the OECD released the 2018 Progress Report that includes the results of the review of all Inclusive Framework members' preferential tax regimes in the scope of BEPS Action 5 that have been identified, including the review of new members and new regimes. With the release of the 2018 Progress Report, the FHTP has reviewed 255 regimes in total since the start of the BEPS Project.

The 2018 Progress Report

The 2018 Progress Report includes new conclusions on 57 regimes, including the 44 regimes where jurisdictions have delivered on their commitment to make legislative changes to abolish or amend the regime. Those regimes relate to the following countries: Antigua and Barbuda, Barbados, Belize, Botswana, Costa Rica, Curaçao, France, Jordan, Macau (China), Malaysia, Panama, Saint Lucia, Saint Vincent and the Grenadines, the Seychelles, Spain, Thailand and Uruguay. As a result, all IP regimes that were identified in the 2015 BEPS Action 5 Report are now either abolished or "not harmful" and consistent with the nexus approach, following the recent legislative amendments passed by France and Spain. Also, three new or replacement regimes of Barbados, Curaçao and Panama were found "not harmful" as they have been specifically designed to meet the Action 5 standard.

With respect to non-IP regimes, according to the 2018 Progress Report, the regime of Montserrat has been found potentially harmful but not actually harmful, while three regimes of Thailand (International headquarters and treasury center, Regional operating headquarters and International trade center regime) have been found potentially harmful. Also, two further commitments were given to make legislative changes to abolish or amend a regime (Malaysia (Principal hub regime) and Trinidad & Tobago (Free trade zones regime)).

The 2018 Progress Report includes three annexes:

i) Annex A delivers on the Action 5 mandate for considering revisions or additions to the FHTP framework, including the criteria and guidance used in assessing preferential regimes and the resumption of application of the substantial activities factor to no or only nominal tax jurisdictions which had been first published in November 2018.[4] Further, the second part of Annex A provides interpretive guidance on applying the factors in the review of preferential regimes.

ii) Annex B sets out the data points and process for carrying out the monitoring of grandfathering for non-IP regimes. According to Annex B, there are two aspects to the monitoring, i.e., the data that should be collected, and the mode for making that data available to the FHTP.

iii) Annex C provides a list of key reference documents relevant to the work of the FHTP.

Next steps

The 2018 Progress Report sets out the next key steps for the FHTP in continuing to address harmful tax practices. According to the report:

i) The FHTP will resume the work on ensuring substantial activities requirements are in place in no or only nominal tax jurisdictions. A significant deliverable in 2019 will be the review of the new global standard on the resumption of the substantial activities factor for no or only nominal tax jurisdictions which will follow a similar approach to the review process used for preferential regimes.

ii) The FHTP will continue to conduct the yearly monitoring process in order to ensure if the implementation of certain aspects is in practice effectively meeting the standard. The monitoring process is conducted through standardized questionnaires, followed by a discussion in the FHTP with the relevant jurisdictions and an opportunity for the FHTP to reconsider its conclusion if necessary to ensure that the standards are met.

iii) The FHTP will continue reviewing any preferential tax regimes that remain under review, any regimes of jurisdictions that join the Inclusive Framework going forward, and any additional "jurisdictions of relevance"[5] as needed. In addition, it will review any newly introduced regimes.

Implications

The 2018 Progress Report shows the swift progress being made in the implementation of BEPS Action 5 and it affirms the actions of Inclusive Framework members that have made significant commitments to change their tax rules. The release of this report also provides clarity to taxpayers on the status of preferential regimes in jurisdictions in which they operate. The FHTP will continue its work, including the monitoring and review of preferential tax regimes which are being amended to conform to the Action 5 minimum standard.

Taxpayers should monitor the work of the FHTP on the regimes that are found to be harmful and are in the process of being amended or eliminated, as well as measures that countries may implement and that take into account payments to harmful regimes.

Endnotes

1. See EY Global Tax Alert, *OECD releases final report on countering harmful tax practices under Action 5*, dated 8 October 2015.
2. See EY Global Tax Alert, *OECD releases peer review documents on BEPS Action 5 on Harmful Tax Practices and on BEPS Action 13 on Country-by-Country Reporting*, dated 6 February 2017.
3. See EY Global Tax Alert, *OECD releases progress report on preferential regimes under BEPS Action 5*, dated 18 October 2017.
4. See EY Global Tax Alert, *OECD releases updated results on scrutiny of preferential tax regimes and substantial activity requirements for no or only nominal tax jurisdictions*, dated 20 November 2018.
5. Some preferential regimes with harmful features may be offered by jurisdictions that 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 and are reviewed according to the same criteria as applies for all other jurisdictions. These are "jurisdictions of relevance."

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