

## OECD releases 2020 update on peer review of preferential tax regimes and no or only nominal tax jurisdictions

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### Executive summary

On 23 November 2020, the Organisation for Economic Co-operation and Development (OECD) released an [update](#) on the results of the peer reviews of jurisdictions' domestic laws under Action 5 (harmful tax practices) of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project. The results were approved on 16 November 2020 by the Inclusive Framework on BEPS.

The updated results cover 49 regimes, bringing the number of regimes that have been reviewed, or are under review, to 295. The reviews were undertaken by the Forum on Harmful Tax Practices (FHTP). Of the 49 reviewed regimes, 37 have been redesigned or abolished and another 7 are currently in the process of being amended. For the remaining five regimes, the FHTP has concluded that they do not currently pose BEPS risks. The Inclusive Framework on BEPS will continue its reviews and will provide updates from time to time.

Additionally, the OECD released updated conclusions on the review of the substantial activities factor for no or only nominal tax jurisdictions in connection with the domestic laws of the 12 jurisdictions that have been identified by the FHTP as being a no or only nominal tax jurisdiction.

## Detailed discussion

### Background

In an effort to realign the taxation of profits with the substantial activities that generate them, and to improve transparency, the OECD started work on addressing harmful tax practices in the late 1990s, resulting in a 1998 report, [Harmful Tax Competition: An Emerging Global Issue](#).

Under this initiative, the OECD also created the FHTP, which has been one of the key groups with a mandate to monitor and review tax practices of jurisdictions, focusing on the features of preferential tax regimes. The Code of Conduct group in the European Commission performs a similar role.

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.<sup>1</sup> The Action 5 Report covers two main areas: (i) applying the “substantial activity” criterion when determining whether tax regimes are harmful; and (ii) improving transparency. The Report also contains a strategy to expand the review of preferential regimes to third countries beyond the OECD/G20 countries.

This expansion has been executed through the Inclusive Framework on BEPS, which currently has 137 member jurisdictions.<sup>2</sup> Each of the member jurisdictions has committed to fulfilling the BEPS minimum standards, including the minimum standard on Action 5. This means that for each of the Inclusive Framework members, their preferential regimes have been, are being or will be reviewed based on the Action 5 criteria, including the new criteria on substance and transparency.

The OECD published the 2017 Progress Report in October 2017.<sup>3</sup> Since then, the FHTP has further continued its work on the review of preferential regimes within the scope of BEPS Action 5:

- ▶ During May 2018, the OECD released updates to the results of the reviews of 11 preferential tax regimes.
- ▶ On 15 November 2018, the OECD released updated results covering the assessment of 53 preferential tax regimes. On the same date, the OECD also released guidance on the application of the substantial activities requirement for “no or only nominal tax” jurisdictions.<sup>4</sup>
- ▶ On 29 January 2019, the OECD released the 2018 Progress Report, reflecting the FHTP’s review of 255 regimes in total since the start of the BEPS project.<sup>5</sup>

- ▶ On 23 July 2019, the OECD released an update to the results of the reviews for 56 preferential tax regimes.<sup>6</sup> Also, review of the 12 identified no or only nominal tax jurisdictions was undertaken for the first time. For 11 jurisdictions, the FHTP concluded that their legislative framework is not harmful. For the United Arab Emirates (UAE), the FHTP concluded in June 2019 that there was one technical point outstanding and the legislation was reported as “in the process of being amended.”

On 16 November 2020, the Inclusive Framework on BEPS adopted an update to the results of the reviews for 49 preferential tax regimes and updated conclusions for one no or only nominal tax jurisdiction (UAE).

### Updated conclusions of the preferential tax regimes review

According to the updated results, 29 additional regimes have been identified as having been abolished as a result of the jurisdictions delivering on their commitments to make the relevant legislative changes. These include:

- ▶ Dominica: International business companies
- ▶ Mauritius: Investment banking
- ▶ Switzerland: Holding company regime
- ▶ Other regimes in Aruba, Belize, Cook Islands, Dominica, Georgia, Maldives, Saint Kitts and Nevis, San Marino, Switzerland and Tunisia

Additionally, four regimes have been amended to remove the potentially harmful features, and four new regimes have been classified as “not harmful” because they were specifically designed to meet the Action 5 minimum standard:

- ▶ Aruba: Investment promotion (amended - not harmful)
- ▶ Curacao: Qualifying activities regime (not harmful)
- ▶ Switzerland: Patent box (not harmful)
- ▶ Other regimes in Aruba, Hong Kong, Morocco and San Marino

The updated results include seven regimes that are “in the process of being amended,” including:

- ▶ Jamaica: Special economic zones
- ▶ North Macedonia: Technological industrial development zone
- ▶ Qatar: Qatar financial center
- ▶ Other regimes in Qatar

In addition, two regimes in Brunei Darussalam have been found to be potentially harmful but not actually harmful. Finally, two regimes in Morocco were found to be out of scope, and one regime in the Dominican Republic was amended to be out of scope.

### Substantial activities requirement for “no or only nominal tax” jurisdictions

On 15 November 2018, the OECD released a standard on substantial activities that would apply to jurisdictions that do not impose a corporate income tax. It would also apply to jurisdictions that are considered to impose only nominal corporate income tax to avoid such requirements. Jurisdictions that have been reviewed on the basis of the preferential regimes they offer are out of the scope of the substantial activities standard, unless they subsequently undertook significant reforms which abolished or substantially abolished their corporate income tax altogether.

After agreeing on the substantial activities standard, the FHTP identified 12 “no or only nominal tax jurisdictions” that had the necessary domestic legal framework to meet the standard, namely Anguilla, the Bahamas, Bahrain, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, Turks and Caicos Islands and the UAE.

Based on the latest FHTP’s review, all no or only nominal tax jurisdictions reviewed by the FHTP have now been assessed as having legislation in force that meets the substantial activities factor. For 11 jurisdictions, the FHTP concluded in 2019 that their legislative framework is not harmful. Since then, the UAE has made legislative changes in accordance with the FHTP standard and the conclusion for its legislative framework is now “not harmful (amended).”

The focus of the FHTP for 2021 will be the effective implementation of the FHTP Standard. According to the OECD, this will include the start of spontaneous exchanges of information on the activities and income of entities by the no or only nominal tax jurisdictions with the jurisdictions of the immediate parent, ultimate parent and beneficial owners of such entities. Simultaneously, the FHTP will initiate an annual monitoring process to ensure that the no or only nominal tax jurisdictions have appropriate mechanisms in place for ongoing compliance with the FHTP Standard.

### Next steps

The FHTP has now reviewed 295 regimes. These reviews have led to extensive amendments to preferential regimes worldwide. Following the reviews and taking into account the

amendments which have already been finalized, 4 of these regimes are currently harmful, 8 regimes are potentially harmful but not actually harmful, 112 regimes are not harmful, 14 regimes are in the process of being eliminated or amended, 3 regimes are not operational, and 105 regimes have been abolished. Additionally, 38 regimes have been found to be out of scope, and 8 regimes are still under review, including the US Foreign-Derived Intangible Income regime. The remaining three regimes relate to disadvantaged areas.

The FHTP will continue reviewing outstanding regimes and new regimes and will continue its annual monitoring on certain aspects of regimes.

Finally, the FHTP has undertaken the fourth year of peer reviews for the Action 5 transparency framework, for which the report is expected to be published on 13 December 2020.

## Implications

The updated results of the review of preferential tax regimes underscore that the Inclusive Framework continues its focus on jurisdictions’ implementation of the BEPS Action 5 minimum standard despite the COVID-19 crisis and the ongoing global discussions on the BEPS 2.0 project. The release of the updated results provides information to taxpayers on the status of preferential regimes in jurisdictions in which they may operate. It also informs the [assessments](#) made by the European Union Code of Conduct which in turn may have a direct impact on taxpayers.

The FHTP will continue its work, including the monitoring and review of preferential tax regimes that are being amended to conform to the Action 5 minimum standard. Taxpayers should pay attention to possible legislative changes with respect to regimes that may be reviewed by the FHTP.

Finally, the release of updated conclusions on the review of the substantial activities standard for “no or only nominal tax” jurisdictions illustrates the OECD’s efforts to ensure that substantial activities are performed in respect of the same types of mobile business activities, with respect to both a preferential regime and a “no or only nominal tax” jurisdiction.

The OECD’s review of the BEPS Action 5 minimum standard (the 2020 review) is ongoing. In the context of this review, members of the Inclusive Framework will assess whether the design and underlying conditions of the minimum standard should be adjusted and how it would interact with the proposed rules under Pillar Two of the BEPS 2.0 project.<sup>7</sup>

## Endnotes

1. See EY Global Tax Alert, [OECD releases final report on countering harmful tax practices under Action 5](#), dated 8 October 2015.
2. <https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>.
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. See EY Global Tax Alert, [OECD releases 2018 Progress Report on Preferential Regimes under BEPS Action 5](#), dated 30 January 2019.
6. See EY Global Tax Alert, [OECD releases update on peer review of preferential tax regimes and no or only nominal tax jurisdictions](#), dated 24 July 2019.
7. See EY Global Tax Alert, [OECD releases BEPS 2.0 Pillar Two Blueprint and invites public comments](#), dated 19 October 2020.

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