BEPS – Action 5
Harmful Tax Competition
A developing country perspective

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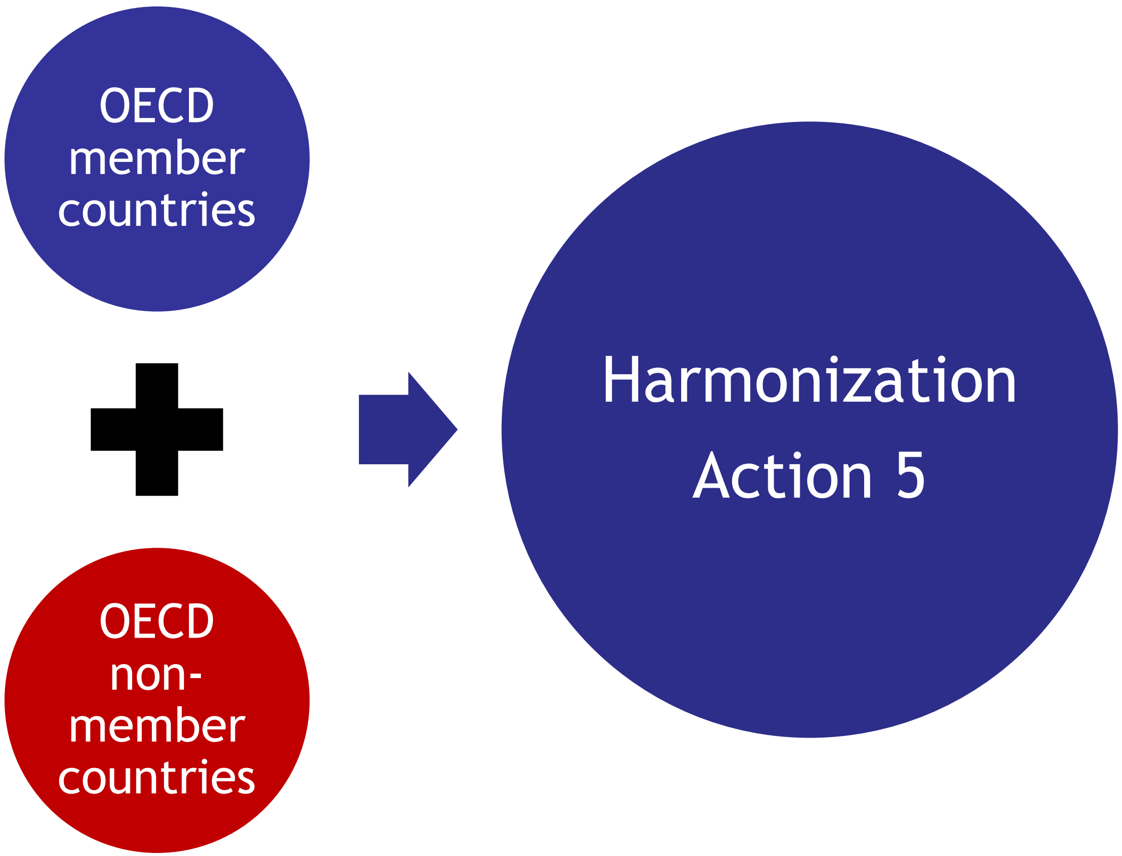
Dialogue between OECD member and non-member countries



Action Plan on Base Erosion and Profit Shifting

Action 5

- Tax Havens
- Harmful Preferential Regimes

Mobile Activities

- R&D activities
- Intangible Assets
- Film and TV production

Factors

- No or low effective tax rate
- Ring-fenced
- Non-transparency
- No effective exchange of information

Criticism to Action 5

- The focus on income tax is naïve

  -“Consumption taxes are explicitly excluded” (BEPS)

  -Investment programs involving consumption taxes have proven effective

Existence of promotional material

Plan Vallejo for Services

PVSS Imports free of tariffs and VAT for service exporters

- The Plan Vallejo for Services is a ring-fenced foreign trade instrument whereby service export companies can request authorization from the Colombian National Tax and Customs Office (DIAN)…

…to import capital goods totally free of import tariffs and VAT…

…in exchange for providing exportable services, such as:

- Film and TV production;
- Research and Development (R&D) services

Criticism to Action 5

- The focus on income tax is naive

-"Consumption taxes are explicitly excluded" (BEPS)

-Investment programs involving consumption taxes have proven effective

- Should developing countries agree to limit their ability to attract investments?

- BEPS: "*Does the tax regime shift activity from one country to the country providing the preferential tax regime, rather than generate significant new activity?*"

• Brazilian Federal government implemented new measures to stimulate the investment in the automotive industry, supporting technology improvement, innovation, environmental protection and energy-efficiency.

• Companies eligible for the program may benefit from an Industrial Products Tax (IPI) reduction of up to 30%.

• It is granted an IPI presumed credit regarding expenses arising from:

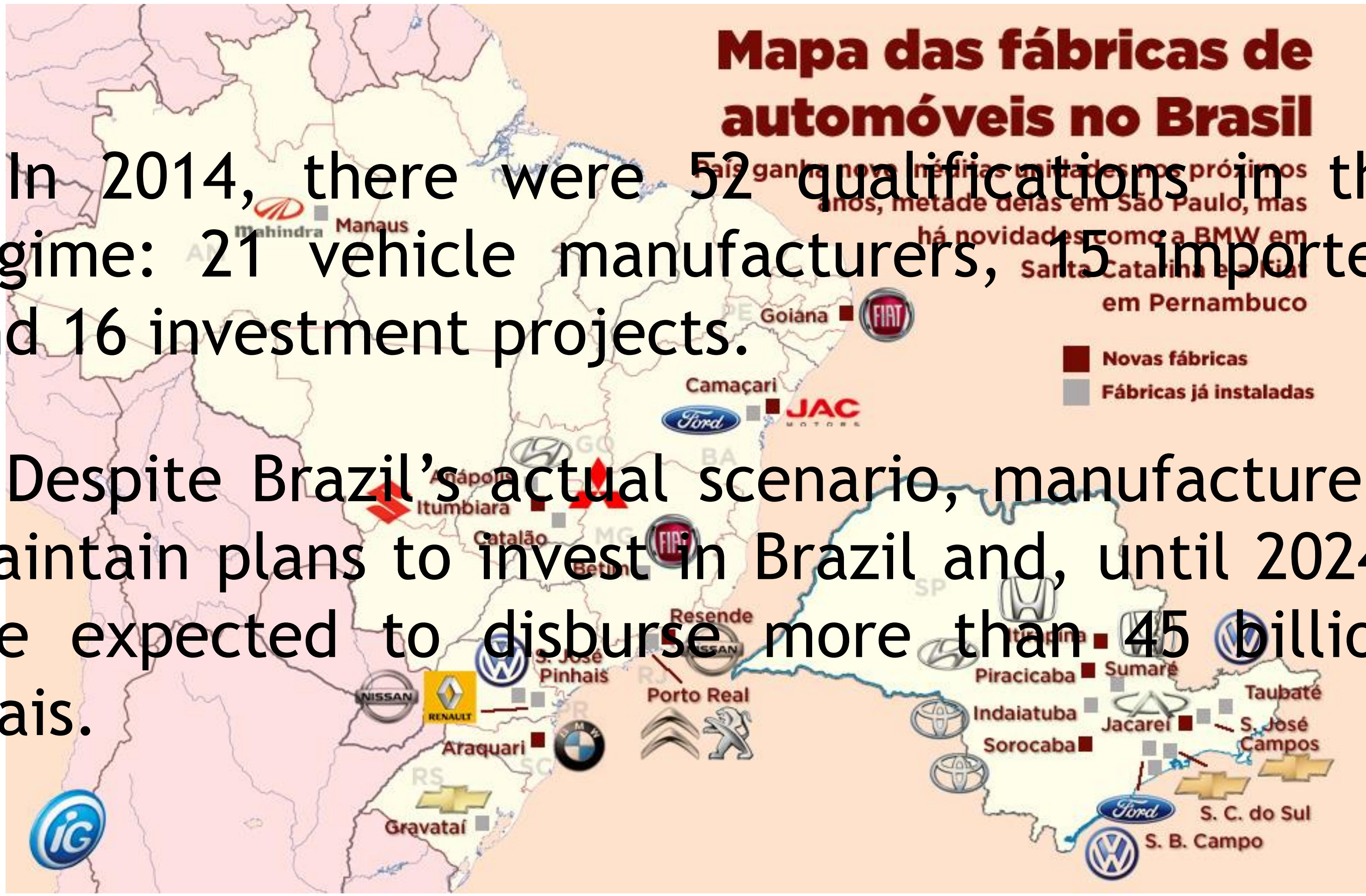
- Research and Development activities (R&D);

- Engineering, Manufacturing Technology (EMT) and training;

- Tagging program.

INOVAR AUTO

✓ Several new factories



✓ In 2014, there were 52 qualifications in this regime: 21 vehicle manufacturers, 15 importers and 16 investment projects.

✓ Despite Brazil's actual scenario, manufacturers maintain plans to invest in Brazil and, until 2024, are expected to disburse more than 45 billion reais.

Criticism to Action 5

- Criteria are too broad

✓ **<u>No or low effective tax rates</u>**

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✓ **<u>Ring-fenced</u>**

✓ **<u>Regime lacks transparency</u>**

✓ **<u>No effective exchange of information</u>**

✓ Artificial definition of the tax base

✓ Failure to adhere to international transfer pricing principles

✓ Foreign source income exempt from residence country taxation

✓ Negotiable tax rate or tax base

✓ Existence of secrecy provisions

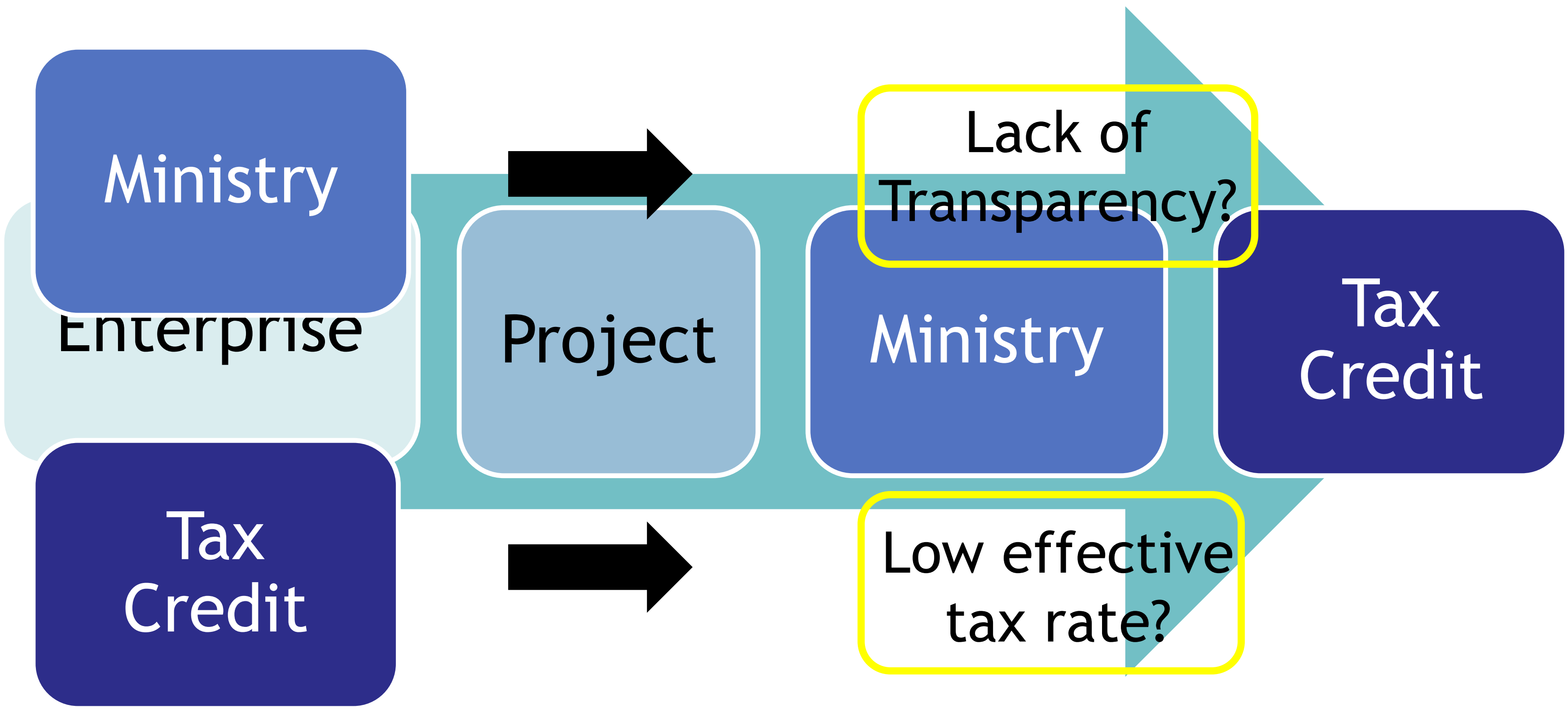
✓ Access to a wide network of tax treaties

✓ The regime is promoted as a tax minimization vehicle

✓ The regime encourages operations or arrangements that are purely tax-driven and involve no substantial activities

Promoción y Fomento de la Innovación Tecnológica

- Argentina's government implemented the program in order to foster R&D activities, granting credits to "*impuestos nacionales*"



Free Trade Zones

- Free Trade Zones are geographic areas designated within the National Territory of Colombia, in which industrial activity is carried out, services are provided or commercial activities are performed, under special legislation for customs, tax and commercial matters.

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- Exemption duties and VAT

Programa de Incentivo à Tecnologia

• *Lei do Bem* is an important tool to support business innovation and has been effective in promoting effective expenditure on R&D, as the investments are six times the granted tax exemption.

- Accelerated amortization of expenditures on acquisition of intangible assets related to R&D activities.

- Reduction to zero of the tax rate on remittances to abroad for registration and maintenance of trademarks and patents;

Combining regimes

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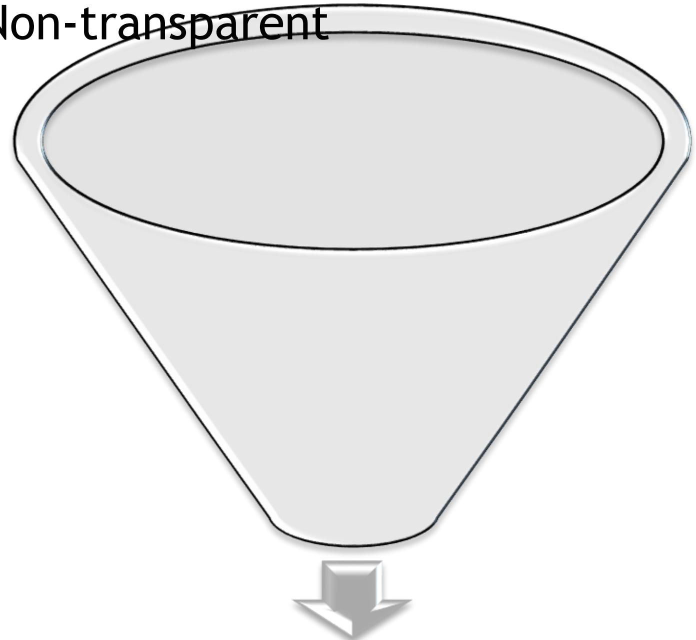
- Income tax incentives
- Non-transparent

ZPE

- Export regime
- Ring-fenced



Lei do Bem

- R&D Activities
- Incentives on remmitances

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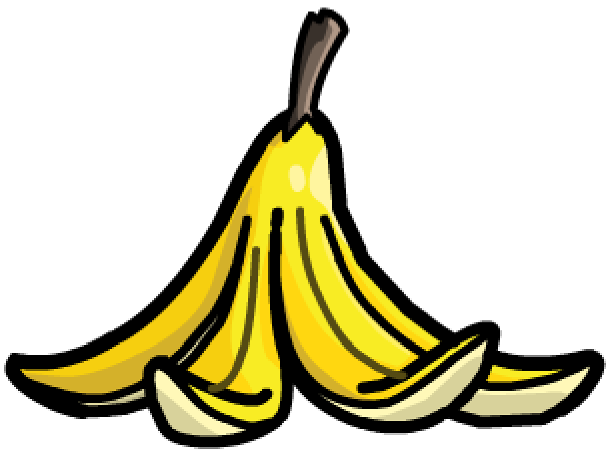
- Income tax Incentives
- Ring-fenced
- Non-transparent
- R&D

Modified Nexus Approach

- Assumes there would be a direct nexus between income arising out of IP and the expenditures contributing to that income

- Designed to combat tax avoidance allowed by tax havens

- Ignores taxing rights of the Source State



Is discrimination a solution?

- The Brazilian example

  - legislative definition of tax haven and privileged tax regime (Articles 24 and 24-A of Law No. 9,430, of December 27th, 1996*)*
    - ✓ taxation of income at a max. 20% rate
    - ✓ inexistence of exchange of information

  - Listing of tax havens (64 jurisdictions) and privileged tax regimes (8 regimes) for the purposes of:
    - ✓ application of thin capitalization rules
    - ✓ deductibility of payments
    - ✓ majoring taxation at source

Is discrimination a solution?

Law No. 12,249/2010

Art. 26. Notwithstanding the provisions of the Corporate Income Tax Legislation (IRPJ), it ***shall not be deductible****, for the purpose of determining the taxable profit and the calculation basis of the Contribuição Social sobre o Lucro Líquido,* ***values paid, credited, delivered or remitted, at any account, directly or indirectly, to natural or legal persons residents or incorporated abroad and subject to a tax haven or privileged tax regime****, as set forth in articles 24 and 24-A of Law No. 9,430, of December 27th, 1996, unless if it is cumulatively provided:*

I – identification of the ***beneficial owner*** *of the foreign entity receiving such values;*

II – proof of the ***operational capacity*** *of the foreign natural or legal person for carrying out such operation;*

III- documental ***proof of payment*** *of the respective price* ***and of receipt*** *of assets and legal rights, or of the use of services;*

§ 1º - For the purpose of Art. 26, I, it shall be deemed as the ***beneficial owner, the natural or legal person, not incorporated with the sole or main purpose of tax reduction, deriving such values on its own account, and not as an agent, trustee or on behalf of a third party.*** *(...)*

Conclusions

- OECD countries roughly share a common perception on tax policy.
  - Sovereignty: developing countries may not wish to follow G20/OECD since their economic environment is distinct.
  - Why should a developing country charge a developed country tax rate? Is harmonization desirable? For whom?

- Success of the project = securing the cooperation of developing countries
  - Aren't developing countries' industrial policy measures legitimate?
  - Why are developing countries making it so easy? How do they benefit from BEPS Action 5 (and BEPS in general)?

- Why should royalties relate to IP expenditures?

Thank You!

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