

The OECD, harmful tax practices and BEPS

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The OECD added a second line of pressure. Its report on harmful tax competition of 1998 defined criteria for preferential regimes that were considered harmful, such as low or zero effective rates, ring-fencing from the domestic economy, lack of transparency and the absence of substantial activity. Switzerland and Luxembourg abstained from the approval of the report, with Switzerland stating its reservations about the analysis of its regimes.¹ In the following decade the OECD's Forum on Harmful Tax Practices reviewed numerous regimes, but it was the financial crisis of 2008 and the pressure on public finances that gave the topic its later momentum.

In 2013 the OECD and the G20 launched the project on base erosion and profit shifting. The action plan published in July 2013 identified fifteen actions, whose final reports were presented in October 2015.² Several of these actions had direct consequences for Switzerland and the Basel groups. Action 5 on harmful tax practices established the "modified nexus approach" for intellectual property regimes, under which the benefit of a patent box must be proportionate to the research and development expenditure incurred by the taxpayer itself. Actions 8 to 10 on transfer pricing emphasised that profits from intangibles should be allocated according to the functions of development, enhancement, maintenance, protection and exploitation, known by the acronym DEMPE. Under this approach, legal ownership and contractual risk allocation alone were no longer sufficient to justify a large share of the residual profit. Action 13 introduced country-by-country reporting for large groups.

Switzerland participated in the BEPS project as a member of the OECD and implemented the minimum standards. The Federal Act on the International Automatic Exchange of Country-by-Country Reports of Multinationals entered into force on 1 December 2017 and applied to fiscal years from 2018.³ The spontaneous exchange of information on tax rulings, required by Action 5, was implemented on the basis of the Convention on

Mutual Administrative Assistance in Tax Matters, which entered into force for Switzerland on 1 January 2017.⁴ These steps transformed the environment in which the Basel groups operated. Arrangements that had once been agreed confidentially with a cantonal administration now became visible to the tax authorities of other states.

The BEPS project also changed the vocabulary of the debate. Where Swiss politicians had once spoken of attractive regimes and competitive locations, they now had to justify any incentive in the terms of substance, nexus and transparency. The replacement measures that Switzerland eventually adopted, notably the patent box and the deduction for research and development, were designed to fit these criteria. Pharmaceutical groups with real research activity in Switzerland could benefit from them, while structures that rested on legal ownership alone could not.

1 Notes

1. OECD, Harmful Tax Competition: An Emerging Global Issue, Paris 1998, with the statements of abstention by Luxembourg and Switzerland annexed to the report. To be verified. ↩
2. OECD, Action Plan on Base Erosion and Profit Shifting, Paris, July 2013; OECD/G20 Base Erosion and Profit Shifting Project, Final Reports, October 2015. To be verified. ↩
3. Federal Act on the International Automatic Exchange of Country-by-Country Reports of Multinationals of 16 June 2017 (ALBA-Gesetz, SR 654.1). To be verified. ↩
4. Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988, as amended by the Protocol of 27 May 2010 (SR 0.652.1), and the Ordinance on International Administrative Assistance in Tax Matters (StAhiV, SR 651.11), which governs the spontaneous exchange of rulings from 2018. To be verified. ↩

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