Explanatory paper
Agreement on Modified Nexus Approach for IP Regimes

The September 2014 progress report on “Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance”¹ set out the progress made under Action 5 of the BEPS Action Plan. A key part of Action 5 involves strengthening the substantial activity requirement used to assess preferential regimes so as to realign taxation of profits with substantial activities. The September 2014 report discusses possible approaches to requiring substantial activities in the context of intangible property (IP) regimes such as patent boxes. One of the approaches considered was the nexus approach.

The nexus approach only allows a taxpayer to benefit from an IP regime to the extent that it can show that it itself incurred expenditures, such as R&D, which gave rise to the IP income.

In order to reach a consensus on a single approach, a proposal was put forward by Germany and the UK, which was endorsed by G20 leaders in Brisbane. The proposal has since been endorsed by all OECD and G20 countries. The agreed approach² maintains the underlying principle of the nexus approach proposed in the September 2014 report but makes some amendments, which are briefly described below: -

- A 30% increase in qualifying expenditures - the expenditures that a taxpayer incurs on IP and which can be taken into account in the nexus approach calculation can, in limited circumstances, be increased by 30%.

- Closing old regimes to new entrants – countries that have IP regimes that are inconsistent with the nexus approach are expected to take steps to amend those regimes and the process to do this should commence in 2015. In addition there can be no new entrants to such IP regimes after 30 June 2016.

- Grandfathering and transition – taxpayers benefitting from existing regimes that do not comply with the nexus approach will not be able to receive any additional tax benefits from those regimes after 30 June 2021.

Work on the practical implementation of the nexus approach is on-going and will focus in particular on three areas:

1. Developing more detailed guidance on how businesses can track expenditure and income to show that the nexus approach is being correctly applied.

2. Considering safeguards to prevent taxpayers from inappropriately using the transitional period to get tax benefits under existing IP regimes.

3. Developing more detailed guidance on what will be regarded as a qualifying IP asset.

Work on implementation will be finalised by 30 June 2015 and the agreed approach and additional guidance will be included in the 2015 progress report on Action 5. Comments on any of these implementation issues should be sent to FHTP@oecd.org by close of business on 20 February 2015. A consultation on any issues raised may be held in early March.

¹ Available on line: http://oe.cd/beps-action-5