

**Euro Tax Flash**

**Issue 243 - December 16, 2014**

## **Euro Tax Flash from KPMG's EU Tax Centre**



### **Code of Conduct Group reports to ECOFIN on patent boxes, hybrid entities**

[ECOFIN – Code of Conduct Group – Harmful tax competition – IP regimes – Aggressive tax planning – Hybrid entities – BEPS](#)

On December 9, 2014 the EU Code of Conduct Group for Business Taxation reported to the Council of the EU (ECOFIN) on various matters including the status of EU 'patent boxes', and hybrid entity mismatches.

#### **Background**

The Code of Conduct Group was set up in 1998 to examine potentially harmful tax measures in EU Member States. In December 2013 the Group was mandated by the ECOFIN to review the 'substance' requirement in the Code and to assess all patent boxes in the EU, taking into account international developments, such as those in relation to the OECD BEPS initiative.

In 2009 the Group started to address hybrid mismatches in the context of its anti-abuse assessments. In its 2012 Action Plan against tax fraud and evasion the Commission called on the group for rapid solutions to mismatches. As part of its regular work

package the Group also addresses the standstill and rollback of harmful tax measures as agreed under the Code of Conduct.

### **Patent boxes**

With the exception of the Netherlands, the Group reported agreement on an approach for determining whether or not IP income may qualify for preferential tax treatment under the Code, and that none of the IP regimes examined was compatible with this approach. This largely follows the 'nexus approach' being developed by the OECD under BEPS action 2 which is designed to ensure the requirement of 'substantial activity' is met under such regimes. The idea is that IP income should only qualify for preferential treatment if it is generated by R&D activity carried on by the taxpayer itself. This is achieved by excluding from qualifying expenses those incurred by related parties, such as outsourcing expenses, and also IP acquisition costs. The proportion of qualifying expenses to total expenses is then applied to total IP income to give the income that may qualify for benefits. The Group's approach modifies the BEPS approach in line with a German/UK proposal made in the context of BEPS action 2, to allow qualifying expenses to be increased by outsourcing and acquisition costs up to a maximum of 30% of qualifying expenses. The Dutch reservation concerns the scope of the assets that qualify for preferential treatment that, as proposed by the Group (in line with the current OESO definition), would be limited to patents. The current Dutch IP regime also grants benefits to income derived as a result of certain non-patented innovations derived from R&D. The report also addresses certain timing issues, in particular that existing regimes should be closed for new entrants by July 2016, and benefits under existing regimes should be withdrawn by July 2021. The report notes that further works is required, in particular as regards a tracking and tracing methodology for R&D expenditure.

### **EU Tax Centre Comment**

Although the ECOFIN took note of the above agreement, it remains to be seen whether the Netherlands' reservation will result in changes being made.

### **Hybrid entity mismatches**

The report sets out guidance agreed by the Group on intra-EU hybrid entities, i.e. entities that are treated as transparent in one Member State and non-transparent in another. The report notes that further work is required on hybrid permanent establishments. The guidance focuses on two mismatch situations involving hybrid entities: one where a double deduction or other relief is given in two Member States for the same payment, and the other where a deduction or relief is given in one Member State without a

corresponding receipt in another country. The solution put forward is for both Member States to treat the entity as non-transparent in the first situation, and as transparent in the second situation.

### **EU Tax Centre Comment**

While the above approach may achieve similar results to those arising from the OECD's BEPS action 2 that was published in September 2014, it remains to be seen how Member States will align the two initiatives in practice, if the Group's approach is formally adopted within the EU.

### **Other issues**

The report commented on a number of other matters, including the status of Gibraltar's tax regime, inbound profit transfers, company tax issues with Switzerland and possible harmful measures in Liechtenstein.

Should you require further assistance in this matter, please contact the EU Tax Centre or, as appropriate, your local KPMG tax advisor.

### **Robert van der Jagt**

Chairman, KPMG's EU Tax Centre and  
Partner, Meijburg & Co  
[vanderjagt.robert@kpmg.nl](mailto:vanderjagt.robert@kpmg.nl)

### **Barry Larking**

Director EU Tax Services, KPMG's EU Tax Centre  
[larking.barry@kpmg.nl](mailto:larking.barry@kpmg.nl)

[Back to top](#)

---

[kpmg.com/socialmedia](http://kpmg.com/socialmedia)



[kpmg.com/app](http://kpmg.com/app)



[Privacy](#) | [Legal](#)

KPMG's EU Tax Centre, Laan van Langerhuize 9, 1186 DS Amstelveen, Netherlands

Euro Tax Flash is published by KPMG International Cooperative in collaboration with the EU Tax Centre. Its content should be viewed only as a general guide and should not be relied on without consulting your local KPMG tax adviser for the specific application of a country's tax rules to your own situation. The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2014 KPMG International Cooperative (KPMG International), a Swiss entity. Member

firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.