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Haven Indicator 17: Deduction limitation for service payments

What is measured?

This indicator measures whether or to what extent a jurisdiction restricts or disallows the deduction of intra-group services payments (management fees, technical fees, consulting services fees) paid to non-resident group affiliates from the corporate income tax base.

A haven score of 100 points is given if a jurisdiction applies no limits on the deduction of intra-group services payments beyond transfer pricing rules, the arm's length principle or other generic rules. A zero haven score is granted in cases where the jurisdiction applies specific restrictions or deduction limitations on the intra-group services payments. This may include, for example, limiting the deduction to a certain percentage of the annual turnover or to a certain percentage of Earnings Before Interest, Taxes, Interest, Depreciation and Amortisation (EBITDA) in specific cases.

The data for this indicator was collected primarily from the country analyses and country surveys in the International Bureau of Fiscal Documentation (IBFD) database.[1] In some instances, we have also consulted additional websites and reports of accountancy firms and other local websites.

The scoring matrix is shown in Table 17.1, with full details of the assessment logic presented in Table 17.3 below.

Table 17.1: Scoring Matrix Haven Indicator 17

Regulation	Haven Score [100 points = maximum risk; 0 points= minimum risk]
The jurisdiction does not apply restrictions on the deduction of intra-group services payments (beyond transfer pricing rules, the arm's length principle or other generic rules).	100
The jurisdiction applies specific restrictions or certain deduction limitations on intra-group services payments	0

All underlying data can be accessed in the Corporate Tax Haven Index database.[2] To see the sources we are using for particular jurisdictions please consult the assessment logic in Table 17.3 and search for the

corresponding info ID (521) in the database report of the respective jurisdiction.

Why is this important?

Intra-group services payments are usually considered deductible expenses and often abused by multinational companies to lower their tax base by shifting their profits from a profitable group company resident and operating in one jurisdiction to another group company resident in a low or no tax jurisdiction. In that respect, intra-group services are quite similar to intra-group interest payments (see haven indicator 15) as well as to intra-group royalty payments (see haven indicator 16). Intra-group services payments are usually deductible against a country's tax base in cases where the payer is a resident of the country or a non-resident with a permanent establishment or fixed base in the country. The deduction of intra-group services payments may thus create risks for eroding the tax base and particularly in cases where a tax treaty limits the taxing rights of the payer's jurisdiction in that respect. Especially in lower income countries which are usually considered to be large scale importers of such services, intra-group service payments can severely constrain domestic resource mobilisation efforts.[3]

In an attempt to address this problem, the United Nations has introduced the new Article 12A "Fees of technical services" in its latest model tax convention. Article 12A aims to allow source countries to tax technical service fees on a gross basis at a limited rate without any threshold requirement (and even in cases where the services are provided outside the country).[4] For countries that are party to the UN model tax convention but have yet to adopt the latest model tax convention, cross-border intra-group service payments are covered by Article 7 or 14 of the convention and are taxable in the source country only if the non-resident has a permanent establishment or a fixed base or spends a significant amount of time in the source country.[5] These provisions are often abused by multinational companies that are able to create a structure where they neither have a permanent establishment nor a fixed place of business.[6] The adoption of article 12A thus may indeed assist jurisdictions in preventing the erosion of their tax base by taxing the intra-group services payments to non-residents in the other jurisdiction.[7]

However, adopting article 12A is likely to impose a heavy financial and administrative burden on jurisdictions. They would need to re-negotiate this kind of new provision for their existing tax treaties, which will take time and is likely to be met with opposition.[8] The ability of developing countries to convince developed countries to include such a provision in tax treaties is in doubt.

The Organisation for Economic Co-operation and Development's (OECD) does not recommend any limitation rule for the deduction of intra-group

service payments even though it does recommend imposing restrictions on the deduction of intra-group interest payments and applying the nexus approach in the case of intra-group royalty payments. However, the OECD in its Base Erosion and Profit Shifting project has already acknowledged that countries are free to include safeguard provisions in their domestic rules against base erosion and profit shifting.[9]

As part of applying such safeguards, countries can, for example, choose to unilaterally limit the deduction of intra-group services payments by using a specific anti-avoidance measures that will allow them to tax these payments on a gross basis and prevent the erosion of their tax base. Several jurisdictions have already done this. For example, Ecuador applies a specific rule that limits the deductibility of technical, administrative and consulting service payments to intra-group companies up to 20% of the taxable base plus those expenses[10] (and when companies are in pre-operational stage, it is further reduced to 10%).[11] Similarly, Brazil limits the deduction of technical, scientific or administrative assistance payments up to a certain percentage specified by the Ministry of Finance based on the type of product or industry involved.[12] In Seychelles, intra-group services payments are deductible up to 3% of the annual turnover.[13] Poland limits the deduction of intra-group service payments up to 5% of EBITDA if the taxpayer that has rendered the services is resident in a country engaging in harmful tax competition.[14]

In a similar vein, the OECD recommended domestic measures to address hybrid mismatch arrangements that link the tax treatment of all kind of intra-group deductible payments, including service fees to the tax treatment in another country.[15] In line with the OECD recommendations, the European Union included hybrid mismatch rules in the Anti-Tax Avoidance Directive (2016/1164/EU),[16] then expanded its scope with an amendment in 2017.[17] However, hybrid mismatch rules only allow countries to “deny the taxpayer’s deduction of a payment to the extent that it is not included in the taxable income of the recipient in the counterparty jurisdiction or if it is also deductible in the counterparty jurisdiction.”[18] As a result, whenever there is a link with the tax treatment in another country, these hybrid mismatch rules do not protect the tax base of the source jurisdiction because they do not offer any limitation to excessive payments that are included in the taxable income of a recipient in the other jurisdiction or when the payment is not deductible there. Furthermore, the fact that in order to apply the domestic rules, a jurisdiction is required to explore and understand the laws of the other relevant country leads to a much more complicated implementation of the rules.[19]

It may be argued that completely disallowing the deduction for intra-group service payments penalises the payer’s legitimate income-earning expenses and thus may lead to undesired economic distortions.[20] However, given the potential for abusive intra-group service payments,

constraining the deduction of such payments may be the only effective way to protect the source country's tax base. The risks of such abuses are particularly high when the source countries are developing countries and especially in cases where the non-resident service provider is a resident of a tax haven jurisdiction.[21]

Haven Indicator 17: Deduction limitation for service payments

Results Overview

Figure 17.1: Deduction Limitation for Service Payments Overview

GG	VG	MX	AT	CH	CZ	FI	GM	IT	LT	MS	PE	SI	ZA
BS	TC	GR	AD	BW	CY	ES	GI	IE	LR	MO	PA	SG	TZ
BM	KY	EC	US	BG	CW	EE	GH	HU	LI	MC	NL	SE	TW
AI	JE	BR	SC	BE	CR	DK	GB	HR	LB	LV	MU	RO	SM
AE	IM	AR	PL	AW	CN	DE	FR	HK	KE	LU	MT	PT	SK

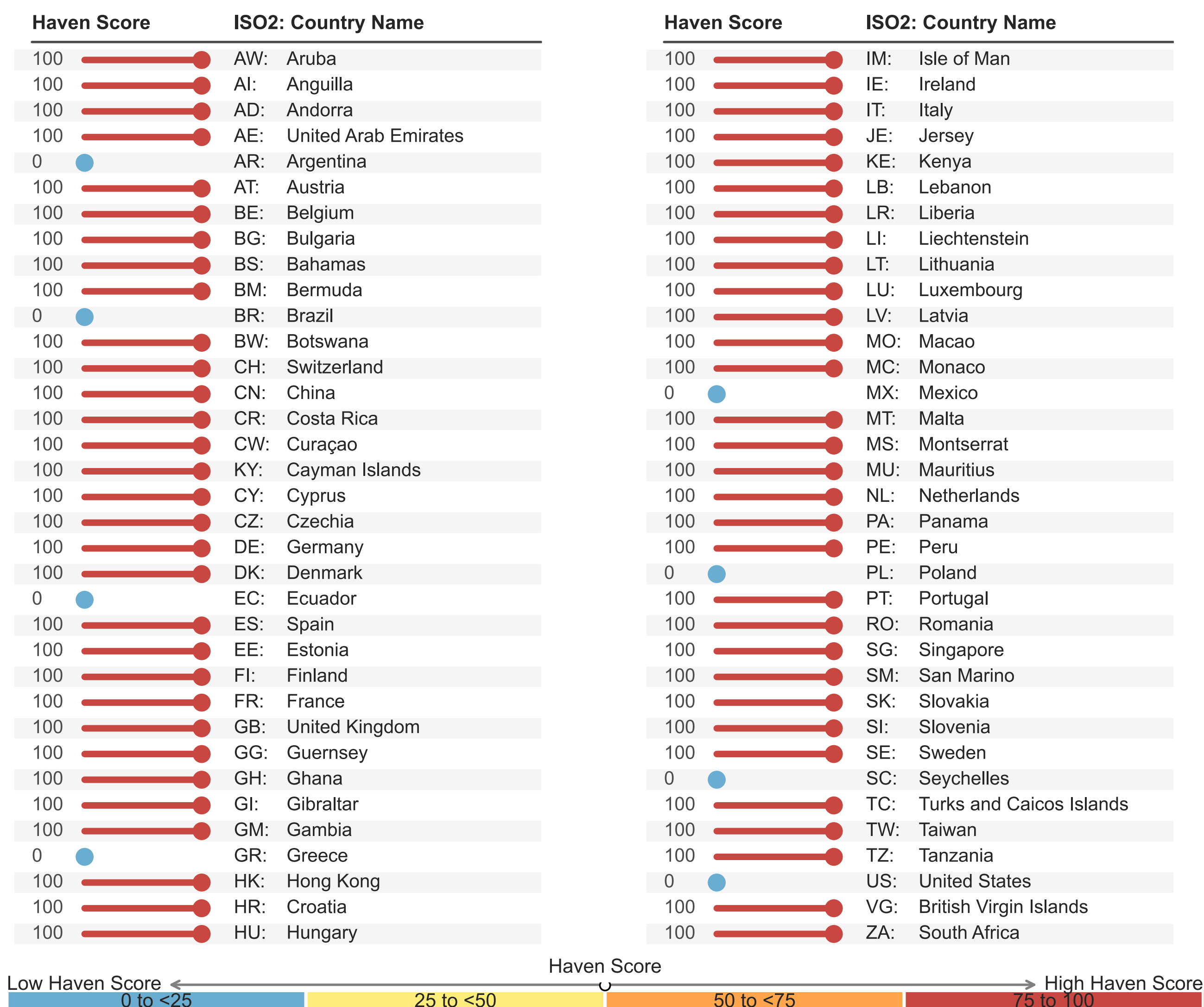
14% (10 countries): -3: Not applicable

11% (8 countries): 1: Yes, there are specific restrictions or deduction limitations on outbound service payments.

74% (52 countries): 0: No, there is no deduction restriction beyond transfer pricing rules, the arm's length principle or other generic rules.

*Note: This indicator is not applicable (N/A) for countries that have no corporate tax system or a zero statutory tax rate. In such cases, the haven score is the highest possible due to the corporate tax avoidance spillover risks as a result of having no corporate tax system or a zero statutory tax rate.

Table 17.2: Deduction Limitation for Service Payments – Haven Indicator Scores



Haven Score	ISO2: Country Name
100	AW: Aruba
100	AI: Anguilla
100	AD: Andorra
100	AE: United Arab Emirates
0	AR: Argentina
100	AT: Austria
100	BE: Belgium
100	BG: Bulgaria
100	BS: Bahamas
100	BM: Bermuda
0	BR: Brazil
100	BW: Botswana
100	CH: Switzerland
100	CN: China
100	CR: Costa Rica
100	CW: Curaçao
100	KY: Cayman Islands
100	CY: Cyprus
100	CZ: Czechia
100	DE: Germany
100	DK: Denmark
0	EC: Ecuador
100	ES: Spain
100	EE: Estonia
100	FI: Finland
100	FR: France
100	GB: United Kingdom
100	GG: Guernsey
100	GH: Ghana
100	GI: Gibraltar
100	GM: Gambia
0	GR: Greece
100	HK: Hong Kong
100	HR: Croatia
100	HU: Hungary
100	IM: Isle of Man
100	IE: Ireland
100	IT: Italy
100	JE: Jersey
100	KE: Kenya
100	LB: Lebanon
100	LR: Liberia
100	LI: Liechtenstein
100	LT: Lithuania
100	LU: Luxembourg
100	LV: Latvia
100	MO: Macao
100	MC: Monaco
0	MX: Mexico
100	MT: Malta
100	MS: Montserrat
100	MU: Mauritius
100	NL: Netherlands
100	PA: Panama
100	PE: Peru
0	PL: Poland
100	PT: Portugal
100	RO: Romania
100	SG: Singapore
100	SM: San Marino
100	SK: Slovakia
100	SI: Slovenia
100	SE: Sweden
0	SC: Seychelles
100	TC: Turks and Caicos Islands
100	TW: Taiwan
100	TZ: Tanzania
0	US: United States
100	VG: British Virgin Islands
100	ZA: South Africa

Table 17.3: Assessment Logic

Info_ID	Text_Info_ID	Answers (Codes applicable for all questions: -2: Unknown; -3: Not Applicable)	Valuation Haven Score
521	Outbound intra-group services deduction limitation: Does the jurisdiction restrict or disallow deducting from the corporate income tax base payments for management, technical, legal or accounting services paid to non-resident group affiliates?	0: No, there is no deduction restriction beyond transfer pricing rules, the arm's length principle or other generic rules; 1: Yes, there are specific restrictions or deduction limitations on outbound service payments.	0: 100 1: 0

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[5] United Nations *United Nations Model Double Taxation Convention between Developed and Developing Countries -between Developed and Developing Countries. 2017 Update.*, 323.

[6] United Nations *United Nations Model Double Taxation Convention between Developed and Developing Countries -between Developed and Developing Countries. 2017 Update.*, 321.

[7] Ault and Arnold, 'Chapter 1: Protecting the Tax Base of Developing Countries: An Overview', 44.

[8] For example, while the United Kingdom has signed (though not yet ratified) a treaty with Botswana that permits Botswana to impose withholding taxes on intra-group services payments, it has been reluctant since then to conclude other tax treaties with such clauses. For further details, see: Martin Hearson, 'The UK - Colombia Tax Treaty: 80 Years in the Making', 2017 <http://eprints.lse.ac.uk/86396/1/Hearson_UK-Colombia_tax_treaty.pdf> [accessed 22 May 2019].

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[10] For an example of calculation see, EY, 'Ecuador Issues Regulations on Ruling Process for Requesting Increase in the Deduction Limit for Expenses Related to Royalties and Technical, Administrative and Advisory Services', *Global Tax Alert* <https://www.ey.com/Publication/vwLUAssets/Ecuador_issues_regulations_on_ruling_process_for_requesting_increase_in_the_deduction_limit_for_expenses_related_to_royalties_and_technical,_administrative_and_advisory_services/$FILE/2015G_CM5794_EC%20issues%20regs%20on%20ruling%20for%20requesting%20increase%20in%20ded%20limit%20for%20expenses%20of%20certain%20tax%20services.pdf> [accessed 22 May 2019].

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