

Key Corporate Tax Haven Indicators

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

All underlying data can be accessed freely in the CTHI [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 to apply 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

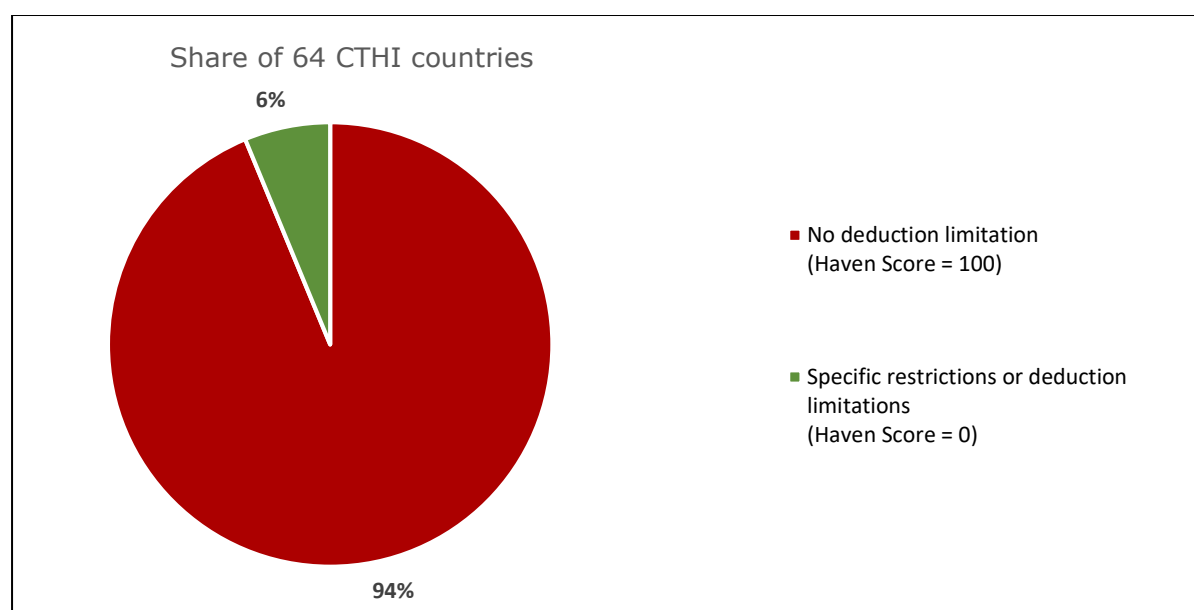
As part of applying such safeguards, countries can, for example, choose to unilaterally limit the deduction of intra-group services payments by using a specific anti-avoidance measures that will allow them to tax these payments on a gross basis and prevent the erosion of their tax base. Several jurisdictions 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 expenses¹⁰ (and when companies are in pre-operational stage, it is further reduced to 10%).¹¹ In the Seychelles, intra-group services payments are deductible up to 3% of the annual turnover.¹² 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.¹³

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 distortions and a loss of dynamics in the economy.¹⁴ To constrain the deduction of intra-group services however may be the only effective way to protect the source country's tax base, given the potential for abusive intra-group service payments. 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.¹⁵

Haven Indicator 17: Deduction Limitation for Service Payments

Results Overview

Graph 17.1. Deduction Limitation for Service Payments Overview



Results Detail

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

Country Name	Score	ISO	Country Name	Score	ISO
Andorra	100	AD	Kenya	100	KE
Anguilla	100	AI	Latvia	100	LV
Aruba	100	AW	Lebanon	100	LB
Austria	100	AT	Liberia	100	LR
Bahamas	100	BS	Liechtenstein	100	LI
Belgium	100	BE	Lithuania	100	LT
Bermuda	100	BM	Luxembourg	100	LU
Botswana	100	BW	Macao	100	MO
British Virgin Islands	100	VG	Malta	100	MT
Bulgaria	100	BG	Mauritius	100	MU
Cayman Islands	100	KY	Monaco	100	MC
China	100	CN	Montserrat	100	MS
Croatia	100	HR	Netherlands	100	NL
Curacao	100	CW	Panama	100	PA
Cyprus	100	CY	Poland	0	PL
Czech Republic	100	CZ	Portugal (Madeira)	100	PT
Denmark	100	DK	Romania	100	RO
Estonia	100	EE	San Marino	100	SM
Finland	100	FI	Seychelles	0	SC
France	100	FR	Singapore	100	SG

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Country Name	Score	ISO	Country Name	Score	ISO
Gambia	100	GM	Slovakia	100	SK
Germany	100	DE	Slovenia	100	SI
Ghana	100	GH	South Africa	100	ZA
Gibraltar	100	GI	Spain	100	ES
Greece	0	GR	Sweden	100	SE
Guernsey	100	GG	Switzerland	100	CH
Hong Kong	100	HK	Taiwan	100	TW
Hungary	100	HU	Tanzania	100	TZ
Ireland	100	IE	Turks and Caicos Islands	100	TC
Isle of Man	100	IM	United Arab Emirates (Dubai)	100	AE
Italy	100	IT	United Kingdom	100	GB
Jersey	100	JE	USA	0	US

Maximum Risk (Haven Score 100)	Haven Score 76 - 100	Haven Score 51 - 75	Haven Score 26 - 50	Haven Score 1 - 25	Minimum Risk (Haven Score 0)
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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

Reference List

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](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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¹ IBFD, *Tax Research Platform: Country Surveys, Country Analyses, Country Key Features*, Accessed 2018-2019, 2018 <<https://research.ibfd.org/>> [accessed 9 May 2019].

² <http://www.corporatetaxhavenindex.org/database/menu.xml>

³ Hugh J. Ault and Brian J. Arnold, 'Chapter 1: Protecting the Tax Base of Developing Countries: An Overview', in *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*, ed. by Alexander Trepelkov, Harry Tonito, and Dominika Halka, Second (New York, 2017), 42–43.

⁴ United Nations *United Nations Model Double Taxation Convention between Developed and Developing Countries -between Developed and Developing Countries. 2017 Update.*, 2017, 23–24 <https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf> [accessed 27 December 2018].

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].

⁹ OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report* <https://read.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en> [accessed 27 December 2018].

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](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].

¹¹ G. Guerra, Ecuador - Corporate Taxation sec. 1., Country Surveys IBFD, 2019, https://research.ibfd.org/#/doc?url=/document/gtha_ec_s_1 [accessed 24 May 2019].

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¹³ M. Olejnicka, Poland - Corporate Taxation sec. 1., Country Analyses IBFD, 2019, https://research.ibfd.org/#/doc?url=/document/cta_pl_s_1 [accessed 24 May 2019].

¹⁴ Brian J. Arnold (2017), 'Taxation of Income from Services' in *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries (Second Edition)*,

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¹⁵ Ault and Arnold, 'Chapter 1: Protecting the Tax Base of Developing Countries: An Overview', 44.