

**Modified Nexus Approach for IP Regimes:  
What It Means and What Happens Next**

*By Kurt Wulfekuhler*

April 2015

**News:** The Group of Twenty (“G20”) Leaders’ Summit in Brisbane in November 2014 may be best remembered for a forlorn President Putin of Russia dining alone during lunch. But the leaders did reach important agreement on a number of issues relating to base erosion and profit shifting (“BEPS”). Among them was the endorsement of a compromise solution under BEPS Action 5, which is intended to counter harmful tax practices by requiring substantial activity for any preferential regime, among other steps. The compromise, known as the Modified Nexus Approach, requires nexus between the location of the activities generating the income eligible for preferential tax treatment and the jurisdiction offering the preferential regime, provides a grandfathering clause of five years, and prohibits new entrants to regimes not meeting the approach after June 2016.

**Views:** Taxpayers should not necessarily rush into existing preferential regimes for intangible property (“IP”), such as patent boxes, by June 2016. The Forum on Harmful Tax Practices (“FHTP”) of the Organization for Economic Co-operation and Development (“OECD”) is considering measures to discourage new entrants intent on benefiting from grandfathering. Additionally, regimes that do not meet the Modified Nexus Approach will have an abolition date five years after the closing date for new entrants, or June 2021, so any benefits from grandfathering will be limited.

Angel Gurría, secretary-general of the OECD, declared at the G20 Finance Ministers and Central Bank Governors Meeting in Istanbul in February 2015, that all OECD and G20 countries had endorsed the Modified Nexus Approach. This approach follows the nexus approach under the September 2014 progress report on *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, with the following amendments:

- Up-lift of 30 percent on qualifying expenditures;
- Closing date for new entrants to old regimes; and
- Defined abolition date for old regimes.

One of the purposes of the Modified Nexus Approach is to “ensure that in order for a significant proportion of IP income to qualify for benefits, a significant proportion of the actual R&D activities must have been undertaken by the qualifying taxpayer itself.”<sup>1</sup> In a concession, albeit a limited one, to businesses that raised concerns about the considerable restructuring costs of changing their existing dedicated R&D companies, countries may allow taxpayers to increase their qualifying expenses by 30 percent, subject to certain limitations. Any regime not meeting the Modified Nexus Approach may not accept new entrants after the introduction of a regime meeting the approach, but no later than June 30, 2016;

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<sup>1</sup> OECD, *Action 5: Agreement on Modified Nexus Approach for IP Regimes* (2015), p. 3.

and the abolition date for old regimes will be five years after the closing date to new entrants, or no later than June 30, 2021.

The FHTP plans to conclude additional work by June 2015. It is developing an approach for tracking and tracing R&D expenditure that is practical for tax authorities and companies to implement. It is also considering measures to safeguard against taxpayers from inappropriately using the transitional period to be grandfathered under existing IP regimes. These measures could include transparency by requiring exchange of information on taxpayers benefiting from a grandfathered regime, monitoring new entrants, and possible restrictions for new entrants. The FHTP also intends to provide guidance on the definition of qualifying IP assets, which under the Modified Nexus Approach include patents and functionally equivalent IP assets that are legally protected and subject to approval and registration processes.

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