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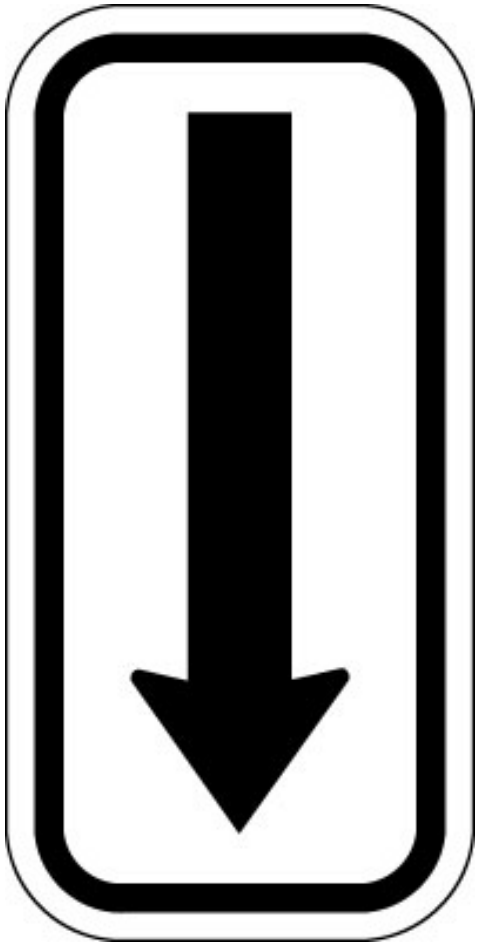
The Current and Future Role of CFC Legislation in the Nordic Countries

University of Bergen / Norwegian School of Economics

Peter Koerver Schmidt, PhD
Professor with special responsibilities in tax law, CBS
Professor II, NHH

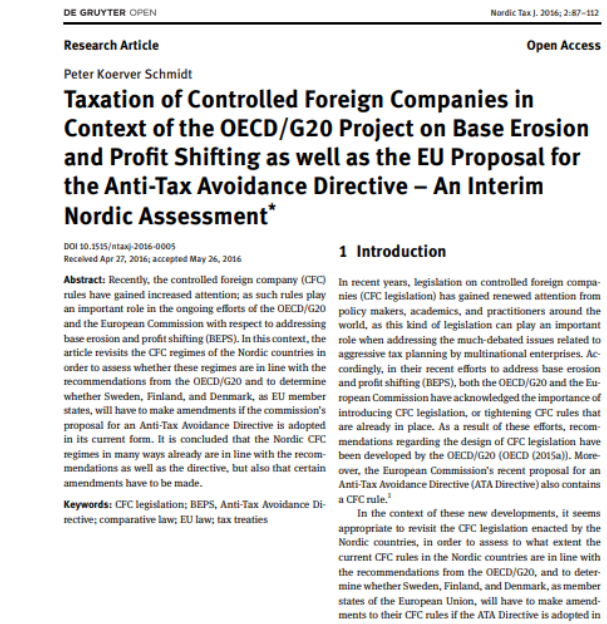
Agenda

- CFC taxation in a nutshell
  - Need and purpose
  - Development and spread
- OECD/G20 BEPS Project, Action 3
  - Building blocks
- EU Law and CFC legislation
  - Primary Law
  - ATAD
- A Nordic perspective
- Looking ahead
- Conclusions



Basis of the presentation

CBS COPENHAGEN BUSINESS SCHOOL
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Research Article — **Open Access**

Peter Koerver Schmidt

Taxation of Controlled Foreign Companies in Context of the OECD/G20 Project on Base Erosion and Profit Shifting as well as the EU Proposal for the Anti-Tax Avoidance Directive – An Interim Nordic Assessment*

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Abstract: Recently, the controlled foreign company (CFC) rules have gained increased attention; as such rules play an important role in the ongoing efforts of the OECD/G20 and the European Commission with respect to addressing base erosion and profit shifting (BEPS). In this context, the article revisits the CFC regimes of the Nordic countries in order to assess whether these regimes are in line with the recommendations from the OECD/G20 and to determine whether Sweden, Finland, and Denmark, as EU member states, will have to make amendments if the commission's proposal for an Anti-Tax Avoidance Directive is adopted in its current form. It is concluded that the Nordic CFC regimes in many ways already are in line with the recommendations as well as the directive, but also that certain amendments have to be made.

Keywords: CFC legislation; BEPS, Anti-Tax Avoidance Directive; comparative law; EU law; tax treaties

1 Introduction

In recent years, legislation on controlled foreign companies (CFC legislation) has gained renewed attention from policy makers, academics, and practitioners around the world, as this kind of legislation can play an important role when addressing the much-debated issues related to aggressive tax planning by multinational enterprises. Accordingly, in their recent efforts to address base erosion and profit shifting (BEPS), both the OECD/G20 and the European Commission have acknowledged the importance of introducing CFC legislation, or tightening CFC rules that are already in place. As a result of these efforts, recommendations regarding the design of CFC legislation have been developed by the OECD/G20 (OECD (2015a)). Moreover, the European Commission's recent proposal for an Anti-Tax Avoidance Directive (ATA Directive) also contains a CFC rule.[1]

In the context of these new developments, it seems appropriate to revisit the CFC legislation enacted by the Nordic countries, in order to assess to what extent the current CFC rules in the Nordic countries are in line with the recommendations from the OECD/G20, and to determine whether Sweden, Finland, and Denmark, as member states of the European Union, will have to make amendments to their CFC rules if the ATA Directive is adopted in

Peter Koerver Schmidt: Assistant Professor, Copenhagen Business School and Technical Advisor, CORIT Advisory P/S, Denmark; Email: pks.jur@cbs.dk

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ARTICLE

A General Income Inclusion Rule as a Tool for Improving the International Tax Regime – Challenges Arising from EU Primary Law

Peter Koerver Schmidt*

The overall concept of the OECD's Global Anti-Base Erosion Proposal is to develop a coordinated set of rules to address ongoing risks from profit shifting and to curb international tax competition. Two important components of the proposal are the income inclusion rule and the switch-over rule and, in this article, these components are examined in consideration of EU primary law. Depending on the final design of the rules, it is concluded that the proposed income inclusion rule – however, probably not the switch-over rule – may end up restricting the fundamental freedoms by treating comparable situations differently. Against that background, a number of policy options for designing the income inclusion rule in accordance with primary EU law requirements are presented, and pros and cons of these design options are discussed.

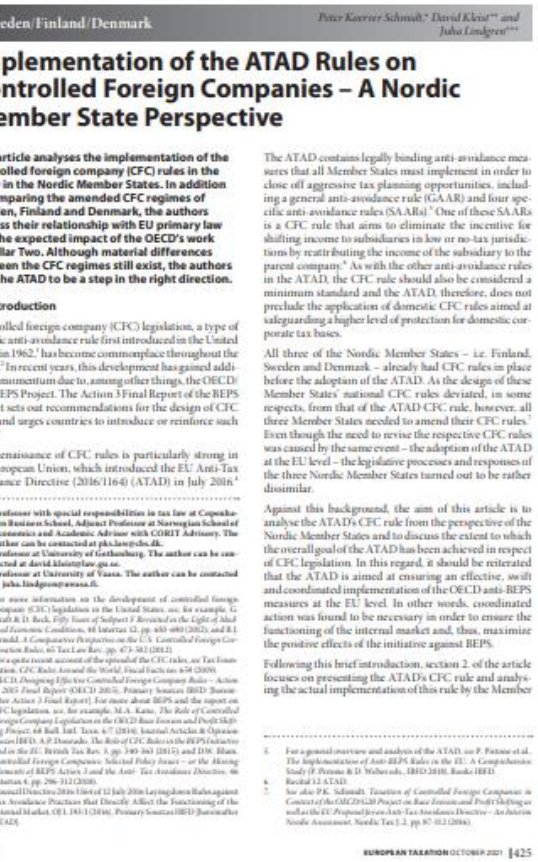
Keywords: Global anti-base erosion proposal (GloBE); EU tax law; fundamental freedoms; tax avoidance; tax competition; tax policy

I Introduction

Within the last decade, several initiatives have been launched to improve the international tax framework. Among these, the OECD/G20 Base Erosion and Profit Shifting Project (the *BEPS Project*) is probably the most prominent,[1] resulting in the release of thirteen final reports in 2015 and a multilateral instrument entering into force in 2018.[2] However, despite these outcomes, the work of the OECD/G20 has continued,[3] meaning that the OECD/G20 is currently working along two lines that are commonly referred to as BEPS 2.0. The so-called Pillar 1 concerns the allocation of taxing rights between jurisdictions including new nexus and income allocation rules whereas Pillar 2 concerns the development of a coordinated set of rules addressing ongoing risks from structures that allow multinational enterprises to shift profits to jurisdictions where they are subject to no or very minimal taxation.[4] Pillar 2 – which is also known as the *Global Anti-Base Erosion Proposal*, or just the *GloBE Proposal* – is the subject of this article.

Considered from one perspective, Pillar 2 may be regarded as an expansion and extension of the original BEPS Project yet, from another perspective, it might be seen as a globalization of the United States' Tax Cuts and Jobs Act, including its rules on global intangible low-taxed income (GILTI) and its base erosion and anti-abuse tax (BEAT).[5] Compared to the original BEPS Project, the novelty of Pillar 2 is that it also aims to combat tax competition and not only base erosion and profit shifting.[6] It is, therefore, clear that the GloBE Proposal

Notes



Sweden/Finland/Denmark — *Peter Koerver Schmidt,* David Kleist** and Juha Lindgren****

Implementation of the ATAD Rules on Controlled Foreign Companies – A Nordic Member State Perspective

This article analyses the implementation of the controlled foreign company (CFC) rules in the ATAD in the Nordic Member States. In addition to comparing the amended CFC regimes of Sweden, Finland and Denmark, the authors discuss their relationship with EU primary law and the expected impact of the OECD's work on Pillar Two. Although material differences between the CFC regimes still exist, the authors find the ATAD to be a step in the right direction.

1. Introduction

Controlled foreign company (CFC) legislation, a type of specific anti-avoidance rule first introduced in the United States in 1962,[1] has become commonplace throughout the world.[2] In recent years, this development has gained additional momentum due to, among other things, the OECD/G20 BEPS Project. The Action 3 Final Report of the BEPS Project sets out recommendations for the design of CFC rules and urges countries to introduce or reinforce such rules.[3]

This renaissance of CFC rules is particularly strong in the European Union, which introduced the EU Anti-Tax Avoidance Directive (2016/1164) (ATAD) in July 2016.[4]

* **Professor with special responsibilities in tax law at Copenhagen Business School, Adjunct Professor at Norwegian School of Economics and Academic Advisor with CORIT Advisory. The author can be contacted at pks.law@cbs.dk.**
** **Professor at University of Gothenburg. The author can be contacted at david.kleist@law.gu.se.**
*** **Professor at University of Vaasa. The author can be contacted at juha.lindgren@uwasa.fi.**

The ATAD contains legally binding anti-avoidance measures that all Member States must implement in order to close off aggressive tax planning opportunities, including a general anti-avoidance rule (GAAR) and four specific anti-avoidance rules (SAARs).[5] One of these SAARs is a CFC rule that aims to eliminate the incentive for shifting income to subsidiaries in low or no-tax jurisdictions by reattributing the income of the subsidiary to the parent company.[6] As with the other anti-avoidance rules in the ATAD, the CFC rule should also be considered a minimum standard and the ATAD, therefore, does not preclude the application of domestic CFC rules aimed at safeguarding a higher level of protection for domestic corporate tax bases.

All three of the Nordic Member States – i.e. Finland, Sweden and Denmark – already had CFC rules in place before the adoption of the ATAD. As the design of these Member States' national CFC rules deviated, in some respects, from that of the ATAD CFC rule, however, all three Member States needed to amend their CFC rules.[7] Even though the need to revise the respective CFC rules was caused by the same event – the adoption of the ATAD at the EU level – the legislative processes and responses of the three Nordic Member States turned out to be rather dissimilar.

Against this background, the aim of this article is to analyse the ATAD's CFC rule from the perspective of the Nordic Member States and to discuss the extent to which the overall goal of the ATAD has been achieved in respect of CFC legislation. In this regard, it should be reiterated that the ATAD is aimed at ensuring an effective, swift and coordinated implementation of the OECD anti-BEPS measures at the EU level. In other words, coordinated action was found to be necessary in order to ensure the functioning of the internal market and, thus, maximize the positive effects of the initiative against BEPS.

Following this brief introduction, section 2. of the article focuses on presenting the ATAD's CFC rule and analysing the actual implementation of this rule by the Member

CFC taxation in a nutshell

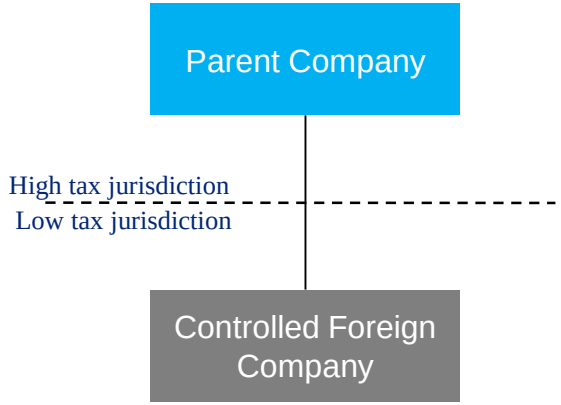
- If effective CFC rules not in place → Possible to reduce the tax burden by shifting mobile assets/income to a company in a low tax jurisdiction

- The opportunity rests on two grounds
  1. The seperate entity principle → deferral/sheltering/avoidance
  2. The existence of low tax jurisdictions

- CFC rules → Current taxation at the level of the parent company of the income in the CFC, despite no dividend distribution

- CFC rules mainly have a prophylactic effect

- The compatibility of CFC rules?
  - EU Law
  - Tax Treaties



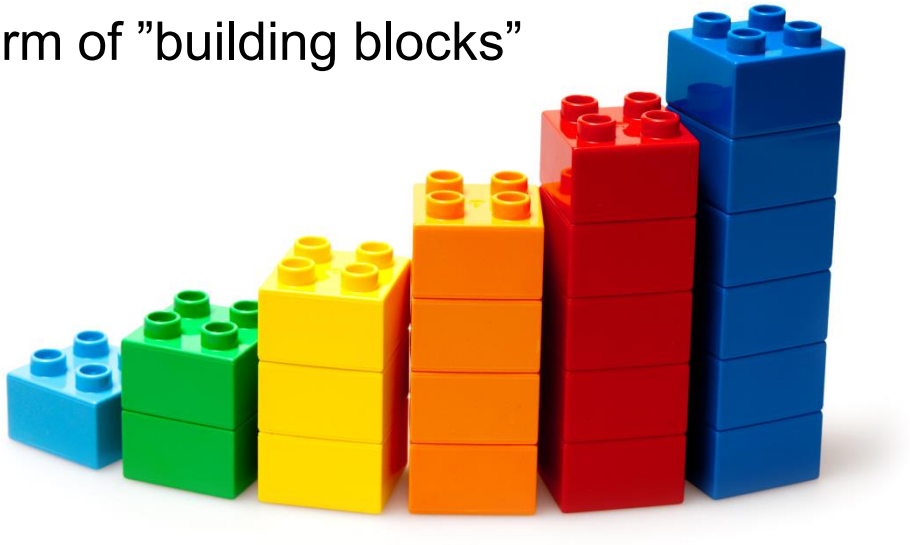
Development

Development and spread of CFC legislation

- 1962: The US adopted CFC rules (Subpart F rules)
- 1970s: Canada, West Germany and Japan
- 1990s: The Nordic countries (except Iceland, 2009)
- 1998: The OECD adopted recommendation on CFC rules
- 2015: OECD/G20 BEPS Report, Action 3
- 2016: ATAD adopted with CFC rule
- 2021: Agreement on OECD Pillar II with a broad IIR

BEPS – Action 3

- Recommendations in the form of ”building blocks”
  - Not minimum requirements
  - Effectivenes vs. flexibility



1) Defining a CFC

2) Exemptions & thresholds

3) Defining tainted income

4) How to compute

5) How to atttribute

6) Preventing double taxation

BEPS – Action 3 – Evaluation

- The recommendations are relatively vague

- Need to ensure flexibilty and different policy objectives → Reduced the report to a catalog setting out different options

- Ilustration – The CFC regimes of the Nordic countries were in many ways already in line with the BEPS recommendations, except e.g.
  - Finland the only country that applied both legal and economic ownership test
  - Only the Danish rules included an explicit definition of CFC income
  - None of the countries had rules in place to ensure that CFC tax assessed on intermediate companies did not lead to excessive taxation

EU Primary Law and CFC Rules

C-196/04 *Cadbury Schweppes*

- Step 1: National provisions which apply to holdings… giving them definite influence… → Freedom of establishment, cf. para 31

- Step 2: …it is common ground that the legislation on CFCs involves a difference in the treatment... → …creates a tax disadvantage for the resident company to which the legislation on CFCs is applicable… → …constitute a restriction…, cf. para. 43-45

- Step 3: …in order… to be justified on the ground of prevention of abusive practices, the specific objective… must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due …, cf. para. 55

. Confirmed in later case law: C-201/04 Test Claimants, C-135/17 X-GmbH and E-3/13 & E-20/13 Fred/Petter Olsen and others

ATAD

The CFC rule in the ATAD (2016/1164) – A minimum standard

- Main conditions:
  - Applicable to both entities and PEs
  - 50% threshold to define direct or indirect, as well as legal or economic control
  - 50% effective tax rate threshold

- Model A: Full-fleged CFC-approach based on analysis of categories of income
  - Substance carve-out rule for applying the approach intra-EU and optional exemptions:
    - if ”tainted” income ≤ 1/3 of total income
    - for financial undertakings if ”tainted” income from group companies ≤ 1/3

- Model B: Ligtht/quasi CFC-approach
  - Only attribution of income from ”non-genuine arrangements”
  - Exemption if accounting profits ≤ EUR 750,000, and non-trading income ≤ EUR 75,000, or of which the accounting profits ≤ 10 % of its operating costs

- Income to be included in proportion to ownership participation
- Relief: Dividends/gains concerning the CFC + Credit relief for tax paid by CFC

Implementation in Nordic MS

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- Control: X ≥ 25 % of votes/capital/profits
- Only foreign entities/PEs
- Low tax test: X < 60 %
- Model A
- Income test: No
- Substance carve-out: Yes, EU/EEA and 3rd states if…
- Inclusion: Entity method



- Control: X ≥ 25 % of votes/capital
- Only foreign entities (not PEs)
- Low tax test: X < 55 % and ”white-list”
- Model A
- Income test: No
- Substance carve-out: Yes, EU/EEA
- Inclusion: Entity method



- Control: X > 50 % of votes/capital/profits
- Foreign and domestic (no low tax test!)



- Model A
- Income test: CFC income > 1/3
- Only a limited/partial substance carve-out for other IP income
- Inclusion: Entity method (optional)

ATAD-implementation of CFC-rules

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Member state	CFC rules pre ATAD	ATAD model	Low tax condition	Substance carve-out
Belgium	No	B	Yes	n/a
Bulgaria	No	B	Yes	n/a
Cyprus	No	B	Yes	n/a
Denmark	Yes	A	No	No
Estonia	No	B	Yes	n/a
Finland	Yes	A	Yes	Yes
France	Yes	A	Yes	Yes
Grækenland	Yes	A	Yes	Yes
Italy	Yes	A	Yes	Yes
Ireland	No	B	Yes	n/a
Latvia	No	B	Yes	n/a
Lithuenia	Yes	A	Yes	n/a
Luxembourg	No	B	Yes	n/a
Croatia	No	A	Yes	Yes
Malta	No	B	Yes	n/a
The Netherlands	No	(A)	Yes	Yes
Poland	Yes	A	Yes	Yes
Portugal	Yes	A	Yes	Yes
Rumania	Yes	A	Yes	Yes
Slovenia	No	A	Yes	Yes
Slovakia	No	B	Yes	n/a
Spain	Yes	A	Yes	Yes
United Kingdom	Yes	B	Yes	n/a
Sweden	Yes	A	Yes	Yes
Czech Republic	No	A	Yes	Yes
Germany	Yes	A	Yes	Yes
Hungary	Yes	A	Yes	Yes
Austra	No	A	Yes	Yes

- CFC rules before ATAD: Around 1/2
- Model A after ATAD: Around 2/3
- Model B efter ATAD: Around 1/3
- Still significant variations, but
  - All MS (except Denmark) only apply the rules cross-border
  - All MS (except Denmark) includes a low-tax condition
  - All MS that have opted for Model A (except Denmark) apply a substance carve-out.

Norway – NOKUS rules



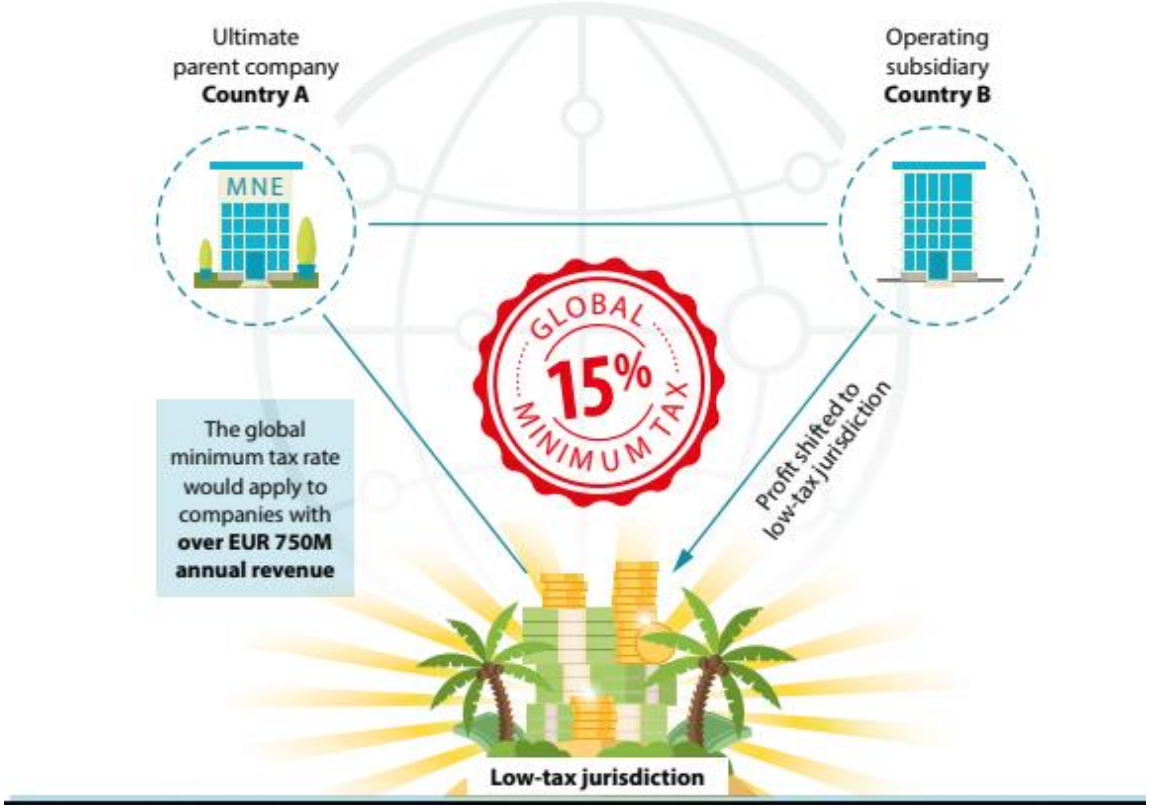
- Control: X ≥ 50 % of the shares/capital held by Norwegian taxpayers
- Only foreign entities
- Low tax test: X < 2/3, white-/blacklist
- Income test: Yes (treaty countries only), mainly passive income
- Substance carve-out: Yes, EU/EEA
- Assembles Model A
- Inclusion: Entity method

Compared to ATAD CFC-rules

- Different control test
  - Not a ”classic” control test
  - No testing based on voting rights / profit share
- Low tax test more strict than ATAD
- Income test less strict than ATAD

Looking ahead – OECD Pillar II

- **Pillar Two provides a minimum 15% tax on corporate profit, putting a floor on tax competition.** Governments worldwide agree to allow additional taxes on the foreign profits of MNEs headquartered in their jurisdiction at least to the agreed minimum rate. This means that tax competition will now be backstopped by a minimum level of taxation wherever an MNE operates.
- A carve-out allows countries to continue to offer tax incentives to promote business activity with real substance, like building a hotel or investing in a factory.



Source: OECD, Pamflet on Two-Pillar Solution to Address the Tax Challanges Arising from the Digitalisation of the Economy, October 2021.

Looking ahead – OECD Pillar II

Overall design

Pillar Two consists of:

- two interlocking domestic rules (together the Global anti-Base Erosion Rules (GloBE) rules): (i) an Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and (ii) an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR; and
- a treaty-based rule (the Subject to tax rule (STTR)) that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. The STTR will be creditable as a covered tax under the GloBE rules.

Source: OECD, Pamflet on Two-Pillar Solution to Address the Tax Challanges Arising from the Digitalisation of the Economy, October 2021.

- IIR with a ”formulaic substance carve-out” to some extent overlap CFC rules!
- European Commission:
  - Pillar II will have implications for existing and pending directives, including ATAD
  - Necessary to explore how to best accomodate interaction between IIR and CFC rules
  - Draft ”Pillar II Directive” expected quite soon

Conclusions

- BEPS action 3: Vague recommendations in the form of building blocks

- The official object of ATAD has not been fully achieved when it comes to the CFC rules of MS
  - Considerable differences across the EU
  - To some extent also with respect to the Nordic MS

- However – in my view – still a step forward
  - All MS now at least have some kind of CFC-rules → Bolsters overall resilience against agressive tax planning through CFCs
  - Preferable compared to the alternative of MS unilaterally implementing the BEPS recommendations in a completely uncoordinated manner

- Need to revise the ATAD and national CFC regimes in order to avoid (to much) overlap with the IIR of OECD Pillar II