

## ACTION 3: STRENGTHENING CFC RULES

### Background Documents:

- [OECD Discussion Draft:](#) May 12<sup>th</sup>, 2015  
[BIAC Response:](#) February 6<sup>th</sup>, 2015  
[OECD Final Report:](#) October 5<sup>th</sup>, 2015

Last updated: 30 November 2015

| TOPIC                         | BIAC COMMENTS                                                                                                                                                                                       | OECD RESPONSE                                                                                                                                                                                                                                                           |
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| <b>General</b>                | 1. Request clarification of the purpose of CFC rules.                                                                                                                                               | It is noted that the purpose and specifics of CFC rules will depend on domestic concerns. Consequently, the objective of Action 3 was to develop recommendations for CFC rules that are effective in dealing with BEPS rather than minimum standards or best practices. |
|                               | 2. A clear common hierarchy of rules would be required across different CFC regimes and between CFC and TP rules.                                                                                   | As per para. 9 of the final report, transfer pricing rules should generally apply before CFC rules.                                                                                                                                                                     |
|                               | 3. The “secondary rule” could cut against the original intention of the BEPS Action Plan, and would reallocate taxing rights purely based on the level of taxation imposed in a particular country. | The secondary rule is neither included, nor mentioned, in the final report.                                                                                                                                                                                             |
|                               | 4. PEs should not be included in the CFC definition.                                                                                                                                                | Recommendations on the definition of CFC indicate that CFC rules could include transparent entities and PEs.                                                                                                                                                            |
| <b>Policy considerations</b>  | 5. We are concerned about proposals suggesting to include “active” income unless threshold tests are met.                                                                                           | This proposal is not included in the final report.                                                                                                                                                                                                                      |
|                               | 6. Minimum standard should be developed in a way that is EU Law compliant, so it can be consistently adopted.                                                                                       | Action 3 is not a minimum standard. The report contains building blocks that are broad enough that they could be combined to effectively address various BEPS concerns, but they are also adaptable, enabling EU members to apply with EU law.                          |
|                               | 7. A fundamental feature of good CFC regimes is a number of simple or low-compliance threshold tests to exclude entities presenting an acceptably low CFC risk.                                     | It is recommended in the final report to include a tax rate exemption. This could be combined with a list (e.g. White list). A <i>de minimis</i> threshold and an anti-avoidance requirement were discussed but not included among the recommendations.                 |
| <b>Threshold requirements</b> | 8. The benefits and disadvantages of <i>de minimis</i> thresholds should be considered.                                                                                                             | The report explains that a <i>de minimis</i> threshold could reduce administrative burdens and make CFC rule more targeted and effective.                                                                                                                               |
|                               | 9. In addition to monetary thresholds, alternative options should be considered (e.g. time thresholds).                                                                                             | The final report only discusses a <i>de minimis</i> threshold, an anti-avoidance requirement and a tax rate exemption. Only the latter is recommended by                                                                                                                |

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|                              |                                                                                                                                                                                                                                                                              | the OECD. There is no reference to time thresholds.                                                                                                                                                                                                                                                                                                                        |
|                              | 10. An anti-avoidance threshold could be a useful compliment to the CFC rules.                                                                                                                                                                                               | Whilst discussed, this is not included as a recommended measure. The OECD recommends a tax rate exemption that could be accompanied by a list such as a white list.                                                                                                                                                                                                        |
|                              | 11. Clear guidance is needed on timing differences, and other legitimate reasons why a CFC's Effective Tax Rate ("ETR") may fluctuate significantly from one year to the next.                                                                                               | No clear guidance on timing differences and other legitimate reasons why ETR may fluctuate. However, in footnote 8 of chapter 3, it is stated that if the tax base in the parent jurisdiction is higher than that in the CFC jurisdiction only because of timing differences in accounting, this may not need to be reflected in the denominator when calculating the ETR. |
|                              | 12. If an ETR approach is adopted, we would recommend flexibility to permit the use of local GAAP.                                                                                                                                                                           | The final report states that the total taxable income could be computed according to the rules of the parent/shareholder's country or according to an international accounting standard such as IFRS.                                                                                                                                                                      |
|                              | 13. CFC rules should be targeted at abusive transactions, not legitimate commercial arrangements.                                                                                                                                                                            | The report recommends that CFC rules only apply to CFCs that are subject to ETRs that are meaningfully lower than those applied in the parent jurisdiction, regardless of the legitimacy of the arrangement.                                                                                                                                                               |
| <b>Definition of control</b> | 14. To establish the use of the objective legal and economic tests as a best practice, removing the words "at least" in para. 65: "CFC rules should <u>at least</u> apply both a legal and an economic control test so that satisfaction of either test results in control." | Para. 65 is para. 25 of the final report and the text requested to be deleted remains.                                                                                                                                                                                                                                                                                     |
|                              | 15. The "acting in concert" tests could add complexity to the rules, and be open to subjective interpretation.                                                                                                                                                               | Despite acknowledging that "acting in concert" test is not very common as it creates significant administrative and compliance burdens, the final report includes a recommendation to aggregate the interest of any taxpayers when determining the level of control.                                                                                                       |
|                              | 16. The "concentrated ownership" approach in the Discussion Draft does not consider cases where a listed company intermediary exists in the ownership structure.                                                                                                             | The concentrated ownership approach in the final report does not consider cases where a listed company intermediary exists in the ownership structure.                                                                                                                                                                                                                     |
| <b>Definition of income</b>  | 17. We encourage the use of practical "threshold tests" that could be applied prior to detailed substance-based tests.                                                                                                                                                       | It is recommended to include a tax rate exemption to exclude companies that are subject to an ETR that is sufficiently similar to the tax rate applied in the parent jurisdiction.                                                                                                                                                                                         |
|                              | 18. The "viable independent entity analysis" and "employees and establishment analysis" would likely override the application of the Arm's Length Principle.                                                                                                                 | Both analyses are included in the options a jurisdiction could consider when designing a substance analysis.                                                                                                                                                                                                                                                               |

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|  | 19. The “substantial contribution analysis” approach may represent a more reasonable balance between the intended outcome of the application of TP principles and an approach that can be applied in practice                                                                   | The final report does not have concrete recommendations in this chapter. Jurisdictions are free to adopt any of the different approaches discussed therein.                                                                                                                                                                                                                           |
|  | 20. The “employees and establishment analysis” would ignore ownership of intangible assets and the management and control of risk.                                                                                                                                              | The final report does not have concrete recommendations in this chapter. Jurisdictions are free to adopt any of the different approaches discussed therein.                                                                                                                                                                                                                           |
|  | 21. Further analysis needed of the benefits and disadvantages of active/passive assumptions, including the burden that a passive assumption places on taxpayers, and to what extent specific BEPS issues are likely to be targeted through a negative vs. positive presumption. | The final report has slightly different wording from the discussion draft (the legal classification still scopes-out dividends paid out of active income (or by related parties out of active income) and if the CFC were in the active trade or business of dealing in securities). However, there is no analysis on the advantages and disadvantages of active/passive assumptions. |
|  | 22. Active financial service businesses should be treated like any other active business -subject to suitable safeguards. Interest income earned by regulated banking entities should not generally be considered passive.                                                      | Interest and financing income is more likely to raise BEPS concern when it has been earned from related parties, when the CFC is overcapitalised, when the activities contributing to the interest were located outside the CFC jurisdiction, or when the income was not earned from an active financing business.                                                                    |
|  | 23. Clear guidance is required to assess when a CFC is engaged in an “active trade or business”.                                                                                                                                                                                | No guidance on when a CFC is engaged in an active trade or business.                                                                                                                                                                                                                                                                                                                  |
|  | 24. Guidance on what should be considered interest income for the purpose of best practice CFC rules.                                                                                                                                                                           | No guidance on what should be considered interest income.                                                                                                                                                                                                                                                                                                                             |
|  | 25. The explanation in Footnote 48 should be extended to consider the different aspects of the UK safe harbour.                                                                                                                                                                 | This footnote was not included in the final report.                                                                                                                                                                                                                                                                                                                                   |
|  | 26. Deletion of: “Further, due to the complexity of the insurance of risks generally, taxing authorities may not have the capacity or ability to successfully challenge the extent to which companies have actually transferred the risks to related CFCs” in Para. 102.        | Para 108 was modified and included in para 78 of the final report. The quoted sentence that BIAC asked to remove was deleted.                                                                                                                                                                                                                                                         |
|  | 27. What does “overcapitalisation” mean in an insurance context, and which capital should be considered?                                                                                                                                                                        | No explanation of the meaning of overcapitalisation in an insurance context.                                                                                                                                                                                                                                                                                                          |
|  | 28. We support an active presumption for services and sales income, unless specific thresholds are breached.                                                                                                                                                                    | The final report does not address whether services and sales income are active or passive, but whether it raises BEPS concerns or not. Invoicing companies and IP income are noted to raise BEPS concerns.                                                                                                                                                                            |

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|                                                      | 29. Essential to recognise that not all IP income is passive.                                                                                                          | The final report does not recognise that not all IP income is passive, instead concludes that legal classification is not enough to determine when IP income raises BEPS concerns.                                                                                                                                                                                                                                                                                   |
|                                                      | 30. A categorical approach to attributing income is preferable to an Excess Profits Approach (EPA).                                                                    | The final report does not have concrete recommendations regarding the approach to follow.                                                                                                                                                                                                                                                                                                                                                                            |
|                                                      | 31. A categorical approach should include filters to exclude substantive activity and active income.                                                                   | The categorical approach does not include filters excluding active income/substantive activity, but it discusses some scenarios that do not raise BEPS concerns.                                                                                                                                                                                                                                                                                                     |
|                                                      | 32. If the EPA is pursued, a substance-based exclusion would be critical.                                                                                              | The final report does not have concrete recommendations in this chapter regarding the approach to follow. However, regarding the EPA there was no consensus on whether it should be combined with a mandatory substance-based exclusion.                                                                                                                                                                                                                             |
| <b>Computing income</b>                              | 33. Para. 131 recommends the use of parent jurisdiction rules to calculate a CFC's income. It should be clarified that this applies only to passive income.            | Jurisdictions are free to choose their rules for defining CFC income.                                                                                                                                                                                                                                                                                                                                                                                                |
|                                                      | 34. CFC loss restrictions may be appropriate. Explicit recommendations should be included so losses continue to be available following a change in ownership of a CFC. | No explicit recommendation regarding losses following a change in ownership of a CFC.                                                                                                                                                                                                                                                                                                                                                                                |
| <b>Attributing income</b>                            | 35. CFC rules should not automatically apply simply because the parent country tax rate is higher than a subsidiary.                                                   | The recommendation is to include a tax rate exemption, so the CFC rules only apply where the ETR is <u>meaningfully below</u> the tax rate in the parent country (there is no guidance on what is "meaningfully below").                                                                                                                                                                                                                                             |
| <b>Rules to prevent or eliminate double taxation</b> | 36. Foreign tax credits should include both corporate income tax and trade taxes.                                                                                      | The final report recommends allowing a credit for foreign taxes on income actually paid (including withholding taxes and CFC tax assessed on intermediate companies).                                                                                                                                                                                                                                                                                                |
|                                                      | 37. Double taxation can also be caused by other timing differences not mentioned in the DD, e.g. dividend add-back rules and thin capitalisation restrictions.         | The final report only considers 3 scenarios of double taxation (CFC income is also subject to foreign corporate taxes, CFC rules in more than one jurisdiction apply to the same CFC income, and the distribution of dividends out of income that has already been attributed to its resident shareholders under CFC rules). It acknowledges there may be other scenarios of double taxation although there are no recommendations in how these should be addressed. |