

The Controlled Foreign Company Regime in the EU CCTB Proposal

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1. Background
2. Description of the Regime
3. Detailed Technical Analysis and Critique
4. Relation to Primary EU Law
5. Outlook

The CCTB-CFC Regime

BACKGROUND

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- BEPS 3
- ATAD
- 2011 CCCTB Proposal

The CCTB-CFC Regime

DESCRIPTION OF THE REGIME

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- Purpose and Effect
- Personal Scope
- Territorial Scope
- Substantive Scope
- Mechanism

- **Purpose and Effect**
- Personal Scope
- Territorial Scope
- Substantive Scope
- Mechanism

- create a “level-playing field regarding the level of tax and competition”
- within the internal market
- protect against base erosion vis-à-vis third countries
- by reattributing income of low-taxed controlled subsidiaries to the parent
- in order to “discourage” profit shifting

- Purpose and Effect
- **Personal Scope**
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- "the taxpayer" = parent company (as defined in Art. 4(1) CCTB)
- "the entity" = subsidiary (CFC) (as defined in Art. 4(30) CCTB)
- "permanent establishment" can also be CFC (as defined in Art. 5 CCTB)

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- EU and third countries
- contrast with 2011 Proposal
- reflective of different purpose (tackling internal market tax competition)
- rules on EU, EEA and third countries differ in strength

- Purpose and Effect
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- Control + low effective taxation
- Control =
  - >50% direct/indirect voting rights
    >50% direct/indirect ownership
    >50% profit entitlement
- Low effective taxation=
  - <50% compared to tax in taxpayer jurisdiction
- Exceptions (≠ ATAD):
  - "Cadbury Schweppes Exception" (<ATAD)
  - 2/3 Active Income Exception (>ATAD)
  - 2/3 Arm's Length Exception (>ATAD)

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- Principle
  - attribution <u>proportional</u> to profit entitlement
  - <u>non-distributed</u> CFC income (≠ ATAD: alternative of income from "non-genuine" arrangement)
  - same year inclusion
- CFC Losses to be carried forward against future CFC inclusions
- Exemption for subsequent distribution
- Credit for tax levied in CFC jurisdiction?

The CCTB-CFC Regime

DETAILED ANALYSIS & CRITIQUE

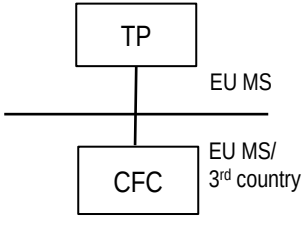
- **Personal Scope**
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- "Entity" is "any legal arrangement to carry on business through either a company or a structure that is transparent for tax purposes" (Art. 4(30) CCTB)
  - Encompasses PE? (defined in Art. 5 CCTB)
- "PE" included where "not subject to tax or exempt" in head office MS – follows from Art. 8(e) CCTB
- Two reasons to include PEs (BEPS 3):
  1. same BEPS risk as with subsidiary
  2. PEs of CFCs should be included in scope of income attribution

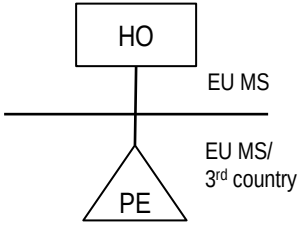
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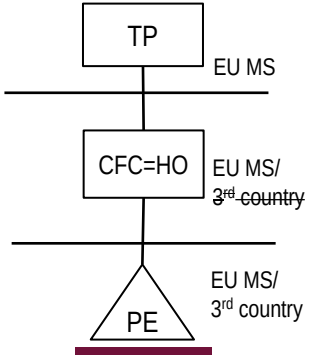
- "An entity, or a permanent establishment of which the profits are not subject to tax or are exempt from tax in the Member State of its head office', shall be treated as a controlled foreign company" (Art. 59(1) CCTB)
- "entity" or "PE" irrespective of location in MS
- PE only included where head office is in MS?



case 1



case 2



case 3

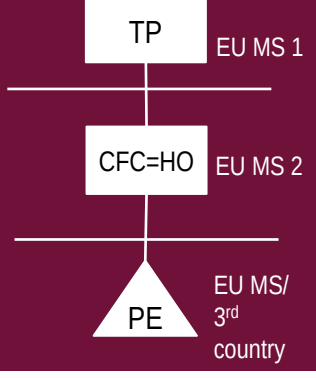
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- Control criteria:
  - only relevant for “entity”; PE always “controlled”
  - combine associated companies’ share (Art. 56(2) CCTB: 20% VR or capital)
  - “direct or indirect participation” – not defined in Art. 59 CCTB → simple multiplication
- Low Taxation:
  - defined as $T_A < T_D - T_A$ ($\rightarrow T_A < T_D/2$)
  - T_A = tax actually charged on CFC
  - T_D = fictional tax chargeable *in taxpayer jurisdiction*
  - In computing T_D, ignore exempt PE income in CFC jurisdiction in “case 3” described above

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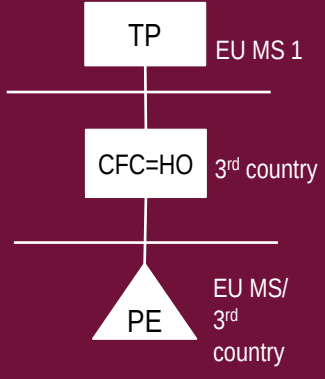
- In computing T_D, ignore exempt PE income in CFC jurisdiction in "case 3" described above
- PE income is *normally* exempt (Art. 8(e) CCTB)
- No problem, since MS 2 also applies CFC rules to HO



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- If CFC is in 3rd country…
- …and that country exempts PE,
- …then the PE income is <u>not</u> taken into account in determining low tax of CFC
- …and thus not effectively included in EU
- <u>opening a gap in coverage</u> that can be exploited by setting up PEs
  (if the PE were incorporated, its exempt income would be included since the TP had indirect control over it)



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- Proportional attribution based on profit entitlement
- CFC income categories:
  - interest or any other income generated by financial assets;
  - royalties or any other income generated from intellectual property;
  - dividends and income from the disposal of shares;
  - financial leasing;
  - insurance, banking and other financial activities;
  - invoicing companies' income

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❖ Credit for foreign tax on CFC?

- ❖ No explicit rule (in contrast to Art. 8(7) ATAD)
- ❖ Art. 55 CCTB includes general FTC provision: "A deduction from the tax liability ('tax credit') of a taxpayer shall be allowed where that taxpayer derives income that has been taxed in another Member State or in a third country"
  – applicable?
- ❖ Art. 53 CCTB included a specific FTC provision for case of Switch-over
  – superfluous?
- ❖ OECD BEPS Action 3 clearly recommends granting a credit
  – relevant?

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- Relief for subsequent income distribution (Art. 60(4) CCTB)
  - deduction of previously included income from the tax base
  - only applies where CFC income is distributed to "the taxpayer"
  - double taxation persists if income is distributed to another person due to ownership change
  - forces distribution of income prior to sale
- Relief from double taxation in case of sale of shares
  - sale proceeds reduced by undistributed profits
  - does not eliminate need to distribute before sale

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RELATION TO PRIMARY LAW

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- Fundamental Freedoms
- State Aid

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- Freedom of Establishment / Freedom of Capital?
- Justification: Need to combat abusive practices
- Presumption of abuse?
  - *Cadbury Schweppes Exception* excludes EU or EEA companies "set up for valid commercial reasons that reflect economic reality" – allows taxpayers to rebut presumption
  - "to the extent that … supported by staff, equipment, assets and premises"
  - not extended to 3rd country entities (≠ ATAD) potential conflict with FoC as Art. 59 CCTB covers situations without definite influence
  - limit of attribution to "passive income" insufficient to justify presumption

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- Fundamental Freedoms
- State Aid

- Can a mandatory exception be State Aid?
  - Art. 107 applies to MS measures only
  - but directives must be implemented, implementation must comply with primary law
  - distortion of competition?
- 2/3 Active Income Exception
  - “not more than one third of income … falls within categories (a) to (f)”
  - reasonable in light of legislative purpose to distinguish between entities with significant passive income and others
- 2/3 Arm’s Length Exception
  - applies only to financial undertakings
  - financial undertakings in different situation to non-financial undertakings?

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- CFC as potential treaty override (≠ OECD view)
- Art. 351 TFEU: EU law does not affect treaties with 3rd countries concluded prior to accession
- *A contrario*, newer treaties are subject to EU law
  - However, DTCs are not directly overridden (no direct effect) by CCTB
  - Member States must implement (and override DTCs) even where treaty override is unconstitutional
  - Application of Art. 351 by analogy to treaties concluded prior to adoption of CCTB?

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- EU DTC Competence

- Does the CCTB lead to a shift in the EU external competence in tax matters?
  - Can EU conclude a DTC with 3rd countries?
  - Can MS still do so after CCTB?
- *ERTA* doctrine:
  - Exclusive EU external competence where an area is “largely covered” by EU law
  - Art. 3(2) TFEU: ‘The Union shall also have exclusive competence for the conclusion of an international agreement … in so far as its conclusion may affect common rules …’

Questions & Comments?

THANK YOU FOR YOUR ATTENTION!