

# **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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## Research Article

## Open Access

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# 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.<sup>1</sup>

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

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<sup>1</sup> Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market, COM (2016) 26 final.

its current form.<sup>2</sup> The insights resulting from such an assessment could, hopefully, be useful for legislators, when reconsidering the design of the Nordic CFC regimes, and for practitioners curious of what to expect.

The article starts out with briefly providing some general background with respect to the need, purpose, and spread of CFC legislation (section 2). In this context, the article also contains a short, introductory explanation of the recent efforts of the OECD/G20 and the European Commission in the area of CFC taxation. Subsequently, a comparative analysis is carried out (section 3). As part of this analysis, the national CFC rules of the Nordic countries are compared with each other, as well as with the recommendations of the BEPS report and the CFC rules in the proposal for an ATA Directive. The comparative analysis is followed by two shorter sections (sections 4 and 5) providing insights into the Nordic discussions and case law concerning the potential conflict between the CFC regimes, EU primary law, and tax treaties, as these issues are also touched upon in the OECD/G20's recommendations on CFC legislation. Finally, an overall assessment is made (section 6).

## 2 Background

Basically, the application of CFC legislation entails that income of a CFC is taxed in the hands of the shareholder(s), even though the CFC has not made a distribution of dividends, and despite the fact that the CFC is a separate entity for tax purposes. In other words, the CFC legislation ensures current taxation by the shareholder's residence state of the income accruing in the CFC (Garfunkel (2010)).

Subject to variations among the different states' regimes, CFC taxation is only triggered if certain requirements are fulfilled, for example, concerning ownership percentage (control requirements), the existence of passive/mobile income generated by the CFC (income/activity requirements) and/or the lack of taxation in the residence state of the CFC (low-tax requirements). Provided that the requirements are fulfilled, the resident shareholder typically has to include a pro-rata share of the income of the

CFC in the shareholder's own taxable income. How to define, compute, and attribute the income of the CFC varies considerably among the states that have enacted the CFC legislation.<sup>3</sup> However, despite these variations, the various CFC regimes in place generally do not directly raise a lot of revenue in the residence state of the shareholder. The reason is that the CFC rules are mainly designed to act as a deterrent, that is, to have a prophylactic effect. Accordingly, the CFC rules are intended to protect the tax revenue by ensuring that profits remain within the tax base of the shareholder (OECD (2015a)).

### 2.1 Need and Purpose of CFC Legislation

If (effective) CFC rules are not in place, it is relatively easy for taxpayers to reduce the overall tax burden by shifting the mobile assets and income to a company/subsidiary in a low-tax country.<sup>4</sup> This opportunity for profit shifting mainly rests on two grounds (Sandler (1998)).

Firstly, most states (if not all) recognize that a company should be considered as a separate entity (also) for tax purposes. Accordingly, the profits of a foreign company should be insulated from tax in the residence state of the shareholders, at least until the time of repatriation (Garfunkel (2010)).<sup>5</sup> This postponement of domestic taxation is commonly referred to as *deferral* or *sheltering* of income (OECD (1996); Broe (2008)). Moreover, if the shareholder's state of residence does not tax the dividends received by the shareholder or any capital gains on the shareholding – for example, because a participation exemption applies – the end result will be that the taxation in the shareholder's state of residence is not only deferred, but completely avoided.<sup>6</sup>

Secondly, the aforementioned opportunity for profit shifting obviously depends on the fact that jurisdictions with low or no corporate tax exist. In other words, deferral or sheltering of income is only beneficial to the extent that the foreign tax is less than the domestic tax. The size of the

<sup>2</sup> Norway and Iceland are not members of the European Union. Accordingly, EU directives on direct taxation do not apply to Norway and Iceland, despite the fact that both countries are part of the European Economic Area (EEA). However, being a part of the EEA, Norway and Iceland are obliged to respect the EEA Agreement, which guarantees the same basic freedoms to the nationals of the EEA states as the Treaty on the Functioning of the European Union (TFEU) provides for nationals of the EU member states. See Helminen (2015).

<sup>3</sup> For a comprehensive comparative overview of the various requirements and legal effects concerning CFC regimes, see Dahlberg & Wiman (2013); Aigner *et al.* (2004); Arnold & Dibout (2001); Sandler (1998), and Arnold (1986). See also OECD (1996).

<sup>4</sup> For a more thorough explanation and exemplification, see Rust (2008).

<sup>5</sup> More precisely, a foreign company is only subject to tax in the residence state of its shareholders if it earns income from sources in that state and such income is taxable there.

<sup>6</sup> In this context, it should be noted that tax deferral over a long enough period could be just as beneficial for the taxpayers as an actual tax exemption (Isenbergh (2008)).

benefit depends on the difference between the foreign and domestic tax rates, the length of the period of deferral, and the prevailing interest rates (Arnold (1986)).

The policy objectives behind the introduction of CFC rules differ among the states that have enacted such legislation. However, fundamentally, the CFC legislation is typically seen as an instrument to guard against the unjustifiable erosion of the domestic tax base by the export of investments to non-resident corporations (OECD (1996)).

The differences among the CFC regimes in place, including the reason why some states have abstained from introducing CFC rules, have partly been explained by the fact that some states mainly follow a doctrine of capital export neutrality (and therefore, mainly grants credit relief for foreign taxes), whereas others follow a doctrine of capital import neutrality (and hence, mainly applies the exemption method) (OECD (1996)).<sup>7</sup> However, even states that normally apply the exemption method have enacted the CFC legislation. In these cases, the CFC rules, thus, prevent the outright exclusion from domestic taxation of certain foreign-source income (Sandler (1998); Blanluet & Durand (2011)).

## 2.2 Development and Spread of CFC Legislation

As the first country in the world, the United States adopted CFC legislation in 1962.<sup>8</sup> This piece of legislation – better known as the Subpart F rules – was a diluted version of the original proposal put forward by the Kennedy Administration, which more generally intended to introduce what later has been described as the policy of capital export neutrality. Accordingly, the enacted rules had a more narrow scope and mainly focused on limiting tax deferral by the use of foreign tax haven devices (Lokken (2005)).<sup>9</sup>

In the 1970s, Canada, West Germany, and Japan also introduced CFC legislation, and more countries joined in the 1980s and 1990s. Hence, at least 15 countries had enacted CFC legislation in the mid 1990s (OECD (1996)).

In 1998, the OECD Council adopted a recommendation in which it recommended that countries, which did not have CFC rules, should consider adopting such rules, and that countries that had such rules should ensure that the rules applied in a fashion consistent with the desirability of curbing harmful tax practices (OECD (1998)). Subsequently, more countries followed and currently, more than 30 countries have CFC legislation in place (OECD (2015a)).

In a Nordic context, Sweden was the first country to introduce CFC legislation.<sup>10</sup> The reason behind the introduction of the rules was the abolition of the Swedish Exchange Control Act (Dahlberg (2012)), and the rules were introduced without any extensive explanations or explicit emphasis on the objective of protecting the tax base. However, in connection to later amendments of the CFC rules, the objective of protecting the tax base against tax planning involving companies in low-tax countries has been further clarified and emphasized (Gerson (2013)).<sup>11</sup> The Swedish CFC rules took effect from 1 January, 1990, and the legislation emerged following the review of a government commission established in 1981.<sup>12</sup>

In 1992, Norway followed Sweden's lead and introduced the CFC rules as a consequence of the abolition of the regulations on currency control.<sup>13</sup> Accordingly, after the removal of the currency control, the legislator was concerned about erosion of the Norwegian tax base through the use of CFCs in low-tax countries (Gjems-Onstad *et al.* (2015); Svensen (2013); Zimmer (2009), and Naas *et al.* (2011)).<sup>14</sup> As a consequence, the Norwegian CFC rules – known as the *NOKUS rules* – were adopted.

Finland introduced CFC legislation in 1994,<sup>15</sup> as the legislator found that CFC rules were necessary in order to prevent the avoidance of Finnish taxation as well as

<sup>7</sup> However, it must be acknowledged that it may be too simplistic to consider the states' international tax policies as a choice or compromise between the capital export neutrality and capital import neutrality (Graetz (2001)).

<sup>8</sup> The Revenue Act of 1962 (U.S.). The rules are to be found in the Subpart F of part III of subchapter N of Chapter 1 of subtitle A of the Internal Revenue Code (U.S.).

<sup>9</sup> For more background, see Avi-Yonah (2005). In the later years, the Subpart F rules have been criticized for being inefficient (Kraft & Beck (2012)).

<sup>10</sup> Inkomstskattelag [IL] [Swedish Income Tax Act] 39a: 1–14 (Swe.). Introduced by adoption of Proposition 1989/90:47 om vissainternationellaskattefrågor [government bill] (Swe.).

<sup>11</sup> Major amendments to the Swedish CFC rules were adopted in 2004.

<sup>12</sup> For more background on the introduction of the Swedish CFC rules, see Wenehed (2000).

<sup>13</sup> Skatteloven [SKTL] [Norwegian Tax Act] sec. 10–60 to 10–68 (Nor.). Introduced by adoption of Lovnr. 41 af 20. April, 1992 [act of parliament] (Nor.).

<sup>14</sup> The preparatory remarks in Ot. prp. 16 1991-92 and Innst. O. 47 1991-92 Deltagerligning av norske skattydere i utenlandske aksjeselskaper samt utenlandske formuemasser [government bill] (Nor.).

<sup>15</sup> Laki ulkomaisten väliytteisöjen osakkaiden verotuksesta [VYL] [Finnish Act on Taxation of Shareholders in Controlled Foreign Companies] (Fin.). Introduced by adoption of Act no. 1217/1994. Already in 1979, it was considered to introduce the CFC legislation, cf. Rapakko (1989).

the accumulation of taxable income in low-tax jurisdictions (Leväjärvi (2013)). Considerable amendments to the regime have been made under way, most notably in 2009 (Helminen (2009)).

Denmark introduced the CFC rules in 1995, following lengthy considerations about the pros and cons of such legislation.<sup>16</sup> From the preliminary remarks to the bill introducing the CFC rules, it followed that the objective behind the new rules was to prevent erosion of the Danish tax base caused by the increasing openness of borders to the flows of capital.<sup>17</sup> More specifically, the aim of the CFC rules was to prevent Danish companies from establishing subsidiaries in low-tax countries and moving income and assets hereto. The Danish CFC legislation has been amended several times since the introduction in 1995.<sup>18</sup>

Finally, Iceland was the last of the Nordic countries to introduce CFC legislation.<sup>19</sup> The rules were introduced in 2009 and modeled after the Norwegian CFC rules (Gudmundsson & Jóhannesson (2010)). The objective of introducing the CFC rules was to combat tax avoidance caused by the general liberalization of capital movements in the world. However, as capital movements have been heavily restricted in Iceland in the years following the financial crisis, the relatively new CFC rules have not yet been applied much in practice (Agnarsdóttir & Jensdóttir (2014)).

### 2.3 The OECD/G20 BEPS Project and CFC Legislation

The BEPS project has rightly been described as the result of a perfect storm (Brauner (2014)). In other words, massive media coverage of tax planning schemes used by multinationals triggered a wider political interest, which was exacerbated by the world's economic downturn. One of the initial results of this perfect storm was the release of the

report addressing BEPS in February 2013 (OECD (2013a)). The report was followed by the adoption of an action plan in September 2013 (OECD (2013b)), which identified 15 actions along 3 key pillars: (1) introducing coherence in domestic rules that affect cross-border activities, (2) reinforcing substance requirements in the existing international standards, and (3) improving transparency as well as certainty. The work carried out according to the action plan resulted in a package of 13 final reports, one of them dealing with the design of effective CFC rules (OECD (2015a)).<sup>20</sup>

Even though the BEPS project has been subject to criticism – inter alia with respect to the project's lack of clear goals and scope combined with unrealistically tight deadlines (Brauner (2014)) – it appears correct to claim that the BEPS project may be the most ambitious reform ever undertaken in the field of international taxation (Pistone (2014)). In the words of the OECD/G20, the BEPS package of measures, thus, represents the first substantial renovation of the international tax rules in almost a century, with the overall aim of realigning taxation with economic activities and value creation (OECD (2015c)).

Action 3 of the BEPS project concerns the rules on CFC taxation and belongs to the key pillar dealing with the introduction of coherence in domestic rules that affect cross-border activities (OECD (2015a)). The objective behind Action 3 was to develop recommendations for CFC rules that are effective in dealing with BEPS. These recommendations take the form of “building blocks,” and it is specifically stated in the report that the recommendations should not be seen as minimum standards. Instead, the recommendations are designed to ensure that the countries' CFC rules will effectively prevent the taxpayers from shifting income into foreign subsidiaries, and at the same time ensure that sufficient flexibility is provided to implement rules in a manner that are consistent with the policy objectives of the overall tax system of the country concerned. The “building blocks” include the following:

1. Rules for defining a CFC (including definition of control)
2. CFC exemptions and threshold requirements

<sup>16</sup> Selskabsskatteloven [SEL] [Danish Corporate Tax Act] sec. 32 (Den.). Introduced by adoption of Lovnr. 312 af 17 May, 1995 (act of parliament) (Den.). The possibility of introducing the CFC rules was already discussed 10 years earlier by a committee appointed by the minister of taxation, cf. Betænkningnr. 1060, 1985 [government recommendation] (Den.). Back then, the committee concluded that the CFC legislation would be too hard to administer.

<sup>17</sup> Lovforslag L 35 (1994/1995) Forslag til lov om ændring af forskellige skattelove – international beskatning [governmentbill] (Den.).

<sup>18</sup> For more background on the purpose and development of the Danish rules, see Schmidt (2013a).

<sup>19</sup> Lög um tekjuskatt[TSKL] [Icelandic Income Tax Act] art. 57a (Ice.). Introduced by adoption of Act 46/2009, art. 2. See also Regulerd um skattlagninguvegnaeignarhalds í lögaðilum á lágsfattasvæðum [Finance Ministry regulation] no. 1102/2013 (Ice.).

<sup>20</sup> The work on the CFC rules has been co-ordinated with the work on some of the other action points, mainly action 1 on tax challenges of the digital economy (OECD (2015e)), action 2 on hybrid mismatch arrangements (OECD (2015f)), action 3 on interest deductions (OECD (2015g)), action 5 on harmful tax practices (OECD (2015c)), and actions 8–10 on transfer pricing (OECD (2015h)). Thus, the reports concerning these action points also contain some considerations regarding the CFC rules. For more on the interaction between the actions on CFC rules and transfer pricing rules, see Dourado (2015).



3. Definition of CFC income
4. Rules for computing income
5. Rules for attributing income
6. Rules to prevent or eliminate double taxation.

## 2.4 The Anti-Tax Avoidance Directive and CFC legislation

On 28 January 2016, the European Commission published its so-called Anti-Tax Avoidance Package,<sup>21</sup> which among other things includes the aforementioned proposal for an ATA Directive. The proposal for an ATA-directive contains legally binding anti-avoidance measures, which all member states should implement in order to shut off major areas of aggressive tax planning, and the overall aim is to ensure that companies that benefit from the single market and generate profits there should pay tax on those profits within the EU, where the activity takes place.<sup>22</sup> The Commission believes that unilateral action by the member states would not adequately tackle the problem of aggressive tax planning and would create problems. More specifically, the Commission fears that a unilateral and divergent implementation of the OECD/G20 BEPS measures by each member state could fragment the single market by creating policy clashes, distortions, and tax obstacles for businesses, and at the same time create new loopholes and mismatches that could be exploited by companies seeking to avoid taxation.

The proposal for the ATA Directive draws on the work previously carried out by the Commission in the course of the proposal for a Common Consolidated Corporate Tax Base (CCCTB).<sup>23</sup> The proposal for a CCCTB directive was put forward in 2011, but so far, agreement has not been reached. The Commission intends to put forward a revised CCCTB proposal in autumn 2016, but it seems to anticipate that an agreement on this proposal cannot be obtained quickly. Accordingly, the Anti-Tax Avoidance Package, including the ATA Directive, should represent a pragmatic

approach that sets out initiatives, which can take effect prior to agreement and introduction of the CCCTB.

Having the aim of combating tax avoidance practices that directly affect the functioning of the internal market, the ATA Directive, thus, lays down anti-avoidance rules in the following six specific fields: deductibility of interest, exit taxation, a switch-over clause, a general anti-avoidance rule (GAAR), the CFC rules, and rules to tackle hybrid mismatches. These rules should create a level playing field of minimum protection for all member states' corporate tax systems. Accordingly, the intention is that the ATA Directive should include principle-based rules that leave the detail of implementation to the member states, with the understanding that they are better placed to shape the precise elements of the rules in a way that best fits their corporate tax systems.

Art. 8 and 9 of the ATA Directive contain the proposed CFC rules. The conditions for the application of the CFC rules are laid out in art. 8, whereas art. 9 concerns the computation of the CFC income. The aim of the proposed rules is to eradicate the incentive of shifting income to low-taxed subsidiaries, and in this regard, the Commission refers to a study that shows that the CFC rules, if well designed and effective, are critical anti-abuse rules as they could defeat most "model aggressive tax planning structures" identified in the study. According to the Commission, the proposed CFC rules in the ATA Directive have been discussed in the context of the CCCTB proposal, and the proposed rules should generally be considered in line with the outcome of Action 3 of the OECD/G20 BEPS project.<sup>24</sup>

## 3 Comparative Analysis

During the last decade, the statutory corporate tax rates have been lowered substantially in the Nordic countries, as a result of international tax competition. However, at the same time, the Nordic countries have been busy introducing and revising anti-avoidance rules to protect their corporate tax bases (Folkvord & Riis (2014)). These efforts have also included the introduction and revision of the CFC rules.

In the following section, a comparative analysis of the CFC rules in the Nordic countries is carried out. The analysis can best be described as a micro-level, functional com-

<sup>21</sup> Communication from the Commission to the European Parliament and the Council – Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU, COM (2016) 23 final.

<sup>22</sup> The Anti-Tax Avoidance Package builds on the action plan published by the Commission in June 2015, cf. Communication from the Commission to the European Parliament and the Council – A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, COM (2015) 302 final.

<sup>23</sup> Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM (2011) 121/4.

<sup>24</sup> Commission Staff Working Document, SWD (2016) 6/2, which refers to the Study on Structures of Aggressive Tax Planning and Indicators, European Commission working paper n. 61, 2015, by Ramboll Management Consulting and CORIT Advisory.

parison with respect to a specific legal problem;<sup>25</sup> namely how the jurisdictions within the Nordic legal family have addressed the problem of parent companies shifting mobile income to the subsidiaries in low-tax countries, by ensuring the current taxation in the parent company's residence state of the income accruing in the subsidiary.<sup>26</sup> However, because of recent international developments, the national CFC rules of the Nordic countries are not only compared with each other, but also with the recommendations of the BEPS report and the CFC rules in the proposal for the ATA Directive.

In order to facilitate a proper structure, the analysis will deal separately with each of the six "building blocks" for CFC legislation suggested in the BEPS report. Accordingly, a sub-section will be devoted to each "building block," and each sub-section will initially outline the OECD/G20's recommendations with respect to the "building block" in question. Subsequently, in each sub-section, the relevant parts of the CFC rules in the proposed ATA Directive will be presented, and finally, the relevant and most significant parts of the national CFC rules will be laid out. Along the way, the main similarities and differences will be pointed out.<sup>27</sup>

The analysis of the Nordic CFC regimes has been carried out by studying the wording of the legislation itself (and in case of Finland and Iceland translations hereof), as well as relevant Nordic case law. Moreover, information has been obtained from numerous books and articles,

which analyzes and describes the CFC rules of the Nordic countries.<sup>28</sup>

### 3.1 Rules for Defining a CFC

The BEPS report initially states that a jurisdiction must consider two questions in order to establish whether the CFC rules should apply (OECD (2015a)). Firstly, it should be considered whether a foreign entity is of the type that would be considered a CFC, and secondly, it should be established whether the parent company has sufficient influence or control over the foreign entity for the foreign entity to be a CFC. These two questions will be dealt with separately in the following paragraphs.

With respect to the first question, the BEPS report recommends to broadly define the entities within the scope of the rules. Accordingly, in addition to including corporate entities, the CFC rules should also apply to certain transparent entities and PEs (to the extent that the income is not already taxed in the parent/headquarter jurisdiction). Moreover, it is recommended to include a form of hybrid mismatch rule to prevent entities from circumventing the CFC rules through different tax treatment in different jurisdictions (OECD (2015a); see sec. 2.1).<sup>29</sup> All together, the BEPS recommendation with respect to defining a CFC is not particularly precise and the supplementary explanations have been kept rather brief.

The CFC rules of the proposed ATA Directive do not define which types of foreign entities the CFC rules should cover. In addition, no CFC-focused hybrid mismatch rule is laid out. However, the ATA Directive does state that the income to be included in the tax base of the parent should be calculated in accordance with the corporate tax rules of the member state where the taxpayer is resident.<sup>30</sup> This may imply that any hybrid mismatch rules, generally applying under the corporate tax rules of the parent's member state (including the national hybrid mismatch rules based on the ATA Directive), should also apply when dealing with CFCs.

With Denmark as a notable exception, the CFC regimes of the Nordic countries only apply to foreign entities. Thus,

<sup>25</sup> Micro comparisons usually focus on a relatively limited legal problem, and functional comparisons aim at localizing how the same legal problem has been addressed in different legal systems. See, for example, Bogdan (2013).

<sup>26</sup> The legal systems of the Nordic countries undoubtedly have differences, but allegedly it still makes sense to speak about the Nordic legal systems as constituting a (distinct) legal family as discussed by Husa *et al.* (2008)). Even though the classification and division into legal families may be difficult and subject to criticism, as correctly pointed out by Kristoffersen (2015), it seems appropriate to demarcate the analysis to the Nordic countries, especially when taking into account that four out of the five Nordic CFC regimes were introduced in the early 1990s, and thus share the feature of being relatively mature regimes. Moreover, the fifth CFC regime (the Icelandic one) was actually modeled after one of the other regimes (the Norwegian one).

<sup>27</sup> Considering the aim and constraints of this article, a full analysis of the quite comprehensive CFC rules in the Nordic countries is not undertaken. Instead, focus will be on providing an overview, which can form a sufficient basis for an interim Nordic assessment of the BEPS recommendations and the ATA Directive concerning the CFC legislation. As the BEPS project and the ATA Directive focus on corporations, and so on, this article will not consider the CFC rules applicable to individuals.

<sup>28</sup> See section 7 for a complete list of references.

<sup>29</sup> An example of the suggested hybrid rule is made in the report. See also Dourado (2015), who correctly argues that the CFC rules in such cases act as back-stop to anti-hybrid measures, which only operate when the mismatch directly occurs between two countries. Further, see the CFC-related considerations in the report on hybrid mismatch arrangements (OECD (2015f)).

<sup>30</sup> Art. 9 (1) of the ATA Directive.

in an attempt to align its CFC legislation with the EU law, the Danish CFC rules for companies also apply to domestic entities.<sup>31</sup> As a starting point, the CFC rules of all five countries apply, concerning the entities that are to be considered separate taxable entities, that is, primarily corporations. However, the Finnish CFC regime can also be applied to entities such as funds, foundations, and trusts (Leväjärvi (2013)).<sup>32</sup> Also, the Icelandic and Norwegian CFC rules have a somewhat similar broad scope.<sup>33</sup> By contrast, a trust or a foundation cannot constitute a CFC according to the Danish CFC regime.<sup>34</sup> However, Denmark has recently introduced a separate anti-avoidance legislation targeted at foreign trusts and foundations.<sup>35</sup> The Swedish CFC rules apply to foreign legal persons, except for the entities that are considered transparent for tax purposes abroad.<sup>36</sup>

The Finnish CFC rules were amended in 2009 in order to ensure that a PE of a foreign company (an indirectly owned PE) may be treated as a CFC if it is situated abroad in a state other than the residence state of the foreign company (Helminen (2009)).<sup>37</sup> Also, Denmark and Sweden have specific provisions in place that under given circumstances ensure CFC taxation of income in such indirectly owned PEs.<sup>38</sup>

All in all, the five Nordic CFC regimes thus appear, at least to a certain extent, to take into account that the use of other entities than corporations could also create risks related to BEPS. However, none of the Nordic CFC regimes appear to include a specific CFC-focused hybrid mismatch rule, as suggested in the BEPS recommendations.<sup>39</sup> Thus, it seems expedient for the Nordic legislators

to consider whether there may be a need for such a rule when/if revising their CFC regimes in the aftermath of the BEPS project.<sup>40</sup>

With respect to question two – whether the parent company has sufficient influence or control over the foreign entity for the foreign entity to be a CFC – the BEPS report recommends that the CFC rules should at least apply both a legal and an economic control test, where the latter mainly focuses on the rights to profits in certain circumstances, such as a disposal, dissolution, liquidation, and other distributions of profit (OECD (2015a); see sec. 2.1). Moreover, countries may include de facto tests to ensure that these control tests are not circumvented. Such a de facto test could inter alia look at who takes top-level decisions, who has influence over the day-to-day activities, or at any particular contractual ties. A CFC should be considered controlled where residents hold, at a minimum, more than 50% control. However, the BEPS report acknowledges that broader policy goals or prevention of circumvention may require a lower threshold. The level could be established through the aggregated interest of related parties or unrelated parties, or from aggregating the interests of any taxpayers that are found to be acting in concert. Accordingly, in this regard, the BEPS report suggests that countries apply either an “acting-in-concert test,” a “related party test,” or “a concentrated ownership requirement.”<sup>41</sup> Finally, it is stated that the CFC rules should apply in cases of both direct and indirect control.

Concerning the required level of control, the ATA Directive stipulates that the taxpayer by itself, or together with its associated enterprises as defined under the applicable corporate tax system, holds a direct or indirect participation of more than 50% of the voting rights, owns more than 50% of the capital, or is entitled to receive more than 50% of the profits of that entity. By using a 50% threshold and focusing on both direct and indirect participations, the ATA Directive’s CFC rules appear to be in line with the recommendations in the BEPS report concerning the control requirement. However, it should be noted that the ATA Directive’s reference to associated enterprises “as

<sup>31</sup> See also section 4.

<sup>32</sup> VYL 2 (Fin.).

<sup>33</sup> TSKL 57a (1) (Ice.) and SKTL 10-60 (Nor.). See also the case decided by Høyesteret [Norwegian Supreme Court] Rt. 2002 s. 747 (*Ptarmigan*) (Nor.), in which the court stated that the CFC rules could be applied with respect to a trust in Lichtenstein.

<sup>34</sup> SEL 32 (1) and (6) (Den.).

<sup>35</sup> Ligningsloven [LL] [Danish Tax Assessment Act] sec. 16 K (Den.). For more on these new rules, see Schmidt (2016).

<sup>36</sup> IL39a:1 (Swe.).

<sup>37</sup> VYL 2 (Fin.).

<sup>38</sup> SEL 32 (3) (Den.) and IL 39a:9 (Swe.).

<sup>39</sup> In the Danish literature, it has been discussed whether the rules on hybrid mismatches should apply in a CFC taxation context, and the conclusion appears to be that it is uncertain (Bundgaard (20007)). In general, however, the Danish administrative case law seems to support that all Danish tax provisions, including anti-avoidance provisions, should generally apply in a CFC context, unless it is explicitly stated in the provision or its preparatory remarks that the provision in question shall not apply in a CFC context, cf. Skatterådet [Tax Assessment Council], SKM2014.577.SR (Den.).

<sup>40</sup> Furthermore, Nordic legislators’ may need to consider how the (simultaneous) application of (new/enhanced) hybrid mismatch rules and the CFC rules should be dealt with, in order to avoid double/multiple taxation or situations where a deduction is disallowed even though the parent company has to include the payment in question due to the CFC rules. For more, see the considerations in the report on hybrid mismatch arrangements (OECD (2015f)).

<sup>41</sup> The ladder test could, for example, entail that the interests, of all residents, in the CFC are aggregated as long as each interest is higher than 10%.



defined under the applicable corporate tax system” gives the member states some leeway to design and apply the control requirement, as they would like. As a result, the scope of application of the CFC rules across the member states may (continue to) differ considerably, and the objective of securing a coherent and coordinated transposition of the BEPS measures into the member states’ national tax systems could be harmed.

A common feature of the Nordic CFC regimes is that they apply in cases of both direct and indirect control/influence. As a starting point, the Norwegian, Icelandic, and Finnish CFC regimes apply if the foreign entity is controlled by the resident taxpayers. Accordingly, these three regimes put emphasis on the fact that the resident taxpayers, taken together, own at least 50% of the capital or hold at least 50% of the voting rights in the foreign entity (the Finnish rules also apply if Finnish taxpayers are entitled to at least 50% of the yield).<sup>42</sup> The Norwegian and Icelandic rules contain no minimum requirement for each resident shareholder, whereas the Finnish rules state that a Finnish resident can only be taxed on CFC income if the taxpayer’s interest in the foreign entity is of least 25%.<sup>43</sup> Alternatively, the Icelandic CFC rules also apply if an Icelandic taxpayer can be considered to control the foreign entity, despite the fact that residents hold less than 50%.

The Danish CFC regime also generally applies a 50% threshold.<sup>44</sup> Thus, the Danish rules only apply if the resident company in question is a shareholder in the entity, and the group to which the shareholder belongs has decisive influence over that entity, that is, the right to control the economic and operational decisions of the entity. This will typically be the case if the group holds more than 50% of the voting rights in the entity. The Swedish CFC rules, on the other hand, apply if the Swedish taxpayer owns at least 25% of the foreign entity’s capital or holds at least 25% of the voting rights.<sup>45</sup>

All five CFC regimes include rules that ensure the control test is not circumvented. The Icelandic CFC rules, for example, apply even though less than 50% of the capital or voting rights are owned/held by Icelandic taxpayers, if it can be shown that the Icelandic resident benefits from the entity in a direct or indirect manner (Gudmundsson & Jóhannesson (2010)).<sup>46</sup> Also, the Norwegian CFC rules may apply even though the 50% the requirement is not met, if

Norwegian taxpayers through other means exercise control (Gjems–Onstad *et al.* (2015)).<sup>47</sup> The Swedish CFC rules apply a wide “definition” of control (Dahlberg (2012)), as control is generally to be understood as any influence on the operative or financial management of the entity, for example, by means of a shareholders agreement,<sup>48</sup> and the Finnish CFC rules safeguard that the individual 25% threshold cannot be avoided by splitting up the ownership between different related parties.<sup>49</sup> Finally, when assessing whether the group has decisive influence according to the Danish CFC regime, quite complex rules on “constructive ownership” have to be taken into account.<sup>50</sup>

In comparison with the BEPS recommendations and the ATA Directive, it is striking that Finland is the only Nordic country to apply both a legal and an economic ownership test, as the Finnish rules also apply if Finnish taxpayers are entitled to more than 50% of the yield. The other Nordic CFC regimes are based on the legal ownership of capital and/or voting rights. In order to be in line with the BEPS recommendations, and in case of Denmark and Sweden, comply with the Directive, an economic ownership test should, therefore, be added.

### 3.2 CFC Exemptions and Threshold Requirements

Exemptions and threshold requirements are commonly used to make CFC rules more targeted and reduce the administrative burden. In this regard, the BEPS report recommends that a tax rate exemption is included (OECD (2015a); see sec. 3.1). This exemption should exclude subsidiaries – that are subject to an effective tax rate that is sufficiently similar to the tax rate applied in the parent jurisdiction – from CFC taxation, and the exemption could be combined with a list, such as a white list. The exemption is based on the effective rate (actual tax paid divided by the CFC’s income), as this approach takes into account the tax base or other tax provisions that may increase or reduce the effective rate paid by the CFC. In this context,

<sup>42</sup> SKTL 10-62 (Nor.), TSKL 57a (3) (Ice.), and VYL 3 (Fin.).

<sup>43</sup> VYL 4 (Fin.).

<sup>44</sup> SEL 32 (6) (Den.).

<sup>45</sup> IL 39a:2 (Swe.).

<sup>46</sup> TSKL 57a (3) (Ice.).

<sup>47</sup> A concrete assessment has to be made. In a decision from Overligningsnemnda [Higher Tax Assessment Appeal Board] Utv. 2001 s. 343 (Nor.), the board found that the control test was met despite the fact that the Norwegian shareholder only owned 33.5% of the shares, as control should be considered obtained through agreements with other participants.

<sup>48</sup> How to assess whether persons should be considered to have shared interests are dealt with in IL 39a:3 (Swe.).

<sup>49</sup> VYL 4 (Fin.).

<sup>50</sup> SEL 32 (6) (Den.).

the CFC's income (the denominator) should be either the tax base in the parent jurisdiction if the CFC income had been earned there or the total income according to an international accounting standard, such as International Financial Reporting Standards (IFRS), with adjustments.

Even though the wording of the ATA Directive includes a low-tax condition, and not a low-tax exemption, the effect is the same, that is, CFCs that are subject to an effective tax rate, which is sufficiently similar to the tax rate in the parent company's jurisdiction, are excluded from the scope of the rules. More precisely, the article states that the CFC rules should only apply if, under the general regime in the country of the entity, profits are subject to an effective corporate tax rate lower than 40% of the effective tax rate that would have been charged under the applicable corporate tax system in the member state of the taxpayer.<sup>51</sup> Accordingly, in line with the BEPS report, the focus is on the effective tax rate of the CFC. However, it would have been expedient if the low-tax condition had been explained in more detail in the Directive, as experience has shown that such a condition can give rise to severe interpretational difficulties.<sup>52</sup>

In addition to the low-tax condition, the ATA Directive also states that the CFC rules should only apply if the entity is not a company whose principal class of shares is regularly traded on one or more recognized stock exchanges. Moreover, the CFC rules should not apply to financial undertakings that are resident in the EU/EEA or in respect of their PEs in one or more member states.<sup>53</sup> Finally, the CFC rules of the ATA Directive contain an exemption for entities resident in the EU/EEA with genuine economic activities.<sup>54</sup>

Concerning the use of a low-tax exemption/condition, the CFC regimes of all the Nordic countries, except for Denmark, are rather similar. Accordingly, the CFC rules of Swe-

den, Norway, Iceland, and Finland apply such an exemption/condition, and despite some differences with respect to calculation, these exemptions/conditions depend on a comparison of effective tax rates. The Swedish rules generally define low taxation as a rate lower than 55% of the Swedish rate,<sup>55</sup> and the general rule is supplemented with a geographically structured list that operates as a kind of white/gray list (Dahlberg (2012)).<sup>56</sup> The Norwegian and Icelandic CFC rules both define low taxation as a level lower than 2/3 of the Norwegian/Icelandic tax that would have been levied if the entity had been resident in Norway/Iceland.<sup>57</sup> Moreover, in Norway, a white/black list is issued and in Iceland, a black list is issued. Finally, the Finnish CFC rules define low taxation as a level that is less than 3/5 of the Finnish tax of the same income.<sup>58</sup> Also, in Finland, a black list is issued.

The CFC rules in Sweden, Norway, Iceland, and Finland all contain an exemption for the entities resident in the EU/EEA with genuine economic activities.<sup>59</sup> According to the Finnish CFC rules, this substance exemption also applies to the entities in treaty countries, unless the entity is located in a country mentioned in the black list, provided that information exchange is possible. More generally, the Finnish CFC rules do not apply if the foreign entity is resident in a treaty state, provided that the country is not mentioned in the black list or benefits from a specific tax relief (the black list includes treaty countries with a substantially lower tax level amounting to less than 75% of the Finnish tax level).<sup>60</sup> The Norwegian and Icelandic CFC rules do not apply with respect to the entities in treaty countries, provided that the entity in question does not mainly generate passive income.<sup>61</sup>

The Danish CFC rules are quite different from the others, as the Danish rules do not include a low-tax exemption/condition because the rules are meant to apply equally to foreign as well as domestic entities. Instead, the

<sup>51</sup> Art. 8(1)(2) of the ATA Directive.

<sup>52</sup> In a Nordic context, this has for example been the case concerning the low-tax condition applied under the previous Danish CFC regime (Schmidt (2013a)) and the current Norwegian CFC regime (Naas *et al.* (2011)). A recent decision from Høyesteret [Norwegian Supreme Court] BE: HR-2016-586-A (Nor.) shed light on some of the interpretational uncertainties. The decision has been commented by Folkvord (2016).

<sup>53</sup> Art. 8(2) of the ATA Directive. The reasoning behind excluding financial undertakings within the EU/EEA is that the CFC rules within this geographical area should be limited to artificial situations without economic substance, which would imply that the financial sector would be unlikely to be captured by the CFC rules, cf. the preamble to the ATA Directive, para. 10. However, as Haslehner (2016) correctly has argued, it seems surprising that such financial undertakings are *a priori* exempted from the CFC rules, as it suggests that these are entirely unsuspecting of the BEPS activities.

<sup>54</sup> This exemption is more extensively dealt with under section 4.

<sup>55</sup> IL 39a:5 (Swe.).

<sup>56</sup> IL 39a: 7 (Swe.).

<sup>57</sup> SKTL 10-63 (Nor.) and TSKL 57a (2) (Ice.).

<sup>58</sup> VYL 2 (Fin.).

<sup>59</sup> This exemption is more extensively dealt with under section 4.

<sup>60</sup> VYL 2 & 2a (Fin.). See the decision made by Korkein hallinto-oikeus [Supreme Administrative Court], KHO 2011:42 (Fin.), in which the court found that an entity resident in Singapore could not be considered a CFC, as Singapore was not included on the black list in that particular year.

<sup>61</sup> SKTL 10-64 (Nor.) and TSKL 57a (4) (Ice.). See also section 3.3. Pursuant to the Icelandic rules, it is also a requirement that the treaty in question or another international agreement make it possible for the Icelandic tax authorities to require all essential information.

Danish CFC rules should not apply if the group has opted for (Danish) voluntary international tax consolidation, if the entity in question is to be considered an “investment company,” or if the special rules for life insurance companies apply, as Danish taxation on a continuous basis has been secured through other means in these situations. Moreover, it may be possible to obtain an exemption from the Danish CFC rules with respect to subsidiaries operating within the financial sector.<sup>62</sup> However, permission will only be granted if a number of relatively strict conditions is fulfilled. Such industry exemptions are also known in some of the other Nordic countries. Thus, subject to certain conditions, the Swedish CFC rules do not apply to the entities engaged in international shipping activities,<sup>63</sup> and the Finnish rules do not apply if the income of the entity mainly originates from shipping, industrial, or other comparable production activities, including sales and marketing activities related hereto.<sup>64</sup>

Overall, the CFC regimes in Sweden, Norway, Iceland, and Finland seem to be broadly in line with BEPS recommendations concerning exemptions and threshold requirements as well as the relevant parts of the ATA Directive. However, as EU countries, Sweden and Finland may be forced to abolish or amend their industry/treaty exemptions if the ATA Directive is adopted. Denmark’s approach in this regard is quite different from the approaches set out in the BEPS recommendations and the ATA Directive. However, the BEPS report acknowledges that the EU member states can choose to apply the CFC rules to both domestic subsidiaries and foreign subsidiaries, in order to avoid a clash with for example, the freedom of establishment,<sup>65</sup> and the ATA Directive only contains minimum rules. Thus, it may be argued that the Danish CFC regime – despite its different design – may still be in line with both the BEPS recommendations and the ATA Directive concerning these matters.<sup>66</sup>

<sup>62</sup> SEL 32 (1-2) (Den.).

<sup>63</sup> IL 39a: 8.

<sup>64</sup> VYL 2 (Fin.). A recent court case found that the business activities of a Malaysian subsidiary performing certain IT services should be considered “other production activities.” Accordingly, the income of the subsidiary was not subject to the CFC taxation at the level of the Finnish parent company. See *Korkein hallinto-oikeus* [Supreme Administrative Court], KHO 2014/198 (Fin.).

<sup>65</sup> See also section 4.

<sup>66</sup> This also seems to be the view of the Danish Government, cf. Grund- og Nærhedsnotat til Folketingets Europaudvalg, SAU Alm. del 2015/2016 bilag 128 [Government memorandum] (Den.).

### 3.3 Definition of CFC Income

After determining that a foreign company should be considered a CFC, it has to be determined whether or not the income earned by the CFC is of the type that raises concern with respect to BEPS. In this context, the BEPS report recommends that the CFC rules should include a definition of income to ensure that income, which raises BEPS concerns, is attributed to controlling the shareholders in the parent jurisdiction (OECD (2015a); sec. 4.1). However, the BEPS report does not include an explicit definition of such income. Instead, the report acknowledges that flexibility is needed in order to ensure that jurisdictions can design CFC rules, which are consistent with their domestic policy frameworks. Accordingly, jurisdictions are free to choose their rules for defining the CFC income.

This recommendation appears weak and unfocused. It encourages jurisdictions to include a definition of CFC income, but without stating how this income should be defined. However, in the accompanying explanation, a non-exhaustive list of approaches, which jurisdictions could use, is provided. These approaches can be divided into four main approaches which may be combined with each other: (1) approaches using a categorical analysis, (2) approaches using a substance analysis, (3) approaches using an excess profits analysis, and (4) transactional and entity approaches.<sup>67</sup>

The categorical approach divides the income into categories and attributes income differently, depending on how it is categorized. The categories could be defined with reference to the legal classification (typically focusing on income, such as dividends, interest, insurance income, royalties and IP income, and sales and services income), relatedness of parties, and/or source of income.

The substance approach, on the other hand, focuses on whether the CFC’s income has been separated from the underlying substance, including people, premises, assets, and risks. Thus, the basic question to be answered (when using this approach) is whether the CFC had the capability to earn the income itself. In answering this question, it could be considered to apply a facts and circumstances analysis, an analysis focusing on the significant functions within the group, an analysis considering whether the CFC had the necessary business premises and establishment in the CFC jurisdiction to actually earn the income, or

<sup>67</sup> Regardless of which approach a jurisdiction chooses to apply, the recommendation states that the CFC rules, at a minimum, should capture the funding return allocated under transfer pricing rules to a low-function cash box.

an analysis based on a modified version of the so-called nexus approach.<sup>68</sup>

The excess profits approach would characterize the income in excess of a normal return earned in low-tax jurisdictions as CFC income. The normal return should be understood as the return that a normal investor would expect to make with respect to an equity investment. This approach has a mechanical nature and does not rely on a formal classification to determine whether income should be included.<sup>69</sup>

On the topic of defining the CFC income, the BEPS report finally notes that regardless of which type of analysis is used, jurisdictions need to decide whether to apply an entity approach or a transactional approach. Under the first approach, an entity that does not earn a certain amount or percentage of the CFC income will be found not to have any attributable income, even if some of the income would be of an attributable character. Accordingly, either all or none of the CFC's income will be included. Under the ladder approach, the character of each stream of income is assessed to determine whether that stream of income is attributable. Thus, under this approach, some income can still be included even if the majority of income does not fall within the definition of CFC income. Overall, the advantage of the entity approach is that it may reduce administrative burdens, but the disadvantage is that the approach is both over-inclusive and under-inclusive. In comparison, the transactional approach may increase the administrative burden, but it is generally more accurate in attributing the income.<sup>70</sup>

Concerning the definition of CFC income in the ATA Directive, the Directive appears to rely on some of the approaches exemplified in the BEPS report. Accordingly, elements of both the categorical approach and the substance approach can be traced in the CFC rules of the ATA Directive. Moreover, the ATA Directive relies on the entity approach when it comes to deciding on how much of the

CFC's income that should be attributed to the parent company.<sup>71</sup>

In more detail, the ATA Directive sets out an income condition, which will be met, if more than 50% of the income accruing to the CFC falls within the following categories:<sup>72</sup>

- Interest or any other income generated by the financial assets<sup>73</sup>
- Royalties or any other income generated from the intellectual property or tradable permits
- Dividends and income from the disposal of shares
- Income from financial leasing
- Income from immovable property, unless the member state of the taxpayer would not have been entitled to tax the income under an agreement concluded with a third country
- Income from insurance, banking, and other financial services
- Income from the services rendered to the taxpayer or its associated enterprises

In general the ATA Directive's definition of "tainted" income seems quite broad. However, the income condition of the ATA Directive shall apply to financial undertakings only if more than 50% of the entity's income in the aforementioned categories comes from the transactions with the taxpayer or its associated parties. In this regard, it should be remembered that the CFC rules should not at all apply to financial undertakings that are resident in the EU/EEA or in respect of their PEs in one or more member states.<sup>74</sup> Finally, it should be noted that elements of the substance approach can be found in the exemption set out in the ATA Directive, according to which, the CFC rules should not apply to the entities resident in the EU/EEA with genuine economic activities.<sup>75</sup>

All of the Nordic CFC regimes generally rely on the entity approach.<sup>76</sup> In addition, traces of both categorical approaches and substance approaches can be found among

<sup>68</sup> The nexus approach was developed in the context of BEPS action item 5 to ensure that preferential IP regimes require substantial activity (OECD (2015c)).

<sup>69</sup> A numerical example is provided in the report (OECD (2015a); see sec. 4.2.3).

<sup>70</sup> For a more thorough discussion of the pros and cons of these two alternatives, see the report itself (OECD (2015a)).

<sup>71</sup> See the wording of art. 8 (1), which simply states that "the non-distributed income" of the CFC should be included. See also Commission Staff Working Document, SWD (2016) 6/2, which explains that for simplicity reasons, the directive foresees that all the income of the CFC will be taken into account when the conditions are met.

<sup>72</sup> Art. 8 (1) (c) of the ATA Directive.

<sup>73</sup> The term "financial assets" is defined in art. 2 (3) of the ATA Directive.

<sup>74</sup> Art. 8(2) of the ATA Directive. See also section 3.2.

<sup>75</sup> Art. 8 (2) of the ATA Directive. This exemption is more extensively dealt with under section 4.

<sup>76</sup> VYL 4 (Fin.), TSKL 57a (5) (Ice.), SKTL 10-61 (Nor.), SEL 32 (1) & (7) (Den.) and IL 39a: 10-13.



the Nordic regimes.<sup>77</sup> Among the Nordic CFC regimes, only the Danish CFC legislation contains an explicit definition of “tainted” income that should trigger the CFC taxation.<sup>78</sup> Thus, according to the Danish rules, CFC taxation shall only take place if the CFC’s so-called “CFC income” amounts to more than 50% of the CFC’s total taxable income in a given year (and the “CFC assets” amount to more than 10% of the CFC’s total assets). An exhaustive list sets out which types of income that should be considered CFC income. The items considered to be CFC income mainly consist of different kinds of passive/mobile income, but the definition of CFC income in the Danish rules appears to be narrower than the definition set out in the ATA Directive. For example, opposite to the Danish rules, the definition in the ATA Directive also generally includes income from the services rendered to the taxpayer or its associated enterprises and certain income from immovable property. In addition, the Danish definition only includes *taxable* dividends and capital gains on shares, whereas the definition in the ATA Directive seem to categorize all dividends and capital gains on shares as tainted income. If this interpretation is correct, it may be argued that the CFC rules of the ATA Directive will end up having too broad a scope, which *inter alia* will not match well with the participation exemptions contained in the tax legislation of the some member states.<sup>79</sup>

As a main rule, the Norwegian and Icelandic CFC rules apply no matter what kind of income the CFC generates, provided that the other conditions for CFC taxation are fulfilled. However, as aforementioned, the Norwegian and Icelandic CFC rules do not apply with respect to the entities in treaty countries, unless the entity mainly generates passive income.<sup>80</sup> No explicit definition of passive income can be found in the Norwegian or Icelandic CFC legislation, but the preparatory remarks to the Norwegian rules contain some guidance. Accordingly, income from the passive management of capital and income from leasing should *inter alia* be included.<sup>81</sup>

Neither the Finnish nor the Swedish CFC rules contains a general passive income requirement/exception. However, as aforementioned, it should be taken into account that the Finnish CFC rules do not apply with respect to the entities in treaty countries, unless the entity is located in a country mentioned in the black list or benefits from a specific tax relief.<sup>82</sup> Moreover, with respect to the Swedish CFC rules (including the white/gray list), it should be noted that the income generated in CFCs in a number of jurisdictions is either completely or partly excluded from CFC taxation.<sup>83</sup> This contributes to making the scope of application of the Swedish CFC regime relatively narrow.

### 3.4 Rules for Computing Income

Concerning the rules for computing the income of the CFC, the BEPS report states that it is necessary to determine which jurisdiction’s rules should apply and whether any specific rules for computing CFC income are necessary (OECD (2015a); see sec. 5.1). Against this background, the BEPS report recommends to use the rules of the parent jurisdiction to calculate a CFC’s income. The reasoning behind this recommendation is that such an approach would be consistent with the goals of the BEPS action plan and would reduce the administrative costs compared with the other options that were considered.<sup>84</sup> In addition, the BEPS report recommends that jurisdictions should have a specific rule limiting the offset of CFC losses, so that they can only be used against the profits of the same CFC or against the profits of other CFC’s in the same jurisdiction. Here, the reasoning is that, allowing CFC losses to be offset against the profits of parent companies or CFC’s in other jurisdictions could encourage manipulation of losses in the CFC jurisdiction.<sup>85</sup>

The CFC rules in the ATA Directive are fully in line with these two recommendations. Thus, it is directly stated that the income to be included in the parent company’s tax base shall be calculated in accordance with the rules

<sup>77</sup> The Nordic CFC regimes’ use of exemptions for genuine economic activities in the EU/EEA may be considered a kind of substance approach. See also section 4.

<sup>78</sup> SEL 32 (5) (Den.).

<sup>79</sup> The Swedish government has noted that the proposal in the ATA Directive may interfere with the Swedish policy of exempting business-related dividends and capital gains on shares, cf. Skatteutskottets utlåtande 2015/16: SkU28 [Opinion from the Tax Committee] (Swe.).

<sup>80</sup> SKTL 10-64 (Nor.).

<sup>81</sup> For a thorough analysis of the concept passive income, see Naas *et al.* (2011).

<sup>82</sup> VYL 2 (Fin.).

<sup>83</sup> See for example the decision from Högsta Förvaltningsdomstolen [Supreme Administrative Court], RÅ 2008 ref. 11 (Swe.) in which a Swiss company’s income generated from an activity related to the handling of the group’s trademarks should not be subject to the Swedish CFC taxation, as the activity in question could not be considered “other financial activity.”

<sup>84</sup> The other options were to use the CFC jurisdiction’s rules, to allow taxpayers to choose, and finally, to use a common standard, such as the IFRS.

<sup>85</sup> For a numerical example, see the report itself (OECD (2015a); see sec. 5.2).



of corporate tax law of the member state, where the taxpayer is resident for tax purposes. In addition, it is explicitly mentioned that losses of the CFC shall not be included in the tax base, but shall be carried forward and taken into account when applying the CFC rules in subsequent tax years.<sup>86</sup>

With respect to computation and utilization of losses, the CFC regimes of all five Nordic countries appear to be in line with the BEPS recommendations, as well as the ATA Directive. Accordingly, pursuant to the CFC rules of all the Nordic countries, the income from the CFC to be included in the parent company's tax base shall be calculated in accordance with the rules of corporate tax law in the parent company's jurisdiction.<sup>87</sup> Some of the regimes include specific rules to address certain questions concerning how to make the computation. For example, both the Swedish and Danish regimes include specific rules on how to determine the entry values for the CFC's assets.<sup>88</sup>

In none of the Nordic jurisdictions is it possible to utilize the losses of the CFC to reduce the parent company's or other group companies' taxable income.<sup>89</sup> However, according to all of the Nordic CFC regimes, tax losses incurred by the CFC can be carried forward and set off against the positive income generated by the CFC in subsequent years. Pursuant to the CFC rules in Sweden and Finland, the CFC's tax losses may be carried forward for maximum 3 years and 10 years, respectively.

All together, the Nordic CFC regimes are, thus, in line with both the BEPS recommendations and the ATA Directive concerning the rules on how to compute the income. However, with respect to the ATA Directive, it should be noted that the calculation in accordance with the rules of

the corporate tax law of the member state where the taxpayer is resident for tax purposes, entails that the legal effect of applying the different member states' CFC rules may (continue to) vary significantly, as the corporate tax rules among the member states differ.

### 3.5 Rules for Attributing Income

When the amount of CFC income has been calculated, the next step is determining how to attribute that income to the appropriate shareholders of the CFC. In the BEPS report, this step is broken into five parts, and for each of these, the report sets out a recommendation (OECD (2015a); see sec. 6.1).

The first recommendation states that best practice would be either to tie the attribution threshold to the control threshold or to use another attribution threshold, which attributes income to, at minimum, the taxpayers who could influence the CFC. Such an approach should entail administrative simplicity and reduced compliance burdens. Moreover, it should ensure that taxpayers have enough influence to gather information on the activities and income of the CFC. The second recommendation states that the amount of income attributed to each shareholder or controlling person should be calculated by reference to both their proportion of ownership and their actual period of ownership. The third recommendation concerns the determination of when the income should be included in the tax returns of the taxpayers, and finally, the fourth recommendation concerns the determination of how the income should be treated. With respect to both, the BEPS report states that countries are free to choose so that the CFC rules will operate in a way that is coherent with the existing domestic law. However, it is mentioned that many existing CFC rules specify that the attributed income must be included in the taxpayer's taxable income for the taxable year in which the end of the CFC's accounting period ends. Moreover, with respect to how the income should be treated, the report notes that the existing CFC rules take several different approaches, including what could be labeled as a deemed dividend approach, a lifting the corporate veil approach, and a flow through approach.<sup>90</sup> Finally, the fifth recommendation sets out that the CFC rules should apply the tax rate of the parent jurisdiction to the attributed income.

<sup>86</sup> Art. 9 (1) of the ATA Directive.

<sup>87</sup> TSKL 57a (5) (Ice.), SKTL 10-65 (Nor.), IL 39a: 10–13. With respect to the Finnish CFC regime, it does not follow directly from the CFC provisions. However, the preparatory remarks as well as subsequent case law, cf. *Korkein hallinto-oikeus* [Supreme Administrative Court], KHO 2003 T 1938 (Fin.), have confirmed that the ordinary Finnish tax rules should be used for the computation of the income in the CFC (Leväjärvi (2013)). The same applies concerning the Danish regime, cf. e.g. L 23 (2008/2009) Forslag til lov om ændring af selskabsskatteloven, fusionsskatteloven og forskellige andre skattelove [government bill] (Den.).

<sup>88</sup> IL 20a:1 (Swe.) and SEL 32 (8) (Den.). Concerning the Norwegian regime, the preparatory remarks explain how to set the entry values for the CFC, Ot. prp. 16 1991-92 (Nor.).

<sup>89</sup> TSKL 57a (5) (Ice.), VYL 5 (Fin.), SEL 32 (1) & (9) (Den.), SKTL 10-61 (Nor.), IL 39a:6 (Swe.). Prior to 2003, losses in a CFC could actually be used to reduce the Norwegian shareholder's other taxable income. However, the Norwegian CFC rules were amended in order to mitigate tax planning based on this possibility.

<sup>90</sup> For more on different attribution methods, see e.g. Schmidt (2013a).

The CFC rules of the ATA Directive broadly seem to be in line with the recommendations in the BEPS report on how to attribute income. Accordingly, the attribution threshold appears to be tied directly to the control threshold.<sup>91</sup> With respect to the amount of income to include, the ATA Directive states that the income to be included in the tax base shall be calculated in proportion to the entitlement of the taxpayer to receive profits of the CFC. In this respect, it should be noted that the entitlement of the taxpayer to receive profits may differ from the taxpayers' proportion of ownership, for example, if the share capital of the CFC is divided into different classes. In this context, it should also be noted that the ATA Directive does not explicitly state how to deal with situations in which the taxpayer's ownership only lasts for a portion of the year. However, it may be argued that the wording ("the entitlement of the taxpayer to receive profits") also entails that the income should only be included in proportion to the portion of the year where the taxpayer actually holds shares in the CFC. Finally, the ATA Directive sets out that the income shall be included in the tax year in which the tax year of the CFC ends.

With respect to all five Nordic CFC regimes, the attribution threshold is to some extent tied to the control threshold.<sup>92</sup> As mentioned earlier, the Finnish rules, as well as the Norwegian and Icelandic rules, put emphasis on whether the resident taxpayers, taken together, own/hold at least 50%.<sup>93</sup> However, as also mentioned, only the Finnish rules contain a minimum requirement ensuring that a resident can only be taxed on the CFC income if the single resident's interest in the foreign entity is of at least 25%.<sup>94</sup> Both the Swedish and Danish attribution thresholds are tied directly to the control threshold, meaning that only the shareholders that fulfill the Swedish 25% requirement or the Danish "decisive influence" requirement can be taxed on the CFC's income.<sup>95</sup>

Concerning the amount to be attributed to the parent, the Swedish, Icelandic, Danish, and Norwegian rules all entail that the CFC's income should be included in proportion to the shareholder's part of the CFC's share

capital.<sup>96</sup> The Finnish CFC rules state that the attribution should be based on the shareholder's share of the capital or entitlement to the profits of the CFC.<sup>97</sup> With respect to situations in which the shareholder has not held the shares in the CFC for the entire income year, the Nordic regimes seem to differ. For example, according to the Danish rules, the amount to be included should be based on the shareholder's average ownership during the income year of the CFC's share capital. Oppositely, the Norwegian rules attribute the CFC's income based on the size of the shareholding at the end of the income year, regardless of whether shares in the CFC have been acquired or sold during the income year.<sup>98</sup>

Finally, all of the Nordic CFC regimes are in line with the last BEPS recommendation concerning attribution, as the ordinary corporate tax rate of the parent jurisdiction in all instances should be applied to the attributed income.

### 3.6 Rules to Prevent or Eliminate Double Taxation

According to the BEPS report, it is a fundamental policy consideration to ensure that CFC legislation does not lead to double taxation, as this could pose an obstacle to international competitiveness, growth, and economic development.<sup>99</sup> In this regard, the BEPS report, therefore, recommends that jurisdictions allow an indirect ordinary credit relief for foreign taxes actually paid, that is, taxes paid by the CFC itself, as well as the CFC tax assessed on intermediate companies.<sup>100</sup> Moreover, the report recommends to exempt dividends from the CFC and gains on disposition of the CFC shares from taxation to the extent the income of the CFC has previously been subject to CFC taxation (OECD (2015a); see sec. 7.1).

The CFC rules of the ATA Directive do not contain a rule stating that the member state of the parent company

<sup>91</sup> Cf. art. 8 (1) (a). See also section 3.1.

<sup>92</sup> For more on the control thresholds, see section 3.1.

<sup>93</sup> SKTL 10-62 (Nor.), TSKL 57a (1) & (3) (Ice.), VYL 3 (Fin.).

<sup>94</sup> VYL 4 (Fin.).

<sup>95</sup> IL 39a:2 (Swe.) and SEL 32 (1) & (6) (Den.).

<sup>96</sup> IL 39a:13 (Swe.), TSKL 57a (1) (Ice.), SEL 32 (7) (Den.), and SKTL 10-61 (Nor.). If the shares in the CFC are divided into different classes with different entitlement to dividend, the size of the entitlement to dividend is decisive pursuant to the Norwegian CFC rules, cf. Ot. prp. nr. 16 (1991-1992) (Nor.).

<sup>97</sup> VYL 4 (Fin.).

<sup>98</sup> Ot. prp. nr. 16 (1991-1992) (Nor.).

<sup>99</sup> For more on the need to avoid economic double taxation triggered by the CFC rules, see Kuzniacki (2015).

<sup>100</sup> For an explanation and an example concerning relief for simultaneous CFC taxation in multiple jurisdictions, see the report itself. In this context, the BEPS report proposes a hierarchy of rules that prioritize the CFC rules of the jurisdiction whose resident shareholder is closer to the CFC in the chain of ownership.

should allow relief for taxes paid by the CFC as well as CFC tax assessed on intermediate companies. Instead, the ATA Directive only addresses relief with respect to situations where the CFC distributes profits or the taxpayer disposes of the shares in the CFC. Accordingly, it is explicitly stated that the amounts of dividend income from the CFC, and the proceeds from disposal of CFC shares that previously have been subject to CFC taxation, shall be deducted from the tax base when calculating the amount of taxes due on these dividends and proceeds.<sup>101</sup>

It seems strange that the CFC rules of the ATA Directive do not contain an explicit rule providing relief with respect to taxes paid by the CFC, as well as CFC tax assessed on intermediate companies. However, it should be noted that the preamble to the ATA Directive states that where the application of the rules set out in the Directive gives rise to double taxation, taxpayers should receive relief through a deduction for the tax paid in another member state or third country, as the case may be.<sup>102</sup>

As also recommended in the BEPS report, the CFC regimes of Sweden, Norway, Finland, and Denmark all provide ordinary credit relief for foreign taxes paid by the CFC,<sup>103</sup> whereas the Icelandic CFC rules do not appear to include such a relief provision. In addition, none of the Nordic CFC regimes have rules in place to ensure that the CFC tax assessed on intermediate companies (i.e., the situation where more than one jurisdiction applies its CFC rules to income of the same CFC) do not lead to excessive taxation in the form of multiple CFC taxation. As more jurisdictions are expected to introduce the CFC legislation in the coming years, the risk of simultaneous CFC taxation of the same income in two or multiple jurisdictions will most likely increase. Against this background, the Nordic legislators should consider amending their CFC rules in order to ensure that an indirect ordinary credit relief for the CFC tax assessed on intermediate companies will be available. Such amendments will also help bringing the Nordic CFC regimes in line with the BEPS recommendations concerning this matter.

The Finnish CFC rules include a provision that allows unused foreign tax credits to be carried forward and deducted in the following 5 years.<sup>104</sup> According to the

Swedish rules, a similar provision applies,<sup>105</sup> whereas the Danish solution is to let the Danish parent leave out of account its own losses in order to utilize the possibility of relief for tax paid by the CFC. In addition, the Danish rules include a quite complex provision concerning reimbursement of excess CFC tax, inter alia caused by timing differences between the Danish and foreign tax rules.<sup>106</sup>

Finally, in most cases, the Nordic regimes appear to exempt dividends from the CFC and gains on disposition of CFC shares from taxation, so that the income of the CFC is not in effect taxed twice in the jurisdiction of the parent company. This either follows from the special rules dealing with these particular issues<sup>107</sup> or from the application of a general participation exemption.

## 4 Relationship with EU Primary Law

When EU/EEA member states introduce or amend CFC legislation, the limits imposed by EU law have to be taken into account.<sup>108</sup> With respect to these limits, it has been argued that the landmark decision of the European Court of Justice (ECJ) in *Cadbury Schweppes* implies that there is little room for the application of CFC rules in the EU/EEA context (Meussen (2007)).<sup>109</sup> In its decision, the ECJ stated that CFC rules, which restrict the freedom of establishment, could be justified on the basis of tax avoidance and evasion, but only if the rules specifically target wholly artificial arrangements that are intended to circumvent the application of the legislation of the concerned member state. Moreover, the ECJ stated that such a restrictive anti-avoidance rule should be proportional, which in other words meant that the rules have to exclude from their scope situations whereby, despite the existence of tax motives, the arrangements reflect economic reality.<sup>110</sup>

The *Cadbury Schweppes* decision concerned the CFC rules in the United Kingdom as they applied at the time. However, several member states found it necessary to amend their CFC rules following the decision, despite a

<sup>101</sup> Art. 9 (4) and (5) of the ATA Directive.

<sup>102</sup> Para. 5 of the preamble of the ATA Directive.

<sup>103</sup> VYL 6 (Fin.), SEL 32 (11) (Den.), SKTL 16-20 (Nor.). Concerning the Swedish CFC taxation, the relief provision are to be found in *Avräkningslagen* [AL] [Swedish Foreign Tax Credit Act] 4:1 (Swe.).

<sup>104</sup> VYL 6 (Fin.).

<sup>105</sup> AL 4:4 (Swe.).

<sup>106</sup> SEL 32 (11) & (13) (Den.).

<sup>107</sup> VYL 4 (Fin.), SKTL 10-67 & 10-68 (Nor.), IL 42:22 (Swe.).

<sup>108</sup> For a more thorough explanation, see also Schmidt (2014). Norway and Iceland are not members of the EU, but being part of the EEA, both countries are obliged to respect the EEA Agreement, which guarantees the same basic freedoms to the nationals of the EEA states as the TFEU provides for nationals of the EU member states. See Helminen (2015)

<sup>109</sup> Case C-196/4 *Cadbury Schweppes* ECLI:EU:C:2006:544.

<sup>110</sup> Case C-196/4 *Cadbury Schweppes*, para 51 and 65.

lack of clear guidance in the existing case law (Schön (2012)). It is true that *Cadbury Schweppes* is now a fairly dated decision. The decision, however, still acts as the cornerstone of the theory of abuse in the field of direct taxes and EU law (Jiménez (2012)), and subsequent decisions on the CFC legislation to a large extent seems to follow this decision.<sup>111</sup>

However, more generally, it seems that the ECJ, over time, has become more willing to accept justifications for restrictive national tax rules (Hilling (2013)). Against this background, it has been argued that the ECJ may now be willing to relax its very tight limits on the acceptability of the CFC rules (Terra & Wattel (2012)). In other words, it has been argued that the *Cadbury Schweppes* decision should not, per se, constitute an insurmountable obstacle to strengthen the CFC rules (Pistone (2014)).

The OECD/G20 appears to have picked up on these more recent tendencies in the ECJ's case law when addressing the challenges for member states with respect to reinforcing CFC legislation, and at the same time, complying with the EU law (OECD (2015a); see sec. 1.2.2). Accordingly, out of the four alternatives listed in the BEPS report, at least the last two alternatives seem rooted in the view described earlier on the ECJ's more recent case law. The four alternatives that the member states could consider are:

1. Including a substance analysis that would only subject taxpayers to the CFC rules if the CFCs did not engage in genuine economic activities.
2. Applying the CFC rules equally to both domestic subsidiaries and cross-border subsidiaries, as CFC legislation with such a wide scope arguably should not be considered discriminatory.
3. Applying CFC rules to transactions that are partly wholly artificial, as recent developments in the ECJ's case law should entail that a CFC rule in a member state that targets the income earned by a CFC that is not itself wholly artificial may be justified, so long as the transaction giving rise to the income is at least partly artificial.
4. Designing CFC rules to explicitly ensure a balanced allocation of taxing powers, as more recent case law suggests that CFC rules could be permitted to apply more broadly, if they could be explained by the need for a member state to ensure a balanced allocation of tax rights (and not merely abuse).

It should be noted that the BEPS report has already received harsh criticism for suggesting that the member states' CFC regimes may not have to be limited to wholly artificial arrangements (Panayi (2016)). The principal arguments presented against the view expressed in the BEPS report is that *Cadbury Schweppes* should still be considered the main precedent, when it comes to the CFC legislation (instead of decisions on limitations on interest deductibility and transfer pricing<sup>112</sup>), and the fact that the ECJ in more recent case law has also reiterated the wholly artificial arrangement test.<sup>113</sup>

Despite this criticism, the ATA Directive also appears to be based on an interpretation of more recent ECJ case law that to some degree resembles the interpretation used in the BEPS report. Accordingly, the ATA Directive states that the member states shall not apply the CFC rules, where an entity is tax resident in the EU/EEA or in respect of a permanent establishment of a third country entity, which is situated in the EU/EEA, unless the establishment of the entity is wholly artificial or to the extent that the entity engages, in the course of its activity, in non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. Moreover, it is explained directly in the Directive that an arrangement or a series thereof shall be regarded as non-genuine to the extent that the entity would not own the assets or would not have undertaken the risks, which generate all or part of its income, if it were not controlled by a company, where the significant people's functions (which are relevant to those assets and risks) are carried out and are instrumental in generating the controlled company's income. Accordingly, where the entity engages in non-genuine arrangements, the income to be included in the tax base of the controlling company shall be limited to the amounts generated through assets and risks, which are linked to significant people's functions carried out by the controlling company. Finally, it is stated that the attribution of the CFC income shall be calculated in accordance with the arm's length principle.<sup>114</sup>

Sweden, Norway, Finland, and Iceland have all attempted to bring their CFC rules in line with the EU law by including an exemption of the kind mentioned in the BEPS report as alternative 1 (see the preceding section). In

<sup>111</sup> Case C-201/05 *TheTest Claimants in the CFC and Dividend Group Litigation* ECLI:EU:C:2008:239. From the EFTA Court, see also Case E-3/13 and E-20/13 *Fred Olsen and others v the Norwegian State* [2014] EFTA Ct. Rep. 400.

<sup>112</sup> Such as case C-524/04 *Test Claimants in the Thin Cap Group Litigation* ECLI:EU:C:2007:161 and case C-311/08 *Société de Gestion Industrielle SA (SGI)* ECLI:EU:C:2010:26.

<sup>113</sup> Case C-282/12 *Itelcar* ECLI:EU:C:2013:629 and case C-112/14 *Commission v. United Kingdom* ECLI:EU:C:2014:2369.

<sup>114</sup> Art. 8 (2) of the ATA Directive.



other words, even though the actual wording of the exemptions varies, all four CFC regimes generally do not apply, if the foreign entity is actually established in the EU/EEA and is engaged in genuine economic activities.<sup>115</sup> Despite the fact that the aim of the legislators has been to ensure that the CFC rules, thereby, should be considered in line with EU law, it has been debated in Swedish (Lindström-Ihre & Karlsson (2008); Samuelson & Karlsson (2010); Barenfeld & Österman (2008) and Dahlberg (2012)), Norwegian (Farstad (2010); Zimmer (2009), and Passalacqua & Henie (2008)), and Icelandic literature (Gudmundsson & Jóhannesson (2010)), whether this aim in fact has been reached.<sup>116</sup> Thus, in short, the main issue appears to be that the explanations and interpretations made by the legislators – typically in the preparatory works – in some instances may not be fully in line with the ECJ's case law. Oppositely, in the available Finnish literature, the conclusion appears to be that the legislator has been successful in bringing the Finnish CFC regime in line with the EU Law (Helminen (2009); Leväjärvä (2013)).<sup>117</sup>

It should be noted that the current EU/EEA exemption applied according to the Swedish and Finnish regimes may be considered too broad in comparison with the ATA Directive.<sup>118</sup> The reason is that CFC taxation, according to the ATA Directive, may take place even though the CFC resident in the EU/EEA is not to be considered wholly artificial, as long as the entity engages, in the course of its activity, in non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage.

**115** TSKL 57a (4) (Ice.), VYL 2a (Fin.), SKTL 10-64 (Nor.), and IL 39a:7 (Swe.). Pursuant to the Icelandic, Norwegian, and Finnish rules, it is also a requirement that the tax authorities can obtain sufficient information.

**116** Högsta förvaltningsdomstolen [Supreme Administrative Court], RÅ, 2008, ref. 24 (Swe.) has found that the Swedish CFC rules cannot be challenged on the basis of the right of free movement of capital. An EFTA Court decision has dealt with the Norwegian CFC rules with respect to a foreign trust, cf. the aforementioned cases E-3/13 and E-20/13 *Fred Olsen and others v the Norwegian State*. See Gjems-Onstad *et al.* (2015). The approach by the EFTA court seems to closely follow the assessment of the ECJ in case C-196/04 *Cadbury Schweppes* closely.

**117** In Finland, a court decision from 2002 was repealed, as the decision was found to be incompatible with the later decision of the ECJ in case C-196/04 *Cadbury Schweppes*, cf. Korkein hallinto-oikeus [Supreme Administrative Court], KHO 2011/1018 (38) (Fin.). The decision has been commented by Helminen (2011).

**118** This also applies to the EU/EEA exemptions under the Norwegian and Icelandic CFC regimes, but as mentioned earlier, these countries are not EU member states.

As noted earlier, the Danish CFC rules for companies also apply to domestic entities.<sup>119</sup> Accordingly, Denmark has attempted to align its CFC legislation with EU law in the way mentioned as alternative number 2 in the BEPS report (see the preceding section). In view of the legislator, this entails that there is no different treatment and that the Danish CFC rules should not be considered in breach of EU law.<sup>120</sup> However, in the Danish literature, several authors have argued that the CFC rules might still be in conflict with the fundamental freedoms (e.g., Hansen & Lytken (2012); Rønfeldt (2010); Schmidt (2013a, 2014)). The main argument is that different treatment still exists, as the application of the CFC rules only entails an additional tax burden for the Danish parent company, if the subsidiary is resident in another country in which the level of taxation is lower than the Danish level of taxation. The primary reason for this is that the relief granted for the taxes paid by a Danish subsidiary should normally fully absorb the parent company's additional tax on the income from the Danish subsidiary.<sup>121</sup>

## 5 Compatibility with Tax Treaties

The question, concerning whether CFC legislation is compatible with tax treaties, has for years been subject to heavy debate in the international tax literature, and case law in different jurisdictions has not been consistent concerning this matter (Broe (2008)). The dispute has primarily concerned whether the CFC taxation should be considered contrary to tax treaties that include provisions similar to art. 7 (1) and 10 (5) of the OECD Model Tax Convention. It seems reasonable, however, to conclude that the prevalent, but not undisputed, position is that the application of the CFC legislation is compatible with tax treaties (Weeghel (2010)).

**119** SEL 32 (1) (Den.).

**120** The preparatory remarks to Bill L 213 (2006/2007) Forslag til ændring af selskabsskatteloven og forskellige andre skattelove – CFC beskatning og indgreb mod kapitalfonde [governmentbill] (Den.). The legislator's view has gained support in a decision from Landsskatteretten [National Tax Tribunal] in its case of 6 May, 2009, journal-nr. 08-02192 (Den.).

**121** As noted in section 3.2, the BEPS report acknowledges that the EU member states can choose to apply the CFC rules to both domestic subsidiaries and foreign subsidiaries. Moreover, as the ATA Directive only contains minimum rules it may be argued that the Danish CFC regime is in line with both the BEPS recommendations and the ATA-directive.



Support for this position can be found in the commentaries to the OECD Model Tax Convention, which addressed the relationship between tax treaties and CFC legislation for the first time in the 1992 version.<sup>122</sup> In 2003, the commentaries dealing with this question were made more comprehensive, and the amended commentaries more clearly stated that CFC legislation should normally not be considered in breach of the countries' treaty obligations.<sup>123</sup> Finally, the recent BEPS report on preventing the granting of treaty benefits in inappropriate circumstances (OECD (2015d)) among other things contains a revision of the commentaries dealing with the relationship between countries' specific anti-avoidance rules and tax treaties. These revised commentaries show an even more unconditional support for the position that CFC legislation should not be considered in breach of tax treaties.<sup>124</sup>

Looking to the Nordic countries, the Danish legislator has consistently maintained the position that the CFC legislation does not conflict with Denmark's tax treaties, as the CFC rules only concern the taxation of a Danish company (*i.e.*, the Danish shareholder).<sup>125</sup> Moreover, in view of the Danish legislator, the CFC rules should not be considered in conflict with Denmark's tax treaties (even though the CFC taxation may result in economic double taxation), as tax treaties in general only concern juridical double taxation. The question has been addressed in Danish administrative case law. Referring to the 2003 commentaries to the OECD Model Tax Convention, the National Tax Tribunal stated that the CFC regime was not contrary to Denmark's obligations, according to the double taxation treaty with Switzerland.<sup>126</sup>

<sup>122</sup> Cf. the commentaries to art. 1 in the OECD Model Convention (1992), para. 22–26. The 1992 commentaries were based on an OECD report dealing with the tax treaties and the use of base companies (OECD (1987)).

<sup>123</sup> Cf. primarily the commentaries to art. 1 in the OECD Model Convention (2003), para. 23 and 26, which can also be found in the 2014 version.

<sup>124</sup> See the suggested revised commentary to article 1, para. 26.8, which deals specifically with the CFC legislation. In comparison with the 2014 commentaries, the suggested revised version does not include a statement expressing that the CFC legislation should not be applied where the relevant income has been subjected to taxation that is comparable to that in the country of residence of the taxpayer. This may be of importance when assessing the Danish CFC regime, as the Danish rules are not limited to CFC's in low-tax countries.

<sup>125</sup> Bill L 35 (1994/1995) annex 16, 46 and 33 (Den.).

<sup>126</sup> Landsskatteretten [National Tax Tribunal], SKM2004.439.LSR (Den.). The decision has been discussed in the Danish literature (Michelsen (2005)). For a more general discussion and overview of the Danish debate with respect to CFC rules and tax treaties, see Schmidt (2013a,b).

In the other Nordic countries, the legislators appear to have been more concerned with respect to a potential conflict between CFC legislation and tax treaties. Thus, as mentioned earlier, the Norwegian and Icelandic CFC regimes do not apply with respect to the entities resident in jurisdictions, which have a treaty with Norway/Iceland, unless the entity's income mainly consists of passive income.<sup>127</sup> In addition, the Finnish CFC rules do not apply if the foreign entity is resident in a treaty state, provided that the country is not mentioned in the black list or benefits from a specific tax relief.<sup>128</sup>

In Sweden, the CFC rules initially did not at all apply with respect to the entities in jurisdictions, which has a tax treaty with Sweden. However, following the inclusion of comments concerning the CFC legislation in the 1992 commentaries to the OECD Model Tax Convention, the scope of the Swedish CFC rules in 1994 were expanded to apply to the entities in tax treaty jurisdictions as well (Dahlberg (2000) and Wenehed (2000)). In a decision from 2008, the Supreme Administrative Court dealt with the issue and concluded that the Swedish CFC rules were not contrary to the tax treaty with Switzerland, which dated back to 1963.<sup>129</sup> However, the court based its conclusion on the fact that the CFC rules were both *lex posterior* and *lex specialis* with respect to the tax treaty with Switzerland, and therefore, the court found no need to go into a specific interpretation of the provisions in the treaty. Subsequently, the reasoning in the decision was subject to heavy criticism in the Swedish tax literature (Hilling (2008); Kleist (2008), and Dahlberg (2008)).

Also, the Finnish Supreme Administrative Court has had the opportunity to deal with the relationship between the CFC legislation and tax treaties.<sup>130</sup> Thus, in a decision from 2002, the Court found that the Finnish CFC regime could be applied to a subsidiary in Belgium, as the treaty with Belgium did not prevent this. Among other things, the Court relied on the 1992 commentaries to the OECD Model Tax Convention. The elements of the court's reasoning have been criticized in the Finnish tax literature, but the outcome seems to have gained support (Helminen (2004)). Finally, with respect to the Norwegian CFC rules, the Ministry of Finance in 2006 issued a statement, which, based on the commentaries to the OECD Model Tax Con-

<sup>127</sup> TSKL 57a (4) (Ice.) and SKTL 10-64 (Nor.).

<sup>128</sup> VYL 2 (Fin.). See section 3.2.

<sup>129</sup> Högstaförvaltningsdomstolen [Supreme Administrative Court], RÅ 2008 ref. 24 (Swe.).

<sup>130</sup> Korkein hallinto-oikeus [Supreme Administrative Court] KHO 2002:26 (Fin.).

vention, concluded that the Norwegian CFC rules were not in breach of Norway's tax treaty obligations.<sup>131</sup>

In summary, the prevailing view in the Nordic tax literature and case law, thus, appears to be that the CFC regimes of the Nordic countries should not be considered contrary to their tax treaties. Support for this view can also be found in the current commentaries to the OECD Model Tax Convention, and even more so in the upcoming revised comments.

## 6 Overall Assessment and Conclusions

Based on the comparative analysis, which has been summarized in table 1.1, it can be concluded that the CFC regimes of the Nordic countries in many ways already are in line with the BEPS recommendations on how to design CFC rules. Accordingly, the Nordic CFC regimes to a certain degree already rely on the “building blocks” for effective CFC rules suggested in the BEPS recommendations. However, this can partly be explained by the fact that many of the BEPS recommendations are relatively vague. Thus, the need to ensure sufficient flexibility with respect to the various countries' tax systems and policy objectives has entailed that the recommendation on the CFC legislation, more or less, has been reduced to a kind of catalog setting out different options countries can choose from.

Even though the minimum CFC rules set out in the ATA Directive are less vague than the BEPS recommendations, it should be noted that also the ATA Directive, for example, concerning the control requirement and computation, gives the member states some leeway to design and apply their CFC rules, as they would like. As a result, the scope of application and the effect of the CFC rules across the member states may (continue to) differ considerably, and the objective of securing a coherent and coordinated transposition of the BEPS measures into the member states' national tax systems may, therefore, be hard to reach.

Despite the vagueness of the BEPS recommendations, some features of the Nordic CFC regimes can be found which are not in line with the recommendations. Thus, in comparison with the BEPS recommendations (as well as the ATA Directive), it is striking that Finland is the only Nordic country to apply both a legal and an economic

ownership test in order to define control, as the Finnish rules also apply, if Finnish taxpayers are entitled to more than 50% of the yield. The other Nordic CFC regimes are mainly based on the legal ownership of capital and/or voting rights. In order to be in line with the BEPS recommendations, and in case of Denmark and Sweden comply with the Directive, an economic ownership test should, therefore, be added. Moreover, the Nordic legislators should consider whether there may be a need for a CFC-focused hybrid mismatch rule, as suggested in the BEPS recommendation.

Another issue where the Nordic CFC regimes fall short of the BEPS recommendation is with respect to including a definition of income that raises BEPS concerns. Hence, among the Nordic CFC regimes, only the Danish CFC legislation contains an explicit definition of CFC income. Moreover, it should be highlighted that none of the Nordic CFC regimes have rules in place to ensure that the CFC tax assessed on intermediate companies (*i.e.*, the situation where more than one jurisdiction applies its CFC rules to income of the same CFC) do not lead to excessive taxation in the form of multiple CFC taxation. As more jurisdictions are expected to introduce CFC legislation in the coming years, the risk of simultaneous CFC taxation of the same income in two or multiple jurisdictions will most likely increase. Against this background, the Nordic legislators should consider amending their CFC rules in order to ensure that an indirect ordinary credit relief for the CFC tax assessed on intermediate companies will be available.

Being member states of the EU Sweden, Finland, and Denmark will have to make some amendments to their CFC rules if the ATA Directive is adopted in its current form. Thus, even though the ATA Directive only contains minimum rules, amendments to the national CFC regimes of Sweden, Finland, and Denmark must be made in order to ensure that the national rules at least target the income and situations comprised by the CFC rules in the Directive under various circumstances. In this context, it should be noted that the CFC rules of the ATA Directive contain a relatively broad definition of “CFC income,” including types of income that are currently not being considered CFC income under the Danish rules. In this regard, it is also worth noting that the Finnish CFC rules do not apply with respect to the entities in treaty countries, unless the entity is located in a country mentioned in the black list or benefits

<sup>131</sup> Cf. *Prinsipputtalelse/Fortolkning* [Guidance from the Ministry of Finance], 28 February, 2006 (Nor.). For more on the discussion of this question in the Norwegian tax literature, see Naas *et al.* (2011).

Building blocks	BEPS	ATA Directive					Finland			Iceland			Denmark	
		Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity	Foreign entity
(1) Rules for defining a CFC	<ul style="list-style-type: none"> <li>• Foreign entity</li> <li>• Broad definition</li> <li>• Legal and economic ownership test</li> </ul>	<ul style="list-style-type: none"> <li>• &gt; 50% of the capital, voting rights, or profits</li> </ul>	<ul style="list-style-type: none"> <li>• ≥ 25% of the capital or voting rights</li> </ul>	<ul style="list-style-type: none"> <li>• ≥ 50% Norwegian ownership of the capital or voting rights</li> </ul>	<ul style="list-style-type: none"> <li>• ≥ 50% Finnish ownership of the capital, voting rights, or profits</li> </ul>	<ul style="list-style-type: none"> <li>• ≥ 50% Icelandic ownership of the capital and voting rights, or control</li> </ul>	<ul style="list-style-type: none"> <li>• Foreign and domestic entities</li> <li>• Group has decisive influence (&gt; 50% voting rights)</li> </ul>	<ul style="list-style-type: none"> <li>• No low-tax condition</li> <li>• No exemption for genuine activities in the EU/EEA</li> <li>• Possibility of exemption for entities within the financial sector</li> </ul>	<ul style="list-style-type: none"> <li>• Low-tax condition, &lt; 2/3</li> <li>• Black list</li> <li>• Exemption for genuine activities in the EU/EEA</li> <li>• Exemption for entities in the treaty countries with mainly non-passive income</li> </ul>	<ul style="list-style-type: none"> <li>• Low-tax condition, &lt; 3/5</li> <li>• Black list</li> <li>• Exemption for genuine activities in the EU/EEA/treaty countries</li> <li>• Exemption for the treaty countries, unless black-listed</li> <li>• Exemption for shipping and industrial activities</li> </ul>	<ul style="list-style-type: none"> <li>• Low-tax condition, &lt; 2/3</li> <li>• White/black list</li> <li>• Exemption for genuine activities in the EU/EEA</li> <li>• Exemption for entities in the treaty countries with mainly non-passive income</li> </ul>	<ul style="list-style-type: none"> <li>• Low-tax condition, &lt; 55%</li> <li>• White/gray list</li> <li>• Exemption for genuine activities in the EU/EEA</li> <li>• Exemption for shipping activities</li> </ul>	<ul style="list-style-type: none"> <li>• Low-tax condition, &lt; 40%</li> <li>• Exemption for the listed entities</li> <li>• Exemption for the financial undertakings in the EU/EEA</li> <li>• EU/EEA exemption, unless establish-ment is wholly artificial or entity engages in non-genuine arrangements</li> </ul>	<ul style="list-style-type: none"> <li>• Tax rate exemption</li> <li>• Optional use of lists, for example, a white list</li> </ul>
(2) Exemptions and threshold requirements														

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Building blocks		BEPS	ATA Directive	Sweden	Norway	Finland	Iceland	Denmark
(3)	Definition of CFC income	• A definition should be included	• Income condition, CFC income > 50%	• No general income condition	• No general income condition	• No general income condition	• No general income condition, but size of passive income relevant if treaty country	• Income condition, CFC income > 50%
		• Jurisdications have flexibility to define	• Explicit definition of CFC income	• Entity approach	• Entity approach	• Entity approach	• Entity approach	• Explicit definition of CFC income
(4)	Rules for computing income	• Entity or transactional approach	• Entity approach		• Entity approach			• Asset condition, CFC assets > 10%
		• Rules in parent company's jurisdiction	• Corporate tax rules in the parent company's member state	• Swedish tax rules	• Norwegian tax rules	• Finnish tax rules	• Icelandic tax rules	• Danish tax rules
		• Losses only deductible against profits of the same CFC or other CFCs in the same jurisdiction	• CFC's losses should not be included in the parent's tax base, but shall be set off against CFC's income in subsequent years	• CFC's losses can only be set off against CFC's positive income in subsequent years	• CFC's losses can only be set off against CFC's positive income in subsequent years	• CFC's losses can only be set off against CFC's positive income in subsequent years	• CFC's losses can only be set off against CFC's positive income in subsequent years	• CFC's losses can only be set off against CFC's positive income in subsequent years

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Building blocks	ATA Directive					Finland			Iceland			Denmark		
	BEPS	ATA Directive	Sweden	Norway	Finland	Iceland	Denmark	Finland	Iceland	Denmark	Finland	Iceland	Denmark	Finland
(5) Rules for attributing income	<ul style="list-style-type: none"> <li>• Attribution threshold tied to the control threshold</li> <li>• Attribution based on the proportion of ownership</li> <li>• Apply tax rate of the parent jurisdiction</li> </ul>	<ul style="list-style-type: none"> <li>• Attribution threshold tied to the control threshold (&gt; 50%)</li> <li>• Attribution based on the entitlement to profits</li> </ul>	<ul style="list-style-type: none"> <li>• Attribution threshold tied to the control threshold (<math>\geq 25\%</math>)</li> <li>• Attribution based on the proportion of the share capital</li> <li>• Application of ordinary Swedish tax rate</li> </ul>	<ul style="list-style-type: none"> <li>• Attribution threshold tied to the control threshold (<math>\geq 50\%</math> Norwegian ownership)</li> <li>• Attribution based on the proportion of ownership</li> <li>• Application of ordinary Norwegian tax rate</li> </ul>	<ul style="list-style-type: none"> <li>• Attribution threshold tied to the control threshold, but 25% min. requirement based on the share of the total profits</li> <li>• Application of ordinary Finnish tax rate</li> </ul>	<ul style="list-style-type: none"> <li>• Attribution threshold tied to the control threshold (<math>\geq 50\%</math> Icelandic ownership)</li> <li>• Attribution based on the proportion of the share capital</li> <li>• Application of ordinary Icelandic tax rate</li> </ul>	<ul style="list-style-type: none"> <li>• Attribution threshold tied to the control threshold (decisive influence)</li> <li>• Attribution based on the proportion of the share capital</li> <li>• Application of ordinary Danish tax rate</li> </ul>							
(6) Rules to prevent or eliminate double taxation	<ul style="list-style-type: none"> <li>• Ordinary indirect credit relief</li> <li>• Also, relief for the CFC tax in intermediate companies</li> <li>• Exemptions for divi-divi-dends/gains on shareholding in the CFC</li> </ul>	<ul style="list-style-type: none"> <li>• Relief for foreign taxes not explicitly mentioned</li> <li>• Exemptions for divi-divi-dends/gains on shareholding in the CFC</li> </ul>	<ul style="list-style-type: none"> <li>• Ordinary indirect credit relief</li> <li>• No relief for CFC tax in intermediate companies</li> <li>• Rules in place to avoid double taxation with respect to divi-divi-dends/gains on shares in the CFC</li> </ul>	<ul style="list-style-type: none"> <li>• Ordinary indirect credit relief</li> <li>• No relief for the CFC tax in intermediate companies</li> <li>• Rules in place to avoid double taxation with respect to divi-divi-dends/gains on shares in the CFC</li> </ul>	<ul style="list-style-type: none"> <li>• Ordinary indirect credit relief</li> <li>• No relief for the CFC tax in intermediate companies</li> <li>• Rules in place to avoid double taxation with respect to divi-divi-dends/gains on shares in the CFC</li> </ul>	<ul style="list-style-type: none"> <li>• No credit relief</li> <li>• No relief for the CFC tax in intermediate companies</li> <li>• Exemption for dividends on shareholding in the CFC</li> </ul>	<ul style="list-style-type: none"> <li>• Ordinary indirect credit relief</li> <li>• No relief for the CFC tax in intermediate companies</li> <li>• Rules in place to avoid double taxation with respect to divi-divi-dends/gains on shares in the CFC</li> </ul>							
														Concluded



from a specific tax relief, and that the Swedish CFC rules either completely or partly excludes the income generated in the CFCs in a number of jurisdictions from CFC taxation. Thus, the scope of application of the Danish, Finnish, and Swedish CFC rules may, in some instances, prove to be too narrow compared with the ATA Directive's scope.<sup>132</sup>

With respect to the treatment of the CFCs resident within the EU/EEA, the ATA Directive appears to be based on an interpretation of more recent ECJ case law that allegedly leaves more space for intra-EU CFC taxation, and which to some degree resembles the interpretation advocated for in the BEPS report. As a consequence, the current EU/EEA exemption applied according to the Swedish and Finnish regimes may be too broad in comparison with the ATA Directive. The reason is that CFC taxation, according to the ATA Directive, may take place even though the CFC resident in the EU/EEA is not to be considered wholly artificial, as long as the entity engages, in the course of its activity, in non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage.

The Danish CFC rules are quite different from the other Nordic CFC regimes, as the Danish rules apply both domestically and cross-border (and as a consequence, the Danish regime does not include a low-tax condition). However, as the BEPS report acknowledges that the EU member states can choose to apply the CFC rules to both domestic and foreign subsidiaries, and since the ATA Directive only contains minimum rules, it may be argued that the Danish CFC regime is in line with both the BEPS recommendations and the ATA Directive concerning this matter.<sup>133</sup>

With respect to tax treaties, the prevailing view in the Nordic tax literature and case law appear to be that the CFC regimes of the Nordic countries should not be considered contrary to their tax treaties. Support for this view can also be found in the current commentaries to the OECD Model Tax Convention, and even more so, in the upcoming revised comments.

All in all, the BEPS recommendations as well as the ATA Directive provide food for thought, when considering the appropriate design of the Nordic CFC regimes. Thus, no matter whether the ATA Directive is adopted (in its current form) or not, it appears to be a good time for the Nordic

countries to reassess and in some instances, amend their CFC rules.

## Post Script (1 June 2016)

The Economic and Financial Affairs Council (ECOFIN) was scheduled to agree on the ATA-directive on its meeting on 25 May 2016. However, after lengthy discussions ECOFIN failed to agree on the ATA-directive and postponed possible adoption to its next meeting on 17 June 2016. The CFC-rule was among the issues causing debate and disagreement.<sup>134</sup> In particular the question on whether and how the CFC rule should apply within the EU/EEA caused problems.<sup>135</sup>

A *presidency compromise* on the ATA-directive has been published.<sup>136</sup> The suggested compromise inter alia entailed adjustments to the CFC rule in art. 8 and 9. In brief, the main adjustments proposed by the presidency were the following:

- The low tax threshold should be set to an effective corporate tax rate lower than 50 % of the effective tax rate that would have been charged under the applicable corporate tax system in the Member State of the tax payer.
- With respect to the general structure of the CFC rule Member States should be able to choose between two different alternatives:
  1. A *categorical approach* according to which certain non-distributed (mobile) income items should be included in the tax base (the list of income items has been reduced/adjusted compared to the original draft directive). Member States may opt not to treat an entity as a CFC, if one third or less of the accrued income falls within the listed income items. In addition, Member States may opt not to treat financial undertakings as CFCs if one third or less of the entity's tainted income comes from transactions with the taxpayer or its associated enterprises. Under the categorical approach the CFC rule shall not

<sup>132</sup> In addition, Sweden and Finland may be forced to abolish or amend their industry exemptions if the ATA Directive is adopted.

<sup>133</sup> However, as explained in section 4, it seems appropriate to question whether the Danish CFC regime should, in fact, be considered in line with primary EU law.

<sup>134</sup> Press release 9342/16, Outcome of the Council Meeting, 25 May 2016.

<sup>135</sup> See also Report from the General Secretariat of the Council, General Approach, 9432/16, 24 May 2016.

<sup>136</sup> Presidency compromise, 9520/16 (FISC 87, ECOFIN 512), 26 May 2016.

apply where the company has been set up for valid commercial reasons and carries on an economic activity supported by commensurate staff, equipment, assets and premises which justify the income attributed to it (a so-called *substance carve-out exception*). Where the CFC is resident in a third country that is not party to the EEA Agreement, Member States may decide to refrain from applying the *substance carve-out exception*.

2. A *transactional approach* according to which only non-distributed income arising from non-genuine arrangements should be included in the tax base (it is a condition that these arrangements have been put in place for the essential purpose of obtaining a tax advantage). Member States may use a “minimum exception” and thus exclude entities with accounting profits of no more than EUR 750,000 and non-trading income of no more than EUR 75,000, or exclude entities where the accounting profits amount to no more than 10 % of its operating costs for the tax period.

- With respect to relief for double taxation the compromise text stated that Member States shall allow a deduction of tax paid by the entity from the tax liability of the tax payer in its state of residence or location. The relief shall be calculated in accordance with national law.
- The compromise text required Member States to implement the directive by 31 December 2018 at the latest.

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