FEE POSITION PAPER ON CONTROLLED FOREIGN COMPANY LEGISLATIONS IN THE EU

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I. OBJECTIVES

The broad aim of this Paper is to verify the existence, within EU Member States, of fiscal laws regarding Controlled Foreign Companies (CFC) and how CFC rules are structured and applied by EU Member States. Furthermore it points out differences and similarities between CFC laws in different EU Member States.

More specifically, this Survey is to verify the consistency of the CFC legislation, as currently applied in EU Member States, with the fundamental principles of the EC Treaty, namely with the non-discrimination provision, and the freedom of capital flows and establishment, within the internal market.

II. FINDINGS

1. The policy rationale for a CFC legislation and its different regimes

A CFC legislation can be broadly defined as a technical provision that allows the shareholder's country of residence to tax the income produced by a foreign company that they control ("sheltered income"), according to the accrual method.

There are many reasons to justify a tax policy for the CFC legislation; consequently, when viewed from different perspectives, a CFC legislation could be seen as:

(i) an **anti-avoidance provision**, to counteract the techniques used by taxpayers to obtain tax deferrals by simply interposing a foreign corporate structure (often resident in a low-tax jurisdiction or benefiting from a low-tax regime in a high-tax country) between themselves and the source of income; since foreign corporations are treated as separate taxpayers, their income is generally taxed in the residence country of its shareholders until such income is remitted;

(ii) a tool for ensuring the **international tax neutrality**, namely following the Capital Export Neutrality model, according to which domestic and foreign incomes should be taxed in the hands of the resident taxpayers in the same way and without deferrals;

(iii) a **defensive measure** against those countries that undertake harmful tax competition, be it as tax havens or adopting harmful preferential tax regimes;

(iv) a tax policy measure against **tax erosion,** aimed at reducing the outflows of capitals from high-tax countries to low-tax countries, that indeed erodes domestic taxable bases;

(v) a tool that solves some practical difficulties in the administration of **transfer pricing** rules (clearly, if some incomes are improperly transferred from the high-tax country of residence of the parent company to the low-tax country of residence of the subsidiary, when a CFC legislation is in place, it becomes much less important to adjust the inter-company prices according to the transfer price rules, since the surplus of income unduly transferred will be taxed in any case in the first country as income of the CFC);

(vi) a tool that solves some inefficiencies of the company **fiscal residence criteria** (in some cases it is difficult to assess a domestic fiscal residence of a foreign company; that assessment becomes less important when its income is taxed according to the CFC rules, in the country of residence of its shareholders;

(vii) a tool that allows the **enforcement of domestic taxation**: even if a foreign corporation is subject to domestic taxation, there are obvious problems regarding the enforcement of such taxation, both in gathering the necessary information to determine tax liability and in collecting the taxes owed, if it has no assets in the domestic jurisdiction; with a CFC system, the information and taxes are collected from resident shareholders.

Different approaches are followed to provide the legal basis for the taxation of shareholder's sheltered income:

(i) the "**deemed dividend approach**", according to which the income is deemed to be distributed as a dividend (taxation of foreign dividend according to the accrual method instead of the remittance basis);

(ii) the "**piercing the veil approach**", according to which the income is deemed to have arisen in the hands of the shareholders, i.e. company activities are to be attributed to them;

(iii) the "**increased ability to pay approach**", according to which the income is deemed to have improved the ability of shareholders to pay taxes because it is economically at their disposal.

Four general methods have been used in designing the legislation:

(i) the "**transactional approach**", that concentrates on the nature of the income (typically on passive income, *i.e.* income arising from financial investments and other similar activities);

(ii) the "**jurisdiction approach**", that concentrates on the location of the foreign entity (typically a low-tax jurisdiction);

(iii) the "**shopping approach**", a variant of the transactional approach , that exempts some "passive incomes" produced in high-tax regimes;

(iv) the "**exemption approach**", a variant of the jurisdiction approach, that exempts some "active incomes" produced in low-tax regimes.

2. EU Countries having a CFC legislation

Not all EU Member States have CFC laws within their national fiscal systems. Nine countries: Denmark, Finland, France, Germany, Italy, Portugal, Spain, Sweden, and the United Kingdom have a fiscal law regarding CFC.

The other six countries: Austria, Belgium, Greece, Luxemburg, Ireland and the Netherlands do not have a law regarding CFCs.

It should be noted, however, that some countries that have no CFC legislation, have specific provisions that, in given cases, produce effects which are economically similar to the attribution of the income to resident shareholders using the CFC technique. For instance in Luxemburg the concept of "abuse of tax law" might lead to a situation similar to CFC-legislation. In the Netherlands rules exist which deny application of the participation exemption if no corporate tax is levied at the level of the foreign subsidiary. Furthermore, Dutch tax corporate tax law applies an accrual/fair value method of taxation in case of foreign passive investment (>25%,

non-EU) subsidiaries[1]. As a consequence of the latter regulation, any increase in value in the passive investment subsidiary will directly be taxed in The Netherlands. In doing, this could be claimed to be 'CFC look-a-like legislation'.

3. The definition of CFC

Nature of the foreign entity

Generally speaking, the CFC legislation applies to foreign entities, which would be treated as separate taxable entities for domestic tax purposes, like corporations and, in some cases, trusts.

In certain cases some entities, other than corporations, are also considered "foreign entities" for CFC purposes, depending on the specific features of the tax systems. For instance, in France, the legislation also applies to foreign permanent establishments of French companies, whose profits are normally exempted from corporate income tax; in Italy, it applies also to non resident partnerships, that are qualified for domestic tax purposes as non transparent taxpayers, and so on.

The level of taxation of the foreign entity

The jurisdiction approach, in its pure form or in its modified form of exemption approach, is adopted by almost all European countries. Indeed, according to this approach, the national CFC laws considered in this survey generally provide that the income produced by CFCs which is subject to a lower tax rate in their country compared to tax rate applicable to the resident shareholders will be classified as CFC taxable income.

Denmark is an exception in the European panorama. It uses the transactional approach, thus targeting incomes of a financial nature, provided they are earned by a CFC whose taxation rules "deviate substantially" from the Danish company income tax rules.

The jurisdictions may be specified under two main methods:

(i) a designated list of countries that are excluded from ("white list") or included in CFC legislation ("black list");

(ii) a comparative tax approach, according to which the legislation can apply to any country where the amount of taxes paid by the CFC is less than a specified rate determined on the basis of one of the following criteria:

   a. the foreign nominal (statutory) tax rate;
   b. the foreign effective average tax rate;
   c. the foreign actual tax paid by the CFC;
   d. the rate of the tax hypothetically payable had the CFC been resident in the domestic jurisdiction.

Most of the countries determine whether a lower level of tax is deemed to have been imposed by considering it as a percentage of the usual tax rate applied to the income of a legal person in the shareholder country or taking into account a tax rate established by domestic law. Some countries use a black list approach including countries viewed as tax havens; other countries use

[1] Since 1/1/2002 also applicable for non-EU passive investment companies held via a special purpose EU vehicle.

a white list including countries with a comparable tax system which are therefore considered as not having any CFCs based there. A combined white list/black list approach is also sometimes applied, as in the UK, where certain specific types of companies located in a white list country may still be deemed "black" and thus creating taxable CFC income.

In particular, Finland applies the CFC law to the shareholding in companies resident in countries where the tax level is less than 3/5 of the Finnish tax level. Furthermore, Finland also have a black list of countries where the taxation of the companies is considered inferior to the tax level of Finland: the CFC law is applied to the countries of the list, that does not include EU Member States.

In France, the CFC law is applicable to shareholdings in companies resident in countries where the income tax is considerably lower than in France; according to a tax administration guideline, the income tax is considerably lower when the tax rate applied in the foreign country is 1/3 lower than the French tax rate; there is no list of countries considered as tax havens.

Germany considers tax regime to be low where the actual rate of taxation of CFC is less than 25%.

Italy has approved a black list of countries with a privileged tax system, based on the following criteria: tax level noticeably lower than Italian tax level; lack of an appropriate exchange of information; other criteria similar to the previous ones. The black list does not include EU Member States, with the sole exception of the Luxembourg 1929 Holding Company.

According to Portuguese law, a privileged tax system exists when the tax dues in the foreign country are less than 60% of the Portuguese tax rate. There is no legal list of tax havens.

In Spain the CFC law must be applied to all the shareholdings in foreign companies when the characteristics meet the definition and, consequently, it is not necessary that the participated company is located in a tax haven. Nevertheless, CFC rule presumes that companies located in tax haven meet in the CFC conditions, and only when the taxpayer can rebut this presumption, the imputation is not applied. The black list includes just one EU Member State: Luxembourg.

There are no rules in the UK concerning determination of which country constitutes a tax haven. On the other hand, there are rules which exempt foreign companies from CFC attack provided that the local tax rates is more than 75% of the UK tax rate. However there is a list of countries that are not deemed to host CFCs (white list). In addition, there is another list of countries whose companies will not be considered CFCs provided they do not fall into certain "privileged" categories (black list) that includes, among the European tax regimes, the Belgian co-ordination centres and the Dutch holding companies.

In Sweden the current tax approach does not involve a precise comparison of foreign and domestic taxes, but CFC rules are applied when the foreign tax is not similar in level and structure to the national corporate tax.

For each country analysed, a company is not exempted *a priori* from the CFC law simply because it is based in a EU Member State.

4. Domestic taxpayers subject to CFC legislation

Finland, France, Germany, Italy, Portugal, Spain and Sweden apply the CFC law to individuals and legal persons owning shareholdings in a company located in country with privileged tax regime. France also extends the application of the CFC legislation to permanent establishment in France of non resident taxpayers

United Kingdom applies the CFC law only to resident companies, although the UK has separated and much older anti-avoidance legislation which effectively restricts the tax free use of CFCs by individuals.

5. The "control" concept

Generally speaking CFC income is taxed in the hands of its resident shareholder provided that it controls the foreign company.

There are different possible solutions to identify the control by domestic shareholders; the criteria are:

(i) the **single control**: a single resident shareholder holds a controlling or a qualified shareholding; this case includes the joint control (or constructive ownership), according to which a group of domestic shareholders, related by internal agreements, family links or other reasons, holds such controlling or a qualified shareholding (Denmark, France, Spain, Italy);

(ii) the **domestic control:** the CFC is controlled by domestic shareholders, even if they are unrelated parties (Finland, Germany, Sweden, United Kingdom, Portugal).

The various national CFC laws are very different as regards the shares that the national subject has to hold for its application.

Most countries use the "***de jure* control test**", according to which the resident taxpayer is liable to tax only if it owns *at least* the 50% [Spain, Sweden, Finland, United Kingdom (where the percentage is recently reduced to 40% for joint ventures)] or *more than* 50% (Germany, Italy) of the voting rights in the CFC and/or of the share capital. According to an anti-avoidance provision, in Finland, Spain and Sweden control is deemed to exist when the CFC is equally owned by resident and non-resident shareholders.

In some cases the "*de jure* control test" is extended to cover also the right of the shareholders to dividends; a company is deemed to be controlled when domestic shareholders are entitled to receive at least 50% of the distributable income of the CFC (France, Finland, Spain, United Kingdom) or, additionally, of the CFC value of assets on liquidation (Spain, United Kingdom).

Some countries, like Italy, use also the "***de facto* control test**", according to which the foreign entity is deemed to be controlled by a resident taxpayer if he has a "substantial influence" on the former, because of their contractual relations or because the shareholder, having a minority voting right, can nevertheless influence decisions taken in the annual shareholders' meetings.

In France, for CFC law to apply, a single shareholder must hold directly or indirectly at least 10% of the share capital (for individuals; for legal person the system that will be operating until 2002 establishes that, for the share owned before 30/09/1992, the company has to hold directly

or indirectly at least 25% of the share capital; for shares owned after 30/09/1992 the company has to hold directly or indirectly at least 10% of the share capital or of the voting rights or of the rights to dividend).

In Denmark the threshold is of 25% of the share capital or more than 50% of the voting rights. In Portugal the threshold is 25% of the share capital.

In France there is also a *de minimis* value threshold, so that if a shareholder has a capital investment of a certain amount (150 millions FF, equal to 22.870.000 €), irrespective of it percentage of shareholding, then CFC rules will apply.

This implies that the Danish, French and Portuguese systems cannot properly be defined as CFC legislations, (the "control" not being required), but rather a "Qualified Shareholding FC" legislation.

In all countries, control can be direct or indirect.

The control can be determined:

(i) at **any time** during the CFC's financial year (Denmark, United Kingdom);
(ii) at the end of the CFC's financial year (France, Germany, Italy, Portugal, Spain, Sweden).

6. Exemptions

The various national laws establish particular cases of exemptions from the application of the CFC rules. Since all surveyed countries (with the exception of Denmark) apply the jurisdiction approach, such exemptions typically reflect a variation of this approach.

One type of exemption is based on the **genuine business activity** of the foreign company: it is the exemption approach of some active income produced in low-tax jurisdictions. Generally speaking, this exemption is allowed in Finland, France (only to companies), Germany, United Kingdom and Italy, provided that the non resident company carries on a real commercial or industrial activity in its country of residence, or in the relevant market. There are no particular exemptions in Portugal and, for individuals, in France.

A second group of exemption depends on the **dividend distribution policy** of the CFC. In this perspective, the United Kingdom establishes an exemption when at least 90% of the profits of the CFC are distributed to shareholders within 18 months (Acceptable Distribution Test).

A third kind of exemption is justified by a ***de minimis* rule**. For instance, Spain establishes that CFC passive income is not taxed when it is lower than 15% of the total income or 4% of the total gross income of the resident taxpayer; United Kingdom exempts CFCs if their total profits are less than £ 50,000; in Germany no attribution takes place if the passive income is less than 10% of the gross income of the CFC, provided that the amount exempted globally not exceeds DM 120.000, equal to about €60.000.

Fourthly, some countries exempt CFC if they are **listed on stock exchanges** (United Kingdom).

Finally, some legislations (France, Italy, United Kingdom) recognise an exemption from CFC rules according to a **Motive Test**, *i.e.* where the domestic taxpayer can demonstrate that the CFC has been established for genuine business purposes and hence not with the aim of

benefiting from tax deferrals; this exemption stresses the nature of CFC laws as anti-avoidance provisions.

7. Attribution and taxation of the CFC income

Having qualified a foreign company as a CFC according to the control test, the following step is to assess to which taxpayers the CFC income should be attributed for tax purposes.

There are different possible criteria to attribute to shareholders their share of the CFC income:

(i) attribution only to the **single domestic controlling shareholder** or to the **joint controlling shareholders** (Denmark, Italy, Spain, United Kingdom);

(ii) attribution to all **qualified domestic shareholders**, *i.e.* to those shareholders that own a participation not less than a given threshold (10% of the shares of the capital stock or of the dividend distributions in Finland, France and Sweden);

(iii) attribution to **all domestic shareholders**, irrespective of their shareholding percentages (Germany, Portugal).

According to the deemed dividend approach, the tax base for CFC purposes is the dividend that could be paid out by the CFC; this method is followed by Germany (whose legislation specifically provides that some tax treaties provisions applicable to distributed dividends also apply to deemed dividends under CFC legislation).

The piercing the veil approach leads to taxation of the profit of the subsidiary, instead of the dividend, calculated according to the shareholders' domestic tax rules. This is the case in Denmark, Finland, France, Italy and United Kingdom.

Portugal, however, determines the income of the CFC according to the foreign rules of the country of residence of CFC.

In some cases, specific tax relieves provided for by domestic legislations are not applicable (for instance in Italy and France, in calculating the CFC taxable income it is not permitted to deduct the additional depreciation allowance; in Italy it is not allowed to share capital gains for tax purposes in more than one fiscal year, and so on).

A number of countries that apply a jurisdiction approach for defining target territories (German and Spain) then apply a **transactional approach in determining the attributed income** (Denmark, Germany, Spain). For instance, German and Spanish laws foresee that only particular categories of incomes (passive incomes) are taxed; Denmark taxes incomes from financial activities, whether passive or active.

Other countries apply the **entity approach** (or "all-or-nothing approach"): if a CFC is not exempt, all the income of the CFC is considered for attribution to resident shareholders (Finland, France, Italy, Portugal, Sweden, United Kingdom).

In some countries (e.g. France, Italy and United Kingdom) a separate regime of taxation is applied.

8. Loss compensation and consolidation

The Danish, Finnish, French, German, Italian and British laws establish that the loss realised in previous fiscal years by the CFC can be used to reduce the CFC income (carry forward). This is not allowed in Portugal and Spain.

The Finnish, Spanish and British laws establish that the CFC taxable income can be reduced by the loss realised by the domestic company. This is not allowed by French, German, Italian and Portuguese legislation.

In France, the income of CFCs can be consolidated where the French corporate shareholder adopts one of the French consolidation methods; consequently, CFC losses can be deducted from the taxable income of the shareholder.

No country (excluding France in case of consolidation) allows offsetting the losses of one CFC with the income of another CFC.

9. Limitations on the tax deduction of cost incurred or charged by CFCs

As regards the tax deduction of the costs incurred by a CFC resident in tax haven countries, the various national laws generally do not provide limitations differing from the general domestic rules for calculating the taxable base.

As far as the costs charged by CFCs to resident taxpayers are concerned, France, Italy, Portugal and Spain do not allow the deduction of expenses or other costs related to transactions between resident enterprises and companies located in countries with a privileged tax system. However, in these countries the deduction of such costs is allowed provided that the resident taxpayer gives evidence that the costs are charged by a company that carries on an effective commercial activity or that the transaction corresponds to an actual economic interest of the domestic taxpayer and it has actually taken place.

To avoid double taxation, Italian law provides that the limitation of the deduction of the costs charged by a CFC does not apply, provided that the income of said CFC has been taxed in the hands of the resident taxpayer to whom the costs have been charged by the CFC.

In France, Germany and the United Kingdom there are no rules specifically relating to CFCs in this respect.

10. Double taxation relieves

Double taxation risks arise as follows:

(i) international legal double taxation: CFC profits are taxed once in the country in which the CFC is located and for the second time in the country in which its shareholders are located;

(ii) domestic economic double taxation: CFC profits are taxed in the country of residence of the shareholders once according to CFC rules and for the second time when the dividends have been paid out;

(iii) international economic double or multiple taxation:

a. due to interactions of CFC regimes of different countries: in case of a parent company located in the State A, that holds a sub-holding located in the State B, that controls a CFC, CFC profits could be taxed, according to the CFC rules, once in State B and for the second time in State A;
b. due to interactions of CFC regimes of one country with different anti-avoidance measures of other countries (transfer price, thin capitalization, refusal of deduction of costs charged by CFCs, etc.).

As far as the first case is concerned, the majority of countries allows a foreign tax credit, thus avoiding a double taxation: shareholders are allowed to deduct from the taxes due in their country of residence the taxes paid by the CFC in the country where the CFC is located (France, Italy, Spain, UK). Other countries mitigate double taxation, allowing the deduction of taxes paid by the CFC from the taxable income of its shareholders (Finland, Portugal).

As far as the second case is concerned, when the actual distribution of dividends takes place, the legislations, in order to avoid double taxation, establishes the exemption of the amount of the income already taxed according to the CFC law (Denmark, Finland, France, Italy, Portugal, Sweden), or grant a tax credit for the amount of the domestic tax already paid according to the CFC law (Spain, United Kingdom), or refund the tax levied on profits previously attributed (Germany), or tax dividends but allow taxpayer to deduct their amount from the attributed income in the year of payment (Portugal).

Having regard to the third case, i.e. the interaction of the CFC regimes of different countries, few legislations contain provisions to avoid double taxation: for instance, Sweden takes into account the foreign taxes paid by a CFC to determine the effective level of taxation; under German provisions, any tax levied on the income of a CFC under another country's legislation is creditable against the German tax on that same income; the French legislation acknowledges that relief may be available pursuant to the mutual agreement procedure provided in a relevant tax treaty.

11. Consistency of the CFC legislations with the tax treaties

The answers reveal mixed opinions on whether CFC legislation can be applied when a tax treaty is in force (no for France, yes for UK), but it is generally pointed out that treaty rules prevail on domestic CFC rules (Italy, Portugal and Spain).

Commentary to Art. 1 of the OECD Model of Double Taxation Convention, at § 23, affirms that some anti-avoidance rules, like CFC legislations, "are not addressed in tax treaties and are therefore not affected by them".

On the other hand, art. 7, § 1 of the Model states "the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein". According to art. 5, § 7, "the fact that a company which is resident of a Contracting State controls or is controlled by a company which is resident of the other Contracting State (...) shall not of itself constitute either company a permanent establishment of the other".

According to these provisions, the business profits of a subsidiary should be taxed only in its State of residence. The right of the State of residence of shareholders to tax this profit should be limited by art. 10 to the "dividends paid", remembering that "the term 'paid' has a very wide

meaning, since the concept of payments means the fulfilment of the obligation to put funds at the disposal of the shareholder in the manner required by contract or by custom" (Commentary to art. 10, § 7).

Some legislations provide an exemption to CFC taxation when the foreign company is resident in a country with which the domestic State has a treaty in force.

This is the case of Finland, whose legislation poses some requirements for this exemption: the foreign country considers the CFC as being resident in that country, the treaty applies to the income of the CFC, it is subject to tax and it has not taken advantage of some tax relief.

Other countries, like France, Germany, Portugal and Spain, have introduced in some of their tax treaties specific provisions aimed at confirming the application of their domestic CFC legislations and at avoiding that some treaty clauses (namely those indicated here above) could be interpreted as limitations to domestic CFC rules. Germany, in addition, generally allows the income attributed to its residents according the CFC rules to benefit from the relieves for dividends provided for by the treaties.

In some treaties there are specific clauses that do not allow a country to apply its domestic CFC legislation in their bilateral relationships (for instance the tax treaty between Denmark and Brazil, at art 23, § 5, prohibits the Danish CFC taxation of financial activities undertaken by Brazilian companies).

At the academic level there is a very interesting debate about the consistency between CFC laws and double taxation convention provisions that has been bettered by some French cases on this topic.

Since this is not an academic paper, but a professional contribution to the issue, it seems more appropriate to focus on the practical application of CFC rules. Where a deemed dividend approach is followed (like in Germany and United Kingdom), the benefits of the conventions are granted and no double taxation arises, it appears that the main objectives of tax treaties are safeguarded. Hence, no conflict between the two systems could be found.

It is useful to point out that, in some cases, a CFC tax treatment determines a lower tax burden than a non-CFC tax treatment that leads to economic double taxation.

Indeed, in case of foreign dividends taxed with a non-CFC method, an economic double taxation often arises (for instance, in Italy foreign dividends earned by individuals are fully taxable, and no exemption or imputation method is in place to avoid economic double taxation); in case of taxation with a CFC method, it is generally allowed to deduct from the domestic tax the foreign tax paid by the CFC, according to the international imputation system.

On the other hand, where a CFC system is designed according to a strict "piercing the veil" approach, thus causing the attribution of the business profit of the CFC to its shareholders, and the rules and benefits concerning dividends are disallowed, it seems that some conflict could arise between such a domestic system and the rules of the tax treaty, except where there is a safeguard clause that allows one of the contracting States to apply its CFC legislation.

12. Consistency between CFC legislations and EU laws

This topic concentrates on the academic debate as well, and focuses mainly on the consistency of CFC rules with principles provided for by the EC treaty or by EC Laws, and namely:

(i) the principle of non discrimination;
(ii) the need to avoid double taxations;
(iii) the freedom of establishment;
(iv) the Parent – Subsidiary directive;
(v) the Code of Conduct on tax competition within the internal market.

It is clear that the aim of this document is not to identify features of the CFC legislation of EU Member States that could be in conflict with the community law, if any, but rather to contribute to the debate, by capitalizing on the practical experience of the professional members of this Working Party.

The above listed principles need to be examined, with regard to the CFC legislation, in a global manner, i.e. each one in relation to the other. From this perspective, we could find a relationship between the freedom of establishment and the non discrimination provision, on the one hand, and the limits of the tax jurisdiction of each Member State within the internal market and the Code of Conduct, on the other.

It seems quite evident that a low-tax regime that is deemed to be in line with the provisions of EC laws, being approved by the Commission and complying with the soft-law rules of the Code, cannot be qualified, *per se*, as "harmful tax competition".

Hence, when a Member State, using its CFC legislation according to the piercing the veil approach, taxes the income of a foreign EC subsidiary which fiscal regime cannot be qualified as harmful tax competition, being in line with the EC laws, it should be assumed that this CFC law constitutes a form of covert discrimination against the freedom of establishment, that cannot be justified using a anti-avoidance argument, and that could be seen as contrary both to the Treaty provisions and the internal market concept.

In other cases, an undue exercise of the taxing jurisdiction in relation to the non discrimination provision and the freedom of establishment arises where some tax relieves provided for by the domestic legislation of the country in which a subsidiary is located, aimed to avoid economic double taxation (e.g. a participation exemption of capital gains granted after a short holding period), leads to the application of the CFC rules in the country of residence of the parent company, just because it does not follow the same approach in avoiding such double taxation and, hence, considers such a relief as a privileged tax regime.

A second remark concerns the absence in some CFC legislations of appropriate methods to avoid international double or multiple taxation. Such technical limits of CFC laws create phenomena of double taxation within the internal market that does not seem in line with EC laws.

Additionally, as far as the non discrimination principle is specifically concerned, it seems evident that the criteria of qualification of an EC subsidiary as a CFC are not always strictly justified; as a consequence, the legislation could produce a discrimination between resident taxpayers holding subsidiaries located in different Member States, one considered as CFC but not the other, without any reasonable justification. For instance, according to a pure transactional approach, a CFC legislation, in considering two EC subsidiaries, one located in State A and the second located in State B, both carrying on a genuine and active business and

having the same level of taxation, could qualify one of them as CFC simply because its activity is of financial nature, and not the other, whose activity is of manufacturing nature. Such an approach, combined with the piercing of the veil concept, leads to the taxation by the State of the parent company of the profit of the first company and not of the second one, even if both companies are in a substantially identical position.

A further discrimination in the taxation of subsidiaries located in different Member States could arise because of different provisions included in the tax treaties between the State of the parent company and the various States of the subsidiaries. Such different provisions may regard the right of the first State to apply its domestic CFC legislation (in some treaties it may be assured, but not in others), or the tax treatment of the CFC profits (in some treaties they may benefit from the dividend relief, but not in others).

The last remark regards the consistency between the Parent-Subsidiary Directive and the CFC legislation. According to a deemed dividend approach, the income of the CFC should be taxed as a dividend, according to the rules of the Directive, provided that its requirements are met. It seems unjustifiable that the other approach of the piercing the veil, that leads to the taxation of the profits of the subsidiary in the hands of its shareholders and offers the argument to State of the parent company that it is not taxing a dividend but a business profit, thus denying the tax relief provided for by the Directive.

III. CONCLUSIONS AND RECOMMENDATIONS

According to this overview, it appears that presently the nine EU countries with CFC legislation are aiming at different goals (avoidance of tax erosion, anti-avoidance provision, international tax neutrality, defensive measure against harmful tax competition, and so on). Some countries try to achieve more than one goal at the same time, and sometimes these different aims seem to be in conflict with each other.

From a difference perspective, it should be noted that arguments adopted to justify the tax policy of a CFC legislation are not always applied in a consistent way.

For instance, the argument that CFC legislation is aimed at avoiding tax deferrals, could create economic discriminations among taxpayers if some domestic taxpayers, investing inbound, are allowed to benefit from tax deferrals offered by the domestic tax law (for instance, special regimes of deferrals or just the deferral due to accumulation of profits in a domestic personal holding company taxed at a rate of corporation income tax which is lower than the progressive marginal income tax on individuals), and other domestic taxpayers, investing in a CFC, are not. This jeopardizes the international tax neutrality concept, which should be the main argument justifying a CFC system.

The international anti-avoidance provisions, used as an argument to justify a CFC law, should be consistent with the principle of proportionality: it is necessary to achieve a proper balance between the aim and the need to assure a full implementation of the internal market without tax obstacles that, at the end, create distortions in the economic allocations of resources and, hence, inefficiencies.

FEE recommends:

1. *That no CFC legislation should be applicable within the internal market, provided that the tax regime of the subsidiary is in line with the prescriptions of the Code of Conduct.*

The Commission should move to dispel the uncertainty surrounding the legality of controlled foreign company legislation in the context of the internal market. Even though no cases have yet been taken to the European Court of Justice, there is a growing body of academic legal opinion that casts doubt on the consistency between the domestic CFC legislations and EC treaty obligations. A legal challenge is only a matter of time. If such a challenge is successful, it will result in a considerable revenue loss for those member states that are relying on CFC legislation to eliminate distortions in the allocation of investment.

If the Commission considers that taxpayers may mount a successful challenge to CFC legislation, member states would be encouraged to cooperate in the existing initiative against unfair tax competition on the basis that this will be their only legitimate remedy to the problems associated with investment misallocation.

FEE also recommends:

2. *A better coordination in the tax treaty policy towards non-EC countries with regard to the application of CFC rules, to avoid distortions in the allocation of resources within the internal market.*

Where member states´ CFC legislation currently targets non-EU countries, it is recommended that member states should seek to coordinate their CFC policies to ensure that their legislation targets the same features of unfair tax competition as any successful initiative on harmful tax competition within the EU. This is to ensure that it cannot be categorised as discriminatory. In addition, they should ensure that their CFC legislation complies with existing treaty obligations.

3. *A better coordination among the different CFC legislations in place in the EU Member States, to avoid international double or multiple taxations.*

IV. Matrix of the key issues regarding the Controlled Foreign Company Legislations in the EU:

	BE	DE	ES	FR	IT	IR	LU	NE	AU	PT	FI	UK[2]
Are there rules on Controlled Foreign Companies (CFC) in the fiscal system of your country?	No	X	X	X	X	No	No	No	No	X	X	X
Who are the national subjects submitted to the CFC rules?												
- individuals		X	X	X	X					X	X	
- legal persons		X	X	X	X					X	X	X
- permanent establishments				X								
Which kind of relationship should there exist between the national subject and the CFC in order for the rule to apply?												
- control			X		X						X	X
- linkage												
- holding		X		X						X		
Does the CFC legislation envisage a list of countries considered as tax havens?			X		X						X	
Could a company be considered a CFC even if it is resident in an EU member country?		X	X	X	X					X	X	X
Does the national law consider taxable:												
- single categories or		X	X									
- the aggregate income of the CFC company				X	X					X	X	X
Are capital gains subject to CFC direction as other types of income?		X	X	X	X					X	X	
Are the taxed incomes:												
- determined by the tax rules of the country where the CFC has its residence or												
- by the beneficiary subject country rules		X	X	X	X					X	X	X
Could the loss realised by CFC in the previous years be carried forward to reduce the CFC income?		X		X	X						X	X
Could the CFC taxed income be reduced by the loss realised in the beneficiary company?			X								X	X
Does the national law grant to the resident subject a tax credit for the tax paid abroad by the CFC?		X	X	X	X					X	X	X

[2] BE: Belgium, DE: Germany, ES: Spain, FR: France, IT: Italy, IR: Ireland, LU: Luxembourg, NE: Netherlands, AU: Austria, PT: Portugal, FI: Finland, UK: United Kingdom

	BE	DE	ES	FR	IT	IR	LU	NE	AU	PT	FI	UK[3]
Does the national law regulate the effect of double taxation over the resident subject at the moment of the dividend distribution from the CFC to the resident subject?		X	X	X	X					X	X	X
Does the national law establish particular cases of exemption by the application of the CFC rule?		X	X	X	X					X	X	X
Are there rules, within the fiscal system of your country, reducing the tax deduction of the costs charged by a CFC resident in tax haven countries?			X		X					X		

[3] BE: Belgium, DE: Germany, ES: Spain, FR: France, IT: Italy, IR: Ireland, LU: Luxembourg, NE: Netherlands, AU: Austria, PT: Portugal, FI: Finland, UK: United Kingdom

PART II

ANSWERS BY COUNTRY

QUESTIONNAIRE ON CONTROLLED FOREIGN COMPANY LEGISLATIONS IN THE EU

1. Are there rules about Controlled Foreign Companies (CFC) in the fiscal system of your country?

Austria

There is no CFC in Austrian tax legislation and there are no proposals pending.

Belgium

No, there are not rules about CFC in the fiscal system of Belgium.

Finland

Yes.

France

Yes.

Germany

The German fiscal system contains one system of regulations concerning the taxation of the revenue realised by Controlled Foreign Companies (CFC).

This system is part of the German Foreign Transactions Tax Act (AStG).

Legal norms: Sec. 7 to 14 Foreign Transactions Tax Act (AStG)

It has to be added that a revision of this part of the Foreign Transactions Tax Act is discussed, which might result in several changes regarding the content of the following answers.

Beyond this special anti-abuse legislation for CFC's, Sec. 42 General Fiscal Code (AO) as a general anti-abuse clause may under some circumstances also apply to Controlled Foreign Companies in tax havens aimed at avoiding German taxation without any reasonable economic background.

Ireland

No.

Italy

On 9/11/2000 it has been approved by the parliament the Law n.342 of 21/11/2000, which introduces in the Italian fiscal system specific rules regarding the Controlled Foreign Companies. Anyway this Law will be effective from the year 2002.

Luxembourg

There are no specific tax rules in Luxembourg. General rules such as the participation exemption, transfer price rules and general anti-abuse clauses apply.
Fiscal integration is only possible with resident companies.

For application of the participation exemption the foreign company needs to be fully taxable at a rate of at least 15%. This could maybe be considered a CFC rule.

The Netherlands

No, there are not rules about CFC in the fiscal system of the Netherlands. (However see part I, paragraph II.2 above).

Portugal

Yes. However the CFC rules only applied to the participated company located in a tax haven.

Spain

Yes, there are two kinds of CFC rules: for individuals (art. 75 Spanish Income Tax) and for legal persons (art. 121 Spanish Corporate Tax).

United Kingdom

The UK has had CFC legislation since 1984.

2. Who are the national subjects submitted to the CFC rules (individual, legal person, permanent establishment)?

Austria

N/A

Belgium

N/A

Finland

CFC's shareholders and/or beneficiaries with unlimited tax liability in Finland (can be individuals or corporate entities).

France

Two Articles of the French Tax Code provide rules about CFC.

1. *Article 123 bis of the French Tax code*
This Article applies to individuals who are resident of France.

2. *Article 209 B of the French Tax Code*
This Article provides two systems.

(a) Initial system

The first system, applicable as from January 1, 1980 until December 31, 2002, applies to businesses subject to French corporate income tax having created or acquired CFC's before september 30th 1992.

(b) New system

The new system, introduced by the 1993 Finance Act, concerns legal persons subject to French corporate income tax.

(c) In both systems, French branches of foreign businesses are also concerned.

Germany

The subjects submitted to the CFC rules are taxpayers being subject to unlimited tax liability.

Therefore reference must be made to the German Income Tax Act (EStG) in cases of natural persons and the German Corporate Tax Act (KStG) in connection with legal entities. Unlimited tax liability generally requires residence of the taxpayer in Germany.

German Permanent Establishments are not subject to the CFC rules.

Legal norms: Sec. 7 Para. 1 Foreign Transactions Tax Act (AStG),
Sec. 1 Para. 1, 2 Income Tax Act (EStG),
Sec. 1 Para. 1, 3 Corporation Tax Act (KStG)

Ireland

N/A

Italy

The Law n. 342 provides to apply the CFC rules to the following subjects:

a) Resident individual;
b) Resident partnership;
c) Resident companies;
d) Public and private Authorities different from resident companies.

Luxembourg

N/A

The Netherlands

N/A

Portugal

- Individuals who are resident of Portugal;

- Legal persons subject to Portuguese corporate income tax.

Spain

Only individuals and legal persons.

United Kingdom

UK resident companies are subject to the UK CFC rules.

3. Which kind of relationship must exist between the national subject so that the rule can be applied (please indicate if control, linkage or simply holding is required)?

Austria

N/A

Belgium

N/A

Finland

For a company to be considered as CFC, it must be controlled from Finland. This means that at least 50 % of the share capital or at least 50 % of the voting power in CFC belongs to persons (natural or legal) with unlimited tax liability in Finland (ownership and voting power can be either direct or indirect). The (potential) CFC is also considered as being controlled from Finland if persons with unlimited tax liability in Finland are entitled to at least 50 % of the yield of the net wealth of the CFC.

For CFC legislation being applicable in a single shareholder's (or beneficiary's) taxation, the shareholder (or beneficiary) in question must own at least 10 % of the shares in the CFC or is entitled to at least 10 % of the yield of the net wealth. The persons and entities belonging into the same group of interest are taken into account.

France

1. *Article 123 bis of the French Tax Code*

   The individual must hold, directly or indirectly, at least 10 percent of the shares, the voting rights or the financial rights.

2. *Article 209 B of the French Tax Code*

   (a) Initial system

   The enterprise must hold, directly or indirectly, at least 25 percent of the capital of the CFC.

   (b) New system

   The legal person must hold, directly or indirectly, at least 10 percent of the capital of the CFC. The new CFC rules are also applicable if the investment cost reaches FF. 1,500,000.

Please note that the new CFC rules are also applicable to foreign permanent establishment (according to French fiscal law, the profits of a foreign permanent establishment of a French company are exempt from corporate income tax).

Germany

Taxpayers being subject to unlimited taxation must have the majority of shares in the CFC. Special rules apply to CFC's realizing capital investment income where a German participation of 10 % is sufficient. According to draft legislation this minimum participation required shall be decreased to 1%.

Shares being hold in an indirect way also have to be included.

Legal norms: Sec. 7 Para. 1 to 4 Foreign Transactions Tax Act (AStG)

Ireland

N/A

Italy

The Law n. 342 establishes that the national subjects, as indicated at point n.2), have to hold directly or indirectly a control share. The same bill specifies that in order to detect the control edge, the shares or quotas, voting rights and rights referring dividends distributed are relevant.

Luxembourg

N/A

The Netherlands

N/A

Portugal

The national person must hold, directly or indirectly, at least 25 percent of the capital.

Spain

The Spanish Corporate Tax Act applies the CFC rules to the nationals that participates in a foreign company when that participation is over 50% of the foreign company's capital, results, vote rights or stockholderequity.

United Kingdom

The key test is 50% or more ownership of the CFC although recent legislation reduced this to 40% for joint ventures.

4. Which are the criteria, within the CFC rule, in order to determined the countries considered as tax havens? The CFC rule foreseen a list of country ? If yes, reported it.

Austria

N/A

Belgium

N/A

Finland

The ultimate criteria is that if a foreign corporate body's actual taxation in its country of residency has been less than 3/5 of taxation a Finnish resident corporate body would have been subject to in Finland, the corporate body is considered to be CFC.

There is also a list of the countries (provided by the National Board of Taxes) where corporate bodies are considered to be liable to pay income tax which substantially deviates from the corporate tax which corporate bodies must pay in Finland. A company in residing in one these countries is not however considered as CFC provided that its actual taxation is not lower than the rule mentioned in the previous chapter requires.

The countries in the list are: The United Arab Emirates, Barbados, Malaysia, Malta, Pakistan, Singapore and Switzerland.

France

The CFC must be subject to a "privileged-tax regime". To be more precise, the CFC must be subject to taxes on profits which are "notably" lower than the taxation of profits in France.

This is to be decided on a case-by-case basis. The French tax authorities have nevertheless issued a guideline stating that the foreign tax must be at least lower by one third than an equivalent French tax.

There is no legal list of "tax havens".

Germany

The system of the German CFC rules does not use the criterion of countries being considered as tax havens in any direct or indirect way. Rather the law defines that any CFC which is taxed at an effective tax rate of less than 25 % in its country of residence and earns passive income is subject to the rules. There is only an unofficial list of the Federal Ministry of Finance containing the "usual suspects".

Ireland

N/A

Italy

The Law n. 342 establishes that it has to be approved a decree containing a list of countries with a endowed tax system on the basis of the following criteria:

e) A consistently lower tax level compared to the Italian tax level;
f) Lack of an appropriate exchange of information;
g) Other similar criteria.

Luxembourg

N/A

The Netherlands

N/A

Portugal

The CFC must be subject to a "privileged-tax regime". The CFC must be subject to local tax rates lower than 60% of the Portuguese tax rate.

At present there is no legal list of "tax havens".

Spain

The CFC rules must be applied to all foreign companies which characteristics suit in the definition, and, consequently, it is not necessary that the participated company is located in a tax haven.

Nevertheless, CFC rules presumes that companies located in tax havens met in the CFC conditions, and only when the taxpayer can reboot this presumption, the imputation is not applied.

The list of tax havens include the following jurisdictions:

EUROPE:

- Andorra
- Gibraltar
- Channel Islands
- Malta
- Isle of Man
- Liechtenstein
- Luxembourg
- Monaco
- San Marino

AFRICA:

- Liberia
- Mauricio
- Seychelles

AMERICA:

- Netherlander Anthill
- Aruba
- Anguilla
- Antigua y Barbuda
- Bahamas
- Barbados
- Bermudas
- Caiman
- Dominica
- Granada
- Jamaica
- Malvinas
- Montserrat
- San Vicente y Las Granadinas
- Santa Lucia
- Trinidad y Tobago
- Turks and Caicos Islands
- British Virgin Islands
- USA Virgin Islands
- Panama

United Kingdom

There are no rules in the UK concerning determination of which country constitutes tax haven. On the other hand, there are rules which exempt foreign companies from CFC attack provided that the local tax rates is more than 75% of the UK tax rate. The UK has also prepared a list of countries where it will not consider a CFC to exist. This is quite a comprehensive list and covers very many of the world's major trading and tax jurisdictions. In addition, there is another list of countries whose companies will not be considered CFCs provided they do not fall into certain "privileged" categories, e.g. Belgian co-ordination companies and Dutch holding companies.

5. Could company be considered a CFC even if the company is resident in an EU member country? Are the "Parent Company rules" restricted by the CFC rule?

Austria

N/A

Belgium

N/A

Finland

It is possible if the company in question has profited from some specific tax relief legislation of the EU country in question and the company's actual taxation in its country of residency has been less than 3/5 of taxation a Finnish resident company would have been subject to in Finland.

France

Yes, it could be considered (without prejudice to Community Law).

No, the "Parent Company rules" are not restricted by the CFC rule.

Germany

A legal entity could be a subject to the CFC rules, even if the CFC is resident in a member country of the EU.

The parent company rules are not restricted by the CFC norms.

Ireland

N/A

Italy

The Law n.342 establishes nothing so at the moment it is not possible to say if the "Parent Company rules" can be applied.

Luxembourg

The 15% rule (cf. 1) applies also to EU companies.

The Netherlands

N/A

Portugal

Yes. Being a member of the UE is not a restriction to apply the CFC rules.

In principle, CFC rules are not in contradiction of Parent – Subsidiary Directive and, consequently, CFC rules does not restrict its application.

Spain

Yes. Being a member of the UE is not a restriction to apply the CFC rules.

As a general idea, Spanish CFC rules provides that Spanish taxpayers must include in their taxable base certain profits obtained by non-resident companies controlled by them. In principle, we must say that those rules are not in contradiction of Parent – Subsidiary Directive and, consequently, CFC rules does not restrict its application.

United Kingdom

A company is not exempted from being attacked under CFC legislation simply because it is based in the EU Member country.

6. Does the national law consider taxable single categories or the aggregate income of the CFC company?

Austria

N/A

Belgium

N/A

Finland

The Finnish CFC –legislation takes account the whole income of the potential CFC. The main principle is that the income of the potential CFC is calculated according to the Finnish legislation.

France

The aggregate income of the CFC company.

Germany

For applying the CFC rules each activity of the CFC has to be analysed separately. Only so-called passive income is subject to the CFC rules.

Therefore two requirements must be fulfilled in connection with the taxation of the income.

First, the CFC has to earn passive income and, secondly, the income of the CFC has to taxed at less than 25 per cent in its residence country.

Legal norm: Sec. 8 Foreign Transactions Tax Act (AStG)

Ireland

N/A

Italy

The Law n. 342 provides that the whole income, produced by companies or other authorities established in tax privileged countries, must be appointed to the resident in proportion to the owned share, without any consideration about the actual dividend distribution.

Luxembourg

The income of the CFC is not taxable in Luxembourg, except if a dividend is paid.

The Netherlands

N/A

Portugal

The aggregate income of the CFC company.

Spain

The Spanish Corporate tax provides that only single positive categories produced by CFC must be included to the national in proportion to the owned share.

United Kingdom

Basically the law looks at the total income of the CFC as calculated in accordance with UK tax legislation.

7. Are capital gains subject to CFC direction as other types of income?

Austria

N/A

Belgium

N/A

Finland

When it is under consideration whether a foreign corporate body should be treated as CFC or not, this evaluation is to be made according to the Finnish legislation. Based on this realized capital gains for a corporate body are taxable income as any other income.

France

Yes.

Germany

The intention of the CFC rules is to identify and to tax “passive income”.

This might although be true for capital gains if the assets sold do not serve “active operations” according to the catalogue in Sec. 8 Para. 1 No. 7 Foreign Transactions Tax Act (AStG).

Ireland

N/A

Italy

The capital gains are subject to the CFC direction as company income.

Luxembourg

N/A

The Netherlands

N/A

Portugal

Yes.

Spain

As the article 121 of the Spanish Corporate tax Act says, all capital gains must be included in the resident taxable income, as other types of CFC income, whenever the assets transmitted would be capable of producing passive income.

United Kingdom

Apparently capital gains arising to overseas companies do not come within the scope of the CFC legislation although this is under consideration.

8. Are the taxed incomes determined by the Tax rules of the country where the CFC has its residence or by the beneficiary subject country rules? In the second case is it possible to apply the same or similar rules to that used in order to tax the income produced by a non-resident branch office?

Austria

N/A

Belgium

N/A

Finland

See answer 6.

France

(a) The taxed profits are in principle determined on the basis of the French Tax Code's rules (corporate income tax).
(b) N/A

Germany

The taxed income is determined in compliance with the German tax and accounting principles, i. e. the beneficiary subject country rules.

A similar approach as in the case of income determination of a foreign p. e. can in practice be taken.

Legal norm: Sec. 10 Para. 3, 4 Foreign Transactions Tax Act (AStG)

Ireland

N/A

Italy

The Law n. 342 establishes that the CFC income must be determined using the usual tax rules of the Italian law: Anyway it is not possible to divide the capital gains, and it's not allowed to utilize accelerated depreciation.

Luxembourg

N/A

The Netherlands

N/A

Portugal

The Law doesn't establish anything about this issue, but in principle, the taxed profits are determined on the basis of the Portuguese Tax rules.

Spain

In Spain the positive CFC's income that must be included to the national's taxable income is determined by the principles and criteria of the Spanish Corporate Tax. The rules used to tax the income produced by a non-resident branch office are not directly applicable to CFC.

United Kingdom

As mentioned earlier, the taxable income of the CFC is calculated in accordance with UK tax rules.

9. Could the loss realised by CFC in the previous years be carried forward to reduce the CFC income ? If yes in which way?

Austria

N/A

Belgium

N/A

Finland

Yes. Basically the loss can be carried forward and utilised during the five years following the year the loss occurred. However the loss may be set off only against the shareholder's/beneficiary's share of taxable income derived from the same CFC.

France

Yes, if the CFC is subject to the CFC rules while the loss is realized.

Germany

Those losses, which can not be carried back under the conditions of Sec. 10d Para. 1 Income Tax Act (EStG), can be carried forward.

A carry forward of losses is only possible in cases of "passive income" according to Sec. 8 Foreign Transactions Tax Act (AStG).

A limitation, e.g. a maximum of years or a financial range, is not set up.

Legal norm: Sec. 10 para. 3 Foreign Transactions Tax Act (AStG) Sec. 10d Para. 2 Income Tax Act (EStG)

Ireland

N/A

Italy

According to the Law n. 342 it is possible to compensate the CFC income with the previous loss.

Luxembourg

N/A

The Netherlands

N/A

Portugal

No.

Spain

No.

United Kingdom

As normal UK tax rules will apply, then losses could be carried forward but it should be noted it is unlikely that a CFC would have tax losses, in particular, trading tax losses.

10. Could the CFC taxed income be reduced by the loss realised in the beneficiary company? If yes in which way?

Austria

N/A

Belgium

N/A

Finland

CFC income is taxable income for the shareholder/beneficiary. After the CFC income has been calculated, it is taken into account as shareholder's/beneficiary's taxable income. If for example the shareholder's/beneficiary's other functions make loss the CFC income and the loss from other functions can be set against each other for tax purposes.

France

No.

Germany

The income of the CFC cannot be reduced by the loss realised by the German taxpayer. However, according to draft legislation the income attributed under the CFC rules can be offset by losses of the German parent.

Ireland

N/A

Italy

The Law n. 342 does not seem to offer this chance.

Luxembourg

N/A

The Netherlands

N/A

Portugal

No.

Spain

Yes. The CFC imputed income is included in the taxable base of the resident taxpayer.

United Kingdom

There are no provisions for offsetting losses of associated companies against CFC profits on a worldwide basis. On the other hand, if the UK company being subject to the CFC charge had its own trading losses, either directly or within its UK group, then these losses could be offset against the CFC income.

11. Does the national law grant to the resident subject a tax credit for the tax paid abroad by the CFC? If yes in which way?

Austria

N/A

Belgium

N/A

Finland

Yes, to some extent. The state tax paid by CFC to its country of residency is deducted from the taxable CFC income. The respective double tax treaty may limit the applicability of this rule. The credit is limited to the amount of Finnish taxes on the same income.

France

Yes, on the condition that the taxes paid by the entities established in the tax haven are comparable to the French corporate income tax.

Germany

The foreign taxes paid by the CFC can be credited as far as they relate to the passive income.

There is also an option to deduct the foreign taxes from the German taxes.

Legal norms: Sec. 10 Para. 1 and Sec. 12 Foreign Transactions Tax Act (AStG)

Ireland

N/A

Italy

The Law n. 342 establishes that the tax paid abroad will be completely deductible from the national tax as calculated at the previous question 8.

Luxembourg

Luxembourg has a general system for offsetting tax paid abroad on income subject to taxation both abroad and in Luxembourg. Foreign taxes are offset with Luxembourg tax within the limit of the Luxembourg tax, a refund is not possible.

So if our general anti-abuse rule would lead to an effect similar to those of CFC rules (that we do not have) this system would apply.

The Netherlands

N/A

Portugal

The tax paid abroad by the CFC is deducted to the taxable income.

Spain

Yes. The resident taxpayer could deduce of its tax quota too, the Spanish equivalent Corporate Tax paid, in proportion to the positive CFC income included to the national's Corporate Tax, except in case of Tax Haven.

United Kingdom

Credit is allowed in the UK for foreign taxes paid by the CFC. This is in accordance with normal UK rules by way of offset against UK tax payable on the CFC income up to a maximum of the UK tax payable.

12. Does the national law regulate the effect of double taxation over the resident subject at the moment of the dividend distribution from the CFC to the resident subject? If yes in which way?

Austria

N/A

Belgium

N/A

Finland

Yes. Basically the dividend income from a CFC is taxable income only to the extent the dividend exceeds the amount of income from the same CFC that has been considered in Finland as taxable CFC income of the shareholder/beneficiary for the same or five previous years.

France

1. *Article 121 bis of the French Tax code*
   Yes. Dividends distributed by the CFC are exempt from personal income tax.

2. *Article 209 B of the French Tax Code*
   Partially by application of the French "Parent Company rules".

Germany

Dividends distributed to German corporations are generally exempt and, therefore, no double taxation can occur. Also for individuals there are quite complicated rules to avoid double taxation. Under proposed legislation also for individuals dividends received shall be tax exempt to the extend income has been attributed under the CFC rules in the seven preceding years.

Ireland

N/A

Italy

The Law n. 342 provides that the profits, however distributed, do not contribute to form the resident subject income for an amount equal to the taxed amount in the previous tax period.

Luxembourg

N/A. As the CFC is not taxed in Luxembourg, there is no double taxation.

The Netherlands

N/A

Portugal

Yes. The dividend income from a CFC is taxable income only to the extent the dividend exceeds the amount of income from the same CFC that has been considered in Portugal as taxable CFC income of the shareholder/beneficiary for the same year.

Spain

Yes, the tax paid at the moment of the dividend distribution can be credited by the receptor, although the imputation was made in a previous period.

United Kingdom

Yes, if tax in the UK has already been paid on the income from which the dividend arises, then credit will be allowed for the UK tax already paid, thus eliminating a double UK tax charge.

13. Does the national law establish particular cases of exemption by the application of the CFC rule? If yes, how is this exemption ruled?

Austria

N/A

Belgium

N/A

Finland

Yes. Like mentioned above the main and ultimate rule is that if a foreign corporate body's actual taxation in its country of residency has been less than 3/5 of taxation a Finnish resident corporate body would have been subject to in Finland the foreign corporate body is considered as CFC (there are also other rules for example the corporate body must be controlled from Finland, see above).

There are two kinds of exemptions:

1) The corporate body is not deemed to be a CFC if its income is mainly derived from industrial activity, any other comparable production activity or shipowning in its country of residency or if the corporate body's income is mainly derived from sales and marketing activity, which directly serves a corporate body conducting one of these areas (three) of activity and which is mainly directed to the territory of the country of residency. The corporate body is not deemed to be a CFC if its income is mainly derived from payments made by a limited liability company within the same group which is resident in the same country as the corporate body in question and conducts there one of the industrial activities mentioned above.

2) The corporate body is not deemed to be CFC if it is resident in a country with which Finland has a double taxation treaty in force provided that the treaty considers the company as being resident in that country and the treaty applies to the company's income and provided that corporate bodies are considered to be liable to pay income tax which does not substantially deviate from the corporate tax which corporate bodies must pay in Finland and if the corporate body in question has not profited from some specific tax relief legislation of that country.

France

1. *Article 121 bis of the French Tax code*
   No.

2. *Article 209 B of the French Tax Code*
   Yes. The French company must demonstrate that the CFC existence does not principally results in "localizing profits in a privileged tax country". Such is the case, notably, if the CFC has mainly an effective industrial or commercial activity and that it carries out its operations in a dominating way on the local market.

Germany

There is an exemption limit of 120.000.- DM, if the passive income does not exceed 10 per cent of the total income of the CFC.

Legal norm: Sec. 9 Foreign Transactions Tax Act (AStG)

Ireland

N/A

Italy

The Law n. 342 establishes that it is not possible to apply the CFC rule on the following alternative cases:

- the resident partnership, company or authority carries on a real commercial or industrial activity in the market where it has its head office;
- the resident subject is able to demonstrate that the holding of the share doesn't obtain the effect to localize income in tax privileged countries.

In both cases there is the possibility to ask for a Tax Ruling.

Luxembourg

N/A

The Netherlands

N/A

Portugal

No.

Spain

There are no exemptions, but there are some CFC income that you do not have to include in the national's income when the passive income:

- would have been over 15% of the national's total income
- would have been over 4% of the CFC's total transactions.

United Kingdom

There are a number of exemptions from CFC attack under UK law.

Firstly, there is a Genuine Trading Test. Where it can be demonstrated that the overseas operation was set up for genuine trading purposes and that its business is operated by appropriate number of staff with real power to run it, then no CFC will exist. There are more restrictions, however, on financial activities and trades - where more than 50% of transactions are intergroup generally a CFC will be deemed to exist, even if otherwise the genuine trading test could be met.

There is an Acceptable Distribution Test whereby provided at least 90% of the profits of the CFC are distributed within 18 months by way of dividend, then no CFC attack will be applied.

There is also a Motive Test, difficult to establish, but where it can be shown that the offshore operation was set up for genuine business reasons and in no way for tax avoidance reasons, then whatever type of operation, the overseas profits could be exempted from CFC attack. There is another slightly anomalous exemption where the company would otherwise be a CFC but is quoted on overseas stock exchange.

14. Does the national CFC law oppose with the duties or facilitation established by treaties against double taxation? Are there internal laws regulating possible conflicts between the internal CFC law and the rules contained in the treaties?

Austria

N/A

Belgium

N/A

Finland

No, but it sets certain limits. In The Act on Taxation of Shareholders in Controlled Foreign Companies there is a clause concerning crediting the foreign tax (see above, 11).

France

Yes the national CFC law opposes with the duties or facilitation established by treaties against double taxation.

No, there are not internal laws regulating possible conflicts between the internal CFC law and the rules contained in the treaties.

According to a recent judgment of the administrative Court of appeal of Paris, most tax treaties concluded by France should prevent the application of Article 209 B.

Germany

Generally, the CFC rules follow the "deemed dividend" concept. Therefore, treaty rules regarding dividends including a participation exemption apply. However, with regard to income from capital investments the German legislations provides for a treaty override.

Ireland

N/A

Italy

The Law n. 342 does not establish anything about this issue.

Luxembourg

N/A

The Netherlands

N/A

Portugal

The CFC law doesn't establish anything about this issue. However, in principle, Treaties rules must be applied with preference.

Spain

In principle, we understand that Spanish CFC rules are compatible with Treaties. If a incompatibility arises, CFC rules provides that Treaties rules must be applied with preference.

United Kingdom

Although this is the subject of academic debate, it is not generally felt that the CFC law conflicts with the provisions of UK double taxation agreements. There are no internal laws relating in any way to conflict of this nature as it is not foreseen that problems will arise in this area.

15. Are there rules, within the fiscal system of your country, reducing the tax deduction of the costs sustained by the CFC resident in tax haven countries? If yes, please explain what the national law establish;

Austria

N/A

Belgium

N/A

Finland

As a general rule it can be said that the CFC's costs connected to its business activities are deductible of its income. This is because the CFC's profit taxable in Finland as CFC income is to be calculated according to the Finnish tax legislation and as a general rule costs connected to a company's economic activities are deductible according to the Business Income Tax Act.

France

There are no specific provisions.

Germany

There are no rules of that kind established.

Ireland

N/A

Italy

There is a rule does not allow to deduce the expenses or other negative components derived to transactions undertaken between resident enterprises and companies whose fiscal

domicile in non EU countries with a privileged tax system. Anyway the companies shall not apply the rule when enterprises resident in Italy furnish proof that the foreign companies engage prevalently in effective commercial activity or that transaction engaged in correspond to an effective economic interest and they were executed correctly.

A decree has detected the countries considered in the CFC rule. The countries are the followings:

Andorra, Anguilla, Antille Olandesi, Aruba, Bahama, Barduda, Bermida, Oibunti, Hong Kong, Canel Island, Cayman Island, Man Island, Turks e Caicos Island, Vergin Island Britanniche, Leichtenstein, Macao, Nauru, Nevis, Oman, Saint Kitts, Seychelles, Vaunatu, Wetern Samoa.

Luxembourg

N/A

The Netherlands

N/A

Portugal

The CFC rules do not allow deducing the expenses or other negative components derived to transactions undertaken between resident enterprises and companies whose fiscal domicile in countries with a privileged tax system. Anyway the companies shall not apply the rule when enterprises resident in Portugal furnish proof that the foreign companies engage prevalently in effective commercial activity or that transaction engaged in correspond to an effective economic interest and they were executed correctly.

Spain

Taking into account that the income to be imputed is the one that would result of the application of the Corporate Tax law, the deduction of the expenses is restricted to the same conditions of all the rest of taxpayers.

Internal Spanish tax law provides that expenses paid to tax havens residents or through tax havens bank account are presumed non deductible, although this presumption can be rebuted by any prove.

United Kingdom

As mentioned earlier, the taxable income of a CFC will be calculated in accordance with UK tax legislation. This means that UK transfer pricing legislation will apply as well as all other aspects of UK legislation which reduce deduction for costs, e.g. disallowance of certain legal expenses, entertainment expenses, etc. There are, therefore, no rules specifically relating to CFCs in this respect.

16. Is there a coordination between the two rules (CFC rules and no deduction cost)? (that is: does the national law provide for the alternative application of the rules or both rules can be applied to the same fact?)

Austria

N/A

Belgium

N/A

Finland

See above answer 15.

France

N/A

Germany

See No. 15.

Ireland

N/A

Italy

The Law n. 342 related to the CFC excludes to apply the rule exposed at the previous question 15 to the resident company to which is applicable the CFC law.

Luxembourg

N/A

The Netherlands

N/A

Portugal

Both rules are compatible. They apply to different taxable bases: income or costs.

Spain

In principle, we understand that both rules are compatible.

United Kingdom

This question is not applicable given the responses to questions 15 and others earlier.