Is two better than one?
The analysis of the CFC rules and the comparison of its rules in the ATAD vis-à-vis the CCTB proposal

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Abstract
This thesis analyses whether there is a necessity to have two different CFC regimes in two legislations, the ATAD and the CCTB proposal. The author examines the issues that are already present in the CFC regime that pose problems. This could support the argument that the EC’s actions in the implementation of the ATAD and the CCTB have been over-reaching in the EC’s attempt to eradicate tax erosion and profit shifting through the examination of the CFC provisions in the ATAD and the CCTB proposal. In this context, this article focuses on the analysis of Articles 7-8 of the ATAD and Articles 59-60 of CCTB.

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Abbreviations

<table>
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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>A-G</td>
<td>Advocate General</td>
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<td>Art.</td>
<td>Article</td>
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<td>ATAD</td>
<td>Anti Tax Avoidance Directive</td>
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<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
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<td>CCTB</td>
<td>Common Corporate Tax Base</td>
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<td>CCCTB</td>
<td>Common Consolidated Corporate Tax Base</td>
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<td>CEN</td>
<td>Capital Export Neutrality</td>
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<td>CFC</td>
<td>Controlled foreign company</td>
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<td>CIN</td>
<td>Capital Import Neutrality</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
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<td>ECJ</td>
<td>European Court of Justice</td>
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<td>EU</td>
<td>European Union</td>
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<td>MLI</td>
<td>Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>OECD MC</td>
<td>OECD Model Tax Convention</td>
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<td>PSD</td>
<td>Parent Subsidiary Directive</td>
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<td>R&amp;D</td>
<td>Research and development</td>
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<tr>
<td>SME</td>
<td>Small and medium-sized enterprise</td>
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<td>TEC</td>
<td>Treaty establishing the European Community</td>
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<td>TFEU</td>
<td>Treaty on the Functioning of the European Union</td>
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1. INTRODUCTION

Designed to target offshore entities in jurisdictions with low tax and little real economic activity, the CFC regime could protect the domestic tax base from tax evasion. In this ever-changing economic globalized environment with fast technology advancement that makes it easier to shift profits coupled with aggressive tax planning, it is no wonder that the OECD has recommended the CFC regime under its BEPS Action 3.\(^1\) With that move, the EU has decided to follow suit by harmonizing the regime through the Council Directive (EU) 2016/1164 (ATAD)\(^2\) and has proposed it in the CCCTB proposal as well. This paper does not doubt the usefulness of the CFC legislation since the OECD’s Committee on Fiscal Affairs has affirmed in its 1996 report in its discussion about detrimental tax competition that the CFC regime is fundamental.\(^3\) However, this implementation of the CFC regime within the EU is not without its problems.

The field of direct taxation, especially in relation to personal and corporate taxation, remains arguably by and large within the domain competence of the EU Member States. The ECJ case laws also rehash this principle that insofar as the conditions governing the legislation do not constitute a discrimination, either directly or indirectly on grounds of nationality, or an obstacle to the exercise of fundamental freedom guaranteed by the EC treaty,\(^4\) the EU Member States are left to decide on their domestic tax rates. However, it is on the legal basis

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\(^{3}\) OECD, Controlled Foreign Company Legislation (1996) 97

\(^{4}\) Case C-385/00 F.W.L. de Groot v Staatssecretaris van Financiën. [2002] ECR I-11819 para 114
of Article 115 of the TFEU\textsuperscript{5} that the EC has been authorized to introduce directives. The Member States would then need to implement a minimum standard, thereby requiring them to make certain relevant amendments in their domestic tax legislations so that they could adhere to the directives.

At present, dealing with company taxation, directives in relation to mergers\textsuperscript{6} including parent companies and their subsidiaries\textsuperscript{7} have already been in place. Yet, the actions of the EC do not appear to be slowing down since the EC has now decided to re-launch the CCTB\textsuperscript{8} and the CCCTB\textsuperscript{9} package in 2016 in its attempt for them to be passed down as directives. With the creation of a single set of corporate tax rules,\textsuperscript{10} this package creates a one-stop-shop, the result of which aims to eradicate distortions associated with cross border transactions relating to transfer pricing and CFC regimes.\textsuperscript{11} Undeniably, the proposal carries legitimate advantages for the EU Member States according to the EC’s impact assessment.\textsuperscript{12} However, it still does not

\textsuperscript{5} Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326 Article 115: Without prejudice to Article 114, the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market

\textsuperscript{6} Council Directive (2009/133/EC) on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] L 310/34


\textsuperscript{8} Proposal for a council directive on a Common Corporate Tax Base (CCTB), COM (2016) 685 final, 2016/0337 (CNS), Strasbourg

\textsuperscript{9} Proposal for a council directive on a Common Consolidated Corporate Tax Base (CCCTB), COM (2016) 683 final, 2016/0336 (CNS), Strasbourg (Hereafter, CCCTB)

\textsuperscript{10} Proposal for a council directive (2016/0337) on a Common Corporate Tax Base (CCTB) COM/2016/0685 final. Pp 2

\textsuperscript{11} C. Spengel, Y. Zöllka, ‘Common Corporate Tax Base (CC(C)TB) and Determination of Taxable Income: An International Comparison (Springer-Verlag Berlin Heidelberg, 2012) Pp 9

escape the prospect that the EC might have gone too far in this comprehensive and extensive proposal.

The CCCTB proposal is certainly a bold project and so in order to increase the likelihood for it to be adopted this time, the project will be divided into two stages.\textsuperscript{13} The first step is the common corporate tax base, which, after its full materialization, will be followed by the CCCTB. As a result, the CFC legislation in the CCCTB proposal under Art 73 follows the CCTB but the scope is limited to group members and entities or PE that are situated in a third country.\textsuperscript{14} For simplicity and to avoid any confusion, this paper will mainly refer to the CCTB instead of the CCCTB unless otherwise specified.

Interestingly, the EC has not only the CFC regime in the CCTB but has also incorporated them into the ATAD. Within the CCTB proposal, the CFC regime is contained in Article 59. Similarly, the ATAD, Articles 7 and 8 deal with CFC rules. With the implementation of ATAD, the opinion by A-G Léger, as illustrated in the seminal Cadbury Schweppes\textsuperscript{15} case that measures relating to counterbalance tax avoidance were very limited,\textsuperscript{16} is no longer valid.

This thesis paper does not seek to assess the statistical impact of the CFC rules founded in the ATAD and the CCTB proposals but rather to evaluate the EC’s actions in its choice to implement the CFC regime throughout the EU. This is because the CFC regime arguably is not without any flaws. Not all of the Member States adopted the

\begin{flushleft}
\textsuperscript{14} Proposal for a council directive (2016/0336) on a Common Consolidated Corporate Tax Base (CCCTB) COM/2016/0683 final, Article 73
\textsuperscript{15} Case C-196/04 Cadbury Schweppes Plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] ECR-07995
\textsuperscript{16} Advocate General’s reference (No 6 of 2006) Case C-196/04 Cadbury Schweppes Plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] ECR-07995
\end{flushleft}
CFC rules in their domestic legislation and it was not until the harmonization of the ATAD that all of the Member States were pushed to adopt and amend their domestic legislation.

1.1 Objectives
This paper seeks to answer some interesting questions. Technically, the CFC regime in the ATAD and the CCTB should be similar, if not identical, but they are not. Having two different CFC regimes would cause more issues especially if they overlap. Could it be attributed the EC being careless? It could very well be, because in order to get more approval by the Member States for the ATAD to be passed, for example, the EC took out the switch-over clause. Would the technical problems of the CFC regime and the difference in the aims of the two acts fulfill the purpose of the regime and their individual aims?

Therefore, the main focus of this thesis is to examine justifications for having two CFC regimes. In order to do so, an examination the general CFC regime is necessary to reveal that the CFC regime is not the best measure to begin with. Following that, a comparison of the regime that have been incorporated in the ATAD and the CCTB/CCCTB proposals will be made to see if the flaws in the general regime have been fixed by the EC. Ultimately, this would enable us to evaluate if the EC actions through the ATAD and the CCTB have been too far-reaching and extensive.

1.2 Delimitation
Nevertheless, this paper is subject to certain caveats to narrow the scope of the thesis. As such, the Council Directive 2011/96/EU

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and the OECD MLI, although frequently discussed in association with the CFC rules in numerous legal tax journals, shall not be analyzed here. However, BEPS has a relatively extensive explanation of the CFC rules and so it will provide the guidance that is necessary in the examination of the EC’s CFC rules. Therefore, as a form of benchmark for the ATAD and CCTB proposal, the use of BEPS, in particular action 3\textsuperscript{19} will be discussed as a point of reference.

Although there are close associations between the switch-over clause and the CFC rules, the switch-over clause will not be discussed in great detail in this paper as it is out of the scope of the CFC regime. However, being one of the most contentious measures in the CCTB,\textsuperscript{20} it could be interesting to point out briefly some of its applicable issues.

It is argued that the switch-over clause has an even more restrictive effect on the freedom of establishment than that of the CFC rules.\textsuperscript{21} The switch over from the exemption of tax to tax credit was initially denied in Cadbury Schweppes after the ECJ found that it was not in line with the freedom of establishment. However, following the Columbus Container Services case, there was a change in the ECJ’s judgment in relation to the switch-over clause. Interestingly, the

CCTB has the clause but it is absent in the ATAD as the commission was not successful in introducing the switch-over clause.\textsuperscript{22}

1.2 Methodology

In order to provide a balanced argument in this thesis, a traditional legal dogmatic method will be applied in the analysis in an attempt to evaluate the actions of the EC.

A comparison of what the various Member States have within their own jurisdictions relating to CFC rules will not be provided here, although examples of what some Member States have in place will be used since the scope of this paper is not to examine what these individual Member States are doing per se but to study if the flaws in those regimes have been addressed in the ATAD and the CCTB. Thereby, a compatibility analysis of the CFC rules in the ATAD, in particular Articles 7 and 8, together with the CCTB proposal, will be provided by using the judgments of the ECJ and AG’s opinions of relevant case laws to give guidance.

After conducting a short research paper in the fall dealing with the CFC regime focusing on the ATAD,\textsuperscript{23} which sparked some interest in the CFC regime, a more natural route would be to use the opportunity of this thesis to develop the issues that were raised there in conjunction with the ATAD and the CCTB proposals.

Another interesting angle would be to compare the CFC rules side by side with ATAD and the CCTB, since, at present, only these two acts contain the relevant CFC regime. As a result, by taking the short


\textsuperscript{23} S. Chen, ‘An analysis of the EC’s measures in light of the CFC rules in the ATAD’ (Memorandum, Uppsala Universitet, 2018)
research paper into consideration, one has a supplement for this thesis that provides a rough introductory analysis of the CFC rules. Additionally, in the hope that this paper will essentially cover all actions taken by the EC concerning the CFC rules, this will help to make this research paper a more well rounded one.

Since the paper will be using BEPS Action plan 3 as a point of reference, it would be useful to discuss briefly the legal significance and weight of BEPS. Like the OECD MC, BEPS Action plan is not a legally binding document. It is a report, which only seeks to illustrate the direction to achieve an effective CFC regime. It is even stated in the CCTB proposal that the definition of PE in CCTB is designed closely to the post-BEPS recommended description of PE in the OECD MC.24 In addition, in relation to anti-tax avoidance measures, the re-launched proposal would incorporate some of the key Actions of the OCED initiative on BEPS.25 That said, it would be ill advised not to use BEPS as a reference even if its significance is less than that of a directive or legislation.

There are plenty of available legal tax journals and books on ATAD. Nevertheless, it should be noted that the CCTB is a re-launched 2016 council proposal that has not been passed as a directive yet. As such, the amount of available scholarly materials analyzing the CFC regime in the CCTB is smaller in quantity than that of the ATAD and the CFC regime. Understandably, since the action plan in the proposal is not set in stone, there will be changes before its final implementation. Nevertheless, it would still be thought provoking to identify if there are any existing underlying issues within the proposal on the CFC rules before its possible implementation in the future.

25 Ibid 14, Pp 4
1.3 Framework of the research paper
The outline of this thesis is as follows: an analysis of the CFC rules will be provided to set the legal background, highlighting certain issues. Subsequently, an analysis will be conducted to see if the CFC regime is restrictive against the context of the EC and its tax principles, such as CEN and CIN, by examining if there is any derogation in relation to the compatibility of the EU law.

Secondly, after dealing with the objectives of the ATAD and the CCTB, a deeper investigation of the CFC rules in both of these acts will be conducted. The scope of both acts and their relevant issues will be provided, as well as a thorough examination of the main provisions by dissecting the various problematic parts of the articles. The section ends by dealing with other related outstanding issues like double taxation conventions and the tax sovereignty of Member States.

Lastly, the paper will conclude with several remarks.

2. THE CFC REGIME
2.1 Introductory remarks of the CFC regime
In the 1998 report on harmful competition, the OECD already expressly recommended the implementation of CFC regimes as a method of counteracting the redistribution of profits to lower tax jurisdictions.26 Even after two decades, it is still yet to be seen that all of the Member States27 in the EU have undertaken this CFC rule in its domestic legislation. However, with the enactment of the ATAD and

27 Listed in alphabetic order: Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Lithuania, Poland, Portugal, Spain, Sweden and the United Kingdom are the Member States with CFC regimes. It is to note that the Netherlands has a CFC type regime but it does not have a CFC regime within the technical context like the rest of the EU Member States.
possibly the CCTB proposal in the future, all Member States are required to implement the CFC regime even if the Member States without it might have their own legitimate reasons against the implementation of the CFC regime.

It is unnecessary to go into details about the CFC regime as a general concept, because it is essential to set the legal context first and present the picture that there are already flaws within the general CFC regime before delving into the CFC regimes in the ATAD and CCTB proposal. Therefore, this section demonstrates that implementing the CFC regime both in the ATAD and the CCTB proposal might potentially cause more problems than what the ATAD and the CCTB proposal aim to achieve.

2.2 Rationales behind the CFC regime

Without the implementation of the CFC regime, the taxation of income earned by the state of the controlling shareholders/parties is deferred. Furthermore, when the CFC is situated in a lower taxed jurisdiction, which provides for preferential tax system with dividends that are not distributed to the controlling shareholders, that income is not taxed. As a result, in order to circumvent tax-driven foreign investments and to minimize the transfer of capital in these lower tax jurisdictions away from their own, it is not surprising that many states have introduced the CFC provisions in their domestic legislations.

Additionally, there are other purposes behind the CFC regime. However, these may raise tax treaties compatibility issues. That is

28 Listed in alphabetic order: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Ireland, Latvia, Luxembourg, Malta, Netherlands, Romania, Slovakia, Slovenia are the member states that need to implement the CFC regime
illustrated in the OCED MC commentaries in Para 26 on Art. 1. It states that generally, the CFC provisions or anti-abuse rules should not be applied where the relevant income has been subjected to taxation that is comparable to that in the residence state of the taxpayer.  

Accordingly, some CFC legislation do tax the income of foreign subsidiary even though the income has been taxed only at a slightly lower corporation tax rate than that of the domestic rates applicable in the state of the parent company. That would not only be contrary to the OECD MC commentary but at the same time, adding to the fuel towards the race to the bottom with regard to corporate tax rates.

By hopefully eradicating any case of “wholly artificial arrangements” within the CFC regime which strengthens the principle of predominance nature of substance over form and consequently the restriction of using interposed entities, the CFC regime will assist in the enforcement of anti-abuse provision as noted for example, in BEPS action plans such as the Principal Purpose Test. Ultimately, although these rationales may be overlapping, the underlying purpose of the CFC regime is the use of an anti-tax avoidance mechanism against entities that impermissibly defer their domestic tax liabilities. It is also interesting to rehash that the other rationale for the CFC could potentially raise tax treaty issues if the CFC rules are not accordingly adjusted in the domestic laws.

On the other hand, it is also important to point out rationales behind why some states do not have CFC regimes. To simply put it, if the CFC regime has only advantages, then countries would not have any

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reasons but to introduce them in their national tax legislation. That itself is an argument to why CFC may not be the best way forward in counteracting tax avoidance, albeit admittedly, a weak one.

Member States such as the Netherlands and Belgium do not have the CFC rule for similar justifications in that they both have open economies but relatively small domestic markets.\textsuperscript{34} Drawing comparison to another example, Singapore, this could very well be one of the reasons why she does not have the CFC regime as her situation is similar to that of the Netherlands and Belgium.\textsuperscript{35} It has been argued that the introduction of CFC rules could potentially have a negative impact on the Netherlands for being a favourable jurisdiction for cross border investment\textsuperscript{36} and that disadvantage outweighs the benefit of the CFC regime protecting its tax base.

Yet, that does not mean that they do not have anti-abuse provisions in their domestic legislations. The Belgian implemented GAAR\textsuperscript{37} and so did the Netherlands.\textsuperscript{38} It is just that they have decided to introduce anti-abuse provisions that will not cause them to lose their competitive edge. When the remaining Member States implement the CFC rules, the CFC regime could have an effect on their international tax policies if they have a similar type of economy as Belgium and the Netherlands.\textsuperscript{39}

It seems as if the CFC regime would not be favourable to states with open economies but relatively small domestic markets. Therefore,

\textsuperscript{35} S.Y. Loo, ‘Singapore - Corporate Taxation, Country Surveys’, IBFD sec. 7.1
\textsuperscript{37} Belgium, ‘Key Features, Country Key Features’, IBFD sec. A.3
\textsuperscript{38} Netherlands, ‘Key Features, Country Key Features’, IBFD sec. A.3
understandably, those states’ tax policies avoid the introduction the CFC regime but instead look for other alternatives that could fulfill the objective of anti-avoidance. Though the CFC regime could be seen as invasive, ultimately, it could be a better tool for anti-avoidance as compared to the GAAR.

2.3 The key components and its underlying issues of the CFC regime

Generally, a CFC is a foreign entity that operates in jurisdiction A while the residency of the controlled person/persons is in B.

However, the definition of control that is determined by the amount of threshold that person/persons in B holds and the nature of participation in order to determine the type of shareholder could vary. The variation of threshold amongst the Member States ranges from 25% to 50%. The requirement of control is crucial as it could effectively change the allocation of profits within the group and thereby the distribution of the CFC’s profits.\(^4\) This by and large goes against the underlying purpose of the CFC regime, which is to counteract entities that impermissibly defer their tax liability.

The effective use of the CFC regime will attain the principle of CEN. It is to be noted that issues relating to the compatibility of CEN and the EC law will be examined further in section 2.4. The argument here to be made is that the tax base of the home state will be safeguarded with this regime.

However, taking into consideration the justifications for why the Netherlands and Belgium do not have CFC rules yet, it is precisely

this protective nature of the CFC that may potentially give rise to domestic concerns relating to their competiveness. Therefore, in relation to that, a possible solution to balance the issue of competitiveness is the need for a distinction of the type of income in the calculation of profits. Germany for example, takes only into consideration passive income\textsuperscript{41} whilst Sweden and the UK take in both passive and active income. Since the type of income varies between Member States as seen in the examples provided,\textsuperscript{42} accordingly, the type of income, i.e. whether it is passive or active and/or even both incomes, needs to be defined clearly in both the ATAD and the CCTB proposal.

Needless to say, the type of income that needs to be taken into consideration is crucial as it could make a difference to the international tax policies undertaken by the Member States. The lack of uniformity in the CFC rules would mean that the results to counter tax avoidance would differ from country to country. This could be one of the reasons why the EC felt the necessity to introduce CFC regime into the ATAD and the CCTB proposal in order to level the playing field.

It could be concluded that the issues that have been highlighted here should be addressed in the CFC regimes set out in the ATAD and the CCTB proposal so as to ensure that the regime would be an effective measure. An analysis of how the two CFC regimes differ from one another and if the issues have been dealt with will be scrutinized in the later chapters in section 3.

\textsuperscript{41} A. Perdelwitz, ‘Germany - Corporate Taxation Country Surveys’, IBFD Sec. 7.4
2.4 The tax principles behind the CFC regime and that of the EC law

Even if CFC regimes are beneficial in safeguarding the host state’s tax base by preventing profit shifting by group companies to low tax jurisdictions\(^ {43}\), there are compatibility issues from the EC law and the fundamental freedoms that have been examined in the various ECJ case laws which this paper needs to acknowledge. The possible compatibility issues would give rise to questions of whether the CFC regime could be the most appropriate measure to take as the EU tackles the issue of profit shifting by corporate entities in order to deter tax liability.

Although, arguably, the lack of a level playing field in the EU dealing with tax avoidance which thereby causes distortions and coupled with the OECD’s pressure from the BEPS project,\(^ {44}\) pushed the EC to implement the CFC regime within the EU. With the implementation of CFC rules in the ATAD and soon to be CCTB proposal if it will be passed through at a directive level, it makes sense to consider first whether the CFC regime falls within the scope of the EC treaty or not. For if it should fall out of the scope, then perhaps it should not be implemented at such a broad level through harmonization of a directive.\(^ {45}\)

The compatibility of the CFC regime with the EC law needs to be examined since the regime might be in conflict with the EC law. This is because the CFC regime applies only to resident shareholders of foreign corporations and the resident who wishes to establish in

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another Member State will be in a less favourable position than the same resident who invests in their home state.\textsuperscript{46} It can be seen that the CFC regimes could pose potential restriction on the freedom of establishment\textsuperscript{47} and the freedom of capital.\textsuperscript{48} Therefore, in order to determine whether the CFC regime encroaches the EC treaty, it has to be established whether there is any discrimination in the first place and if that could be justified.

This author acknowledges and understands the fact that the Member States with CFC regimes currently in place have different rules from one another and the various case laws that will be used in this section are not based on identical facts. However, it is still helpful to use them as a form of guidance of the ECJ’s attitude and how generally the CFC could be shaped in order to attain its objective.

\textbf{2.4.1 Compatibility of CEN and the CIN principle in the CFC regime}

Firstly, it can be said that the CFC regime more likely than not is based on the principle of CEN rather than CIN. There are several justifications for that statement. The CFC regime is based largely on CEN as it aims to tax the taxpayer regardless of where they choose to invest. Additionally, CEN is built on the concept that the taxpayer’s total tax burden should be at the residence, i.e. home state, and accordingly at the tax rate of the home state. In other words, CEN safeguards the market of the home state of the investor by levying the same tax treatment that should also be administered on the domestic level.\textsuperscript{49}

\textsuperscript{46} M. Helminen, “Is There a Future for CFC-regimes in the EU?”, 33 Intertax 3 (2005), Pp. 120
\textsuperscript{47} Official Journal C 326 on the Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326 - Article 49: Right of establishment
\textsuperscript{49} R. Fontana, The Uncertain Future of CFC regimes in the Member States of the European
On the other hand, the EC internal market is largely based on the CIN principle. According to CIN, the investors of a member state are free to invest and compete in the markets of the other Member States i.e. host state under the same tax conditions as decided by the host state.\(^{50}\) The similar tax conditions are steered by the principle of reciprocity, mutual recognition and the desire for tax competition.\(^{51}\) In numerous ECJ cases\(^{52}\) the ECJ reiterated that in accordance with the mutual recognition principle, Member States must acknowledge the tax systems of others.

With that view in mind, Member States in support of the CEN are in fact prevented from applying unfavourable tax treatment on account of the tax advantages arising as an outcome of the tax systems of other Member States.\(^{53}\) If that line of reasoning was held true and it is to be applied in this context in the view that the CFC regime is based on CEN, it casts doubts on the reasons why the EC would want this CFC regime implemented if it would mean applying disadvantageous tax treatment on account of the tax advantages as an outcome of the different tax systems of other Member States which was just a mere result of the Member States competence over direct taxation.

Furthermore, in the same line of argument for CIN, CEN could potentially infringe Art. 10 in the EC treaty. Art. 10 EC specifies that “Member States shall take all appropriate measures (…) to ensure fulfillment of the obligations arising out of the treaty (…) and they


shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty.” This principle of community loyalty is rarely taken into account\textsuperscript{54} but it might be crucial for this section since it focuses on the compatibility of the CFC regime and the EC law. In this regard, it focuses on the domestic beneficial rules that have been approved by the EC in the form of state aid.\textsuperscript{55}

Member States applying CFC rules on investments which come under state aid rules and when other Member States are excluded,\textsuperscript{56} these preferential rules infringe on Art. 10 as it oppose the principle of community loyalty. The incompatibility with Art.10 gives more weight for the argument that the CFC regime might not be the right measure for the EU since it does not follow the principles that the EU stands by.

Another difference between these principles is the relief for double taxation on foreign income. In CEN, where it would be in the form of ordinary tax credit method, in the case of CIN, that would be generally using the exemption method.

In addition, it can be argued that the principle of CEN supposedly protects the market of the home state and, as a result, the tax competition could be limited. In an increasingly globalized and competitive world, perhaps the CFC regime, which appears to be founded upon the CEN principle, could be seen as a double-edge sword. That might not be the best way forward for the Member States


\textsuperscript{55} M. Helminen, “Is There a Future for CFC-regimes in the EU?”, 33 Intertax 3 (2005), Pp. 122

to remain competitive. Moreover, CEN also causes the CFC regime to be imposed even when there is an existence of the wholly artificial arrangement.\textsuperscript{57}

Without being paradoxical, it is the presence of a wholly artificial arrangement that should be avoided since the entity does not carry out genuine activity. It was held further according to the Cadbury Schweppes case that the existence of a wholly artificial arrangement with the view of tax avoidance provides a justifiable ground for its national measure being a restriction of establishment.\textsuperscript{58} Thereby, if it was not established on the necessity to counter tax avoidance, one could question the principle of CEN if it leads to the implementation of the CFC regime.

Yet, the compatibility of CEN and the EC law seemed to be approved by the ECJ in the Gilly\textsuperscript{59} case. This was because the ECJ indirectly acknowledged the credit method in the tax treaty and the PSD. This gave Member States the competence to choose between the tax relief methods, and that signals that both CIN and CEN are in line with the EC law.\textsuperscript{60} However, the line of argument cannot be broadened to justify that both principles are compatible in the light of EC law. In fact, the ECJ could be seen to have an inclination towards CIN when they dismissed Gilly’s claims.\textsuperscript{61}

\begin{footnotesize}
\begin{enumerate}
\item Case C-196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue, Para 51
\item Case C-336/96, Mr and Mrs Robert Gilly v. Directeur des services fiscaux du Bas-Rhin [1998] ECR I-2793, Para. 47
\item Ibid 60
\end{enumerate}
\end{footnotesize}
It all seems too hard to make a clear distinction between the compatibility of both principles in light of the EC law, but it could be concluded that whilst the CFC regime is based on the CEN, the Member States are compelled to follow the CIN principle. That can be noted in the EC law and followed through in the ECJ’s case laws judgments that in the field of direct taxation and where there are no harmonization, the EU Member States have in their competence the right to exercise their sovereignty insofar their actions are not contrary to the EC law.

It should not be forgotten that the main purpose of the EC treaty is to establish an internal market to be an “area without internal frontiers in which the free movement of goods, persons, services and capital is ensured.” As a consequence, the EC law prohibits Member States to implement laws with protectionist ramifications. If it can be agreed that the CFC regime does have such an outcome then there appears to be a dichotomy here. It is precisely this contradiction that is contentious as to why the EC would want to introduce and even harmonize the CFC regime within the EU first through the ATAD and next possibly through the CCTB proposal.

2.4.2 The applicable fundamental freedoms of the EC law

2.4.2.1 Potential breach of the freedom of establishment and the freedom of capital in the TEFU

Through the ECJ case laws regarding CFCs, this two articles have always been brought to attention, notably the freedom of establishment Art. 49 of the TFEU (ex Art. 43 EC) and the freedom of capital Art. 63 of the TFEU (ex Art. 56 EC). The main focus of this section is to distinguish the potential infringement of the two freedoms.

Firstly, before going into the examination of these two freedoms, there are several issues that should be highlighted. It is understood that from the wording of Art. 43 EC, its objective is to protect cross-border economic activities of PE. However, the wording in Art. 43(2) EC does not make it clear if activities relating to portfolio or capital assets could also fall under this article\(^{66}\), and since CFC regime concerns predominantly passive income, this would be relevant in our context. As a consequence, since Art. 56 deals with the free movement of capital, this article is of importance for portfolio stockholders.\(^{67}\) If Art. 43(2) EC is not applicable for the taxpayers, they could still fall onto Art. 56(1) EC.

Although both the freedom of establishment and capital could be used to examine the potential contravention induced by the CFC regime, because of the control or influence element within the CFC rules i.e. more than 50% of the share capital or voting power, the freedom of establishment falls into the scope more than the freedom of capital.\(^{68}\) That was also rehashed in A-G in his opinion in the Cadbury...
Schweppes case, that Art. 43 of the EC should be applied instead of Art. 56 EC since the resident Member States has the definite control over its company’s decisions in another Member States since it has as a holding in the capital of that company.\(^69\) In addition, as mentioned in the Omega case, Art. 43 EC tend to take precedence over Art. 49 EC since capital is an inevitable outcome from the restriction of establishment.\(^70\) Regardless, it is sufficient to conclude here that either way; it is possible for those articles to be applicable.

However, it may be necessary to distinguish the scope of these two freedoms. The scope of the free movement of capital is wider than that of the freedom of establishment since the latter only extends to relations within the EU. There is a prohibition to the restriction of the freedom of capital and this extends to relations with third states.\(^71\) Since CFCs are also seated outside of the EU, this means that Art. 63 of the TFEU could be invoked by third states and so it is interesting in this context especially since the scope of possible infringement has been widened.

This also signals that in the future, with respect to Art. 73 of the CCCTB proposal,\(^72\) Art. 63 of the TFEU would be relevant and in scope for the third states. It has been reiterated in the cases of X AB and Y AB v Riksskatteverket,\(^73\) Baars,\(^74\) Metallgesellschaft Ltd and Others Hoechst AG, Hoechst UK Ltd v Commissioners of Inland Revenue.\(^75\) A-G’s reference (No 32 of 2006) Case C-196/04 Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] I-07995

\(^{69}\) Omega [2004] ECR I-9609 at [27]

\(^{70}\) Official Journal C 326 on the Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326 - Article 63(1)

\(^{71}\) Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) 2016/0336 (COM) 2016/683 final. Article 63: For the purposes of this Directive, the scope of controlled foreign company legislation under Article 59 of Directive 2016/xx/EU shall be limited to relations between group members and entities that are resident for tax purposes, or permanent establishments that are situated, in a third country.

\(^{72}\) Case C-200/98 X AB, Y AB v Riksskatteverket [1999] ECR I-8261, Para 30

\(^{73}\) Case C-251/98, C. Baars v. Inspecteur der Belastingdienst Particulieren/Ondernemingen Gorinchem [2000] ECR I-2787, Para 42
Revenue, H.M. Attorney General,\textsuperscript{75} that when the freedom of establishment has been found to be an infringement of the EC treaty and so the free movement of capital would not have to be dealt with, however nothing was said that it will not be applicable.\textsuperscript{76} The issue of the freedom of capital was simply not discussed.

This could stem from the fact that the countries involved in these case laws are all within the EU and since the freedom of establishment has already been established, the ECJ did not see any point going further. Therefore, it would not be possible to derive to any absolute conclusions here. However, even though there is nothing concrete from the ECJ stating that the free movement of capital should not be applicable, unlike the freedom of establishment, it should be highly likely that capital article will be applicable as well.

On the other hand, it would be relevant for two main reasons in this context to question if the free movement of capital and payment under Art. 56 EC would be outside the scope of the right of establishment under Art. 43 EC and cover both portfolio and direct investment in CFCs in third states.\textsuperscript{77} The first being that portfolio and direct investments are common within corporations and the second being that CFCs could be located in third states. This question, although it has been raised in the CFC and Dividend Group Litigation\textsuperscript{78} case, has not been thoroughly discussed by the ECJ other than stating that ‘Art. 43 does not include (...) any situations which involve the

\textsuperscript{75} Joined Cases C-397/98 and C-410/98, Metallgesellschaft Ltd and Others Hoechst AG, Hoechst UK Ltd v Commissioner of Inland Revenue, H.M. Attorney General [2001] ECR I-1727, Para 75


\textsuperscript{78} Case C-201/05 The Test Claimants in the CFC and Dividend Group Litigation V Commissioners of Inland Revenue [2008] ECR I-02875 Para 87-97
establishment of a company of a Member State in a non-member country and that Art. 56 EC are not precluding.

2.4.2.2 Restrictions on the freedom of establishment and the freedom of capital in the TFEU

Generally, as examined in the earlier section, the breach of the freedom of establishment in regard to the case of the resident taxpayers in the other EU Member States and the restriction of the free movement of capital to other Member States and/or to the third states are indications that the CFC regime is in conflict with the EC treaty.

The CFC regime may constitute a discrimination against the domestic shareholder rather than the non-residents of the foreign CFC entity. The comparable situation in this context is that only the shareholder of the CFC may have to pay the taxes on the undistributed for the profits earned from an entity whereas the shareholder who does not need to for its participation in a domestic corporation. This concept that residents are not commonly taxed on non-residents earning foreign income follows from the principle of personality where the taxpayer is taxed on their own income and not on the income acquired by another person. As part of group consolidation purposes, however, this principle could be set aside which questions if the CFC regime could still be counted as discrimination against the domestic shareholder.

Nonetheless, assuming that the profits are only distributed later, the shareholder could potentially run the risk of interest loss and he will have to bear this loss. The ECJ held that this loss constitutes a

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79 Ibid 78, Para 87
80 M. Helminen, “Is There a Future for CFC-regimes in the EU?”, 33 Intertax 3 (2005), Pp. 120
81 J. Monsenego, ‘An analysis of the conflict between the objective of achievement of the European internal market and the principles of worldwide taxation’ Vol 22 IBFD Doctoral Series (2012), Pp 71
82 Ibid 81
restriction within the meaning of Art. 43 EC in the case of X & Y.\textsuperscript{83} The reason was that if any Member State concerned were to refuse the benefit of deferring capital gains tax, they are essentially depriving the transferor of a cash flow advantage only because the parent company of the transferee is situated in another Member State.\textsuperscript{84} As a result, Art. 43 would be deprived of its meaning since there is a difference in treatment of the taxpayer who should instead be treated the same way as a natural person who is a national of a Member State regardless of where the company wishes to establish or has its seat.\textsuperscript{85}

\subsection*{2.4.2.3 Possible grounds of justifications against breach of fundamental freedoms}

It is crucial to examine if there could be any basis for the potential breach of fundamental freedoms within the CFC regime. This is because even if the CFC regime has infringed certain fundamental freedoms and is therefore restrictive in nature, the measure has been proven to be proportionate, i.e. the measure should not have gone beyond what is necessary to achieve the objective\textsuperscript{86} after providing grounds of justification which stem from the rule of reason principle\textsuperscript{87} then the CFC regime is deemed nevertheless to be precluded. The justifications that this paper will focus on are tax avoidance, tax erosion from the loss of tax revenue and the need to uphold effectiveness of fiscal supervision. The proportionality test and its related issues will be discussed the justifications.

\begin{itemize}
\item \textsuperscript{83} Case C- 436/00, X & Y, ECR \textsuperscript{[2002]} I-10829, Para 38
\item \textsuperscript{84} Ibid 83
\item \textsuperscript{85} Case C-250/95 Futura Participations and Singer \textsuperscript{[1997]} ECR I-2471, Para 24
\item \textsuperscript{86} Case C -120/78 Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwei \textsuperscript{[1979]} ECR 649.
\item \textsuperscript{87} Ibid 86, Para 8
\end{itemize}
Possible grounds of justification 1: Tax avoidance

Arguably, one of the main rationales behind the CFC regime, which is to deter corporations from shifting their profit to low tax jurisdictions so as to avoid taxation, could be one justification. However, this argument has not been accepted by the ECJ due to the principle of proportionality. In addition, the ECJ also has a narrow interpretation of competition law and will not allow any potential measures that restrict competition. Even within the EC treaty, as noted in Art 101 to 109 of the TFEU, there are anti-competition rules in place that show the EC’s stance towards anti-competition practices.

The ECJ’s attitude towards the concept of abuse is an objective one. At present, it would appear that the ECJ has a narrow interpretation of anti-abuse legislation and the argument of tax avoidance is not a justification for the breach of fundamental freedoms by the CFC regime. However, it is still crucial to note if there are any changes towards the ECJ’s attitude towards the concept of abuse since this could shed light towards their acceptance of the incompatibility of the CFC regime and the EC law. Furthermore, the ECJ has far-reaching discretionary powers and could interfere in the tax systems of the Member States insofar as to achieve the standards for abuse as delineated in the EC law.  

On the other hand, the argument of tax avoidance would have failed the proportionality test because some Member States effectively bypassed the loophole in the CFC regime by setting a lower degree of control so as to apply the CFC regime to the resident shareholder.

89 For example, in the case of Portugal and Sweden. Respectively, they only requires 25% or more of its capital; or 10% or more of its capital where more than 50% of its capital is owned (directly or indirectly) by Portuguese resident participators: A. Valente
However, now that there is the CFC rule in the ATAD that stipulates that the minimum control is 50%, the ECJ would be less inclined to use the fact that the CFC regime has the proportionality test. It is also to be noted that in the CCTB proposal, the percentage of control similar and that is reasonable. It would not have been wise to have varying degrees of control in the two CFC regimes.

Furthermore, the CFC regime cannot be considered to be consistent with the EC treaty because an anti-avoidance measure could only be treated as compatible if that measure has been particularly devised to exclude a tax advantage from abusive situations according to well-established ECJ case laws. It can be seen in case laws from the EC all of which have referred back to the ICI case that the legislation at issue did not contain the specific purpose of preventing wholly artificial arrangements, set up to circumvent [the United Kingdom tax legislation] […] but applies generally to all situations in which the majority of a group's subsidiaries are established […]. In the context of this research paper, it was thereby pivotal that the CFC regime only addresses the issue of wholly artificial arrangements.

On that basis, considering that the CFC rules broadly speaking are applicable to all taxpayers who have stake in a CFC, the CFC regime

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Vieira ‘Portugal - Corporate Taxation’ sec. 10.4, Country Analyses IBFD For Sweden, at least 25% of the capital or voting rights in the foreign legal entity is controlled, directly or indirectly, by the shareholder alone or together with persons who have a community of interests with the shareholder (chapter 39a, section 2 of the IL): E. Nilsson, ‘Sweden - Corporate Taxation’ sec. 10.4 Country Analyses IBFD


91 Proposal for a council directive (2016/0337) on a Common Corporate Tax Base (CCTB) COM/2016/0685 final, Article 59(1)(a)


93 Case C-264/96, Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes) [1998] I-04695

94 Ibid 93, Para 26

95 R. Fontana, The Uncertain Future of CFC regimes in the Member States of the European
is not consistent with the EC treaty. However, since the CFC regime cannot be considered as a specifically designed test only because the regime applies to all taxpayers who have participation in a CFC and that it is not only designed to curb wholly artificial arrangements, it appears that the chance to fulfill this specifically designed test is quite slim. Understandably, the measure should not be general like the one established in the Lasteyrie case. 96 But, on the other hand, it begs the question if it is beneficial for the EC law when the ECJ chooses to uphold such a hard test. As rightfully pointed out by A-G Léger with regard to the UK CFC regime, taking into consideration its applications and exemptions is devised to cover only in very specific circumstances […] 97

Lastly, there is possibly the shift towards placing more significance on the concept of proportionality rather than focusing on the wholly artificial arrangement and the freedom of establishment. 98 Although it should be noted first that in the Thin Cap 99 case it was concerning thin capitalization rules in the UK unlike the Cadbury Schweppes case and its CFC rules but like the UK CFC rules, the UK thin capitalization rules were restrictive to the fundamental freedoms.

However, the ECJ immediately dealt with the issue of proportionality of the justification provided 101 without giving much attention to the wholly artificial arrangements as opposed to what it did in the

97 Advocate General’s reference (No 6 of 2006) Case C-196/04 Cadbury Schweppes Plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] I-07995, Para 137
98 M. Seiler. ‘ GAARs and Judicial Anti-Avoidance in Germany, the UK and the EU (Series on International Tax Law: Vol. 98, Linde, 2016) Pp 118
99 Case C-524/04 Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue [2007] I-02107
100 Ibid 99, Para 16
101 Ibid 99, Para 80-83
Cadbury Schweppes case by merely stating that the thin cap measure ‘may be justified if it specially targets wholly artificial arrangements designed to circumvent […]’. Much of the argument has been provided in the Cadbury Schweppes case and thus the ECJ did not feel the need to discuss more on the issue.

Yet, what could be of interest here is the use of a different jargon. In the Cadbury Schweppes case, the ECJ stated that the measure might be justified where it specially relates to wholly artificial arrangements […] whereas in Thin Cap, it states where the measure specially targets wholly artificial arrangements. As much as the ECJ did not go into much detail on the issue of the wholly artificial arrangement, this slight change in terminology creates a more narrow interpretation. This would be in line with what has been discussed in the previous paragraph about the specially designed test.

**Possible grounds of justification 2: Tax erosion**

Although one of the rationales for the CFC regime is to protect the tax base of the home state from potential tax avoidance, it has been well established in the case of ICI that diminution of tax revenue cannot be considered as a justification to override general interest in order to validate unequal treatment.¹⁰⁴

On a similar basis, the ECJ does not justify the adoption of restrictive tools like the CFC regime only to balance out the advantages,¹⁰⁵ for example in terms of the lower corporate taxation rates that other Member State could offer that the Home State could not. This can be

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¹⁰² Ibid 99, Para 71
¹⁰³ Case C-196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue Para 51
¹⁰⁴ Case C-264/96, Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes) [1998] I-04695, Para 28
¹⁰⁵ Case C-270/83, Commission of the European Communities v. French Republic (Avoir fiscal) [1986] ECR 273, Para 21
seen to be consistent with how the ECJ ensures competition law within the union by making sure that no Member State should have restrictive policies as a way out to balance, for example, the higher corporate tax rates in its domestic jurisdiction.

**Possible grounds of justification 3: Safeguarding the cohesion of tax systems**

The ECJ has accepted the need to maintain the cohesion of tax systems but only in certain circumstances where a direct link has to be established between the measure in question for the taxpayer and the benefit that the taxpayer is granted so that it preserves the cohesion of the tax system.\(^\text{106}\) However, it has been argued otherwise\(^\text{107}\) that the link does not exist in the CFC regime. The CFC regimes deal firstly with two separate corporate income tax systems, i.e. the one in the domestic state and the one in the other state. Secondly, it involves the resident taxpayer and the corporate entity and that weakens the direct link that needs to be established to show the benefit that the taxpayer will be entitled to from the measure provided.\(^\text{108}\)

However, going against the ECJ’s decisions in Bachmann, it was argued that there are economic and legal links since the corporate entity’s income should generally bring about “indirect” income for the shareholder.\(^\text{109}\) Therefore, from an economic point of view, corporate tax is essentially a prepayment of the shareholder’s income tax.\(^\text{110}\) Regardless of any disagreements, it would appear that the ECJ was

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\(^{106}\) Case C-204/90 Hanns-Martin Bachmann v Belgian State [1992] ECR I-249 Para 21  
\(^{108}\) Ibid 107  
\(^{110}\) Ibid 109
coherent that a Member State could only rely on this rationale if only the said restrictive tax tools are applied cohesively.\(^{111}\)

**Possible grounds of justification 4: Effective fiscal supervision**

As established in the Cassis de Dijon\(^{112}\) case the effectiveness of fiscal supervision could ‘constitute […] justifying a restriction on the exercise of fundamental freedoms […]’\(^{113}\) and so this could potentially justify the CFC regime restriction against the EC’s fundamental freedoms. However, this ground of justification failed the proportionality test as noted in Futura.\(^ {114}\) In addition, with the implementation of the Mutual Assistance Directive\(^ {115}\) that the Member States need to adhere to, it would be highly unlikely for the need of effective fiscal supervision to be a justifiable and proportionate rationale that is precluded by the ECJ.

**The principle of proportionality**

It should be mentioned briefly that even after going through the different justifications, the CFC regime would still need to meet the proportionality test. More often than not, justifications fail the proportionality test, for example when the EC has other instruments such as the Mutual Assistance Directive where its main objective is to enhance cooperation between Member States in the field of direct taxation. This is often contested by the ECJ as a less restrictive measure.\(^ {116}\) However, A-G Léger has argued against the view that the

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\(^{111}\) Case C-80/94 (Wielockx) [1995] ECR I-2508, Para. 23
\(^{112}\) Case C-120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein (Cassis de Dijon) [1979] ECR 649
\(^{113}\) Ibid 112, Para. 8.
\(^{114}\) Case C-250/95 - Futura Participations and Singer v Administration des contributions [1997] I-02471, Para 31
\(^{116}\) Advocate General’s reference (No 6 of 2006) Case C-196/04 Cadbury Schweppes Plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] I-07995, Para 134
Mutual Assistance Directive could be as effective as the CFC legislation. Arguably, he did not find that it is in excess for a Member State to introduce a presumption instead of relying on the directive for communication of information.\footnote{Advocate General’s reference (No 6 of 2006) Case C-196/04 Cadbury Schweppes Plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] I-07995, Para 138-140} Perhaps, the focus should not be if the measure is restrictive towards the fundamental freedoms but rather if the measure has proven to be better and more effective. If so, it should not fail the proportionality test.

In this sense, the ECJ focuses only on the exercise of the powers in the fields of direct taxation and does not appear to challenge the character of the national powers\footnote{Case C-490 Commission v Luxembourg [2011] ECR I-247 Para 5} since it has a relatively strict assessment of the applicability and the restriction test as it ultimately understands the balance that the ECJ needs to strike and thereby as stated in the Commission v Luxembourg that ‘the achievement of the fundamental freedoms guaranteed by the EC inevitably requires the Member State to make some adjustments […].’\footnote{L. Boucon, ‘EU Law and Retained Powers of Member States’ in L. Azoulai, ‘The Question of Competence in the European Union’ (1st edn, Oxford University Press, 2014) Pp177} As a consequence, this gives the Member States the retained powers they nevertheless have. Even though the Commission v Luxembourg case is related to the field of social security, it is also relevant in this context since they are areas of competences, which are retained for the Member States.

It could be concluded here that the EU Member States still retain some of their powers as the court more often than not gives them the margin to develop a wide array of justifications.\footnote{Ibid 119, Pp178} Since the main attention of the ECJ is to exercise the powers, this could explain why the ECJ may be so strict in the justifications and proportionality test.
3 THE CFC REGIME IN THE ATAD AND THE CCTB PROPOSAL

3.1 Introductory remarks

After a thorough discussion of the general CFC regime in section two, it is clear that the regime is not flawless with its compatibility issues behind the tax principles and the infringement of fundamental freedoms in the EC law. With that in mind, it begs the question why the EC would want to not only implement the CFC regime in the ATAD but to also propose it in the CCTB proposal. With the background of the CFC regime already provided in section two, it is now appropriate to delve into the potential and perhaps deeper problems that could arise within the ATAD and the CCTB proposal.

Building on top of the issues from the general CFC regime, this section seeks to go into the specific criteria provided in the CFC regime in the ATAD and the CCTB. To limit the scope of this section, it should be pointed out again that only Art. 7 and 8 of the ATAD,\(^\text{121}\) together with Art. 53, 59 and 60 of the CCTB,\(^\text{122}\) will be discussed. The legal basis, subsidiarity and proportionality which ATAD and CCTB are built upon will not be examined as this paper instead aims to scrutinize the CFC rules within each piece of legislation.

However, in this section, most of the focus will be on issues such as whether the rules provide the solution for double taxation and the effective tax rate threshold. Given that there are concerns\(^\text{123}\) even at the basic general anti-avoidance rules level, it only seeks to emphasise the issues that could be found within the specific anti-avoidance measures and, in this context, the CFC regime.

\(^{121}\) ATAD Art 7 and 8

\(^{122}\) Proposal for a council directive on a Common Corporate Tax Base (CCTB), COM (2016) 685 final, 2016/0337 (CNS), Strasbourg

\(^{123}\) See below for more extensive reasoning, see sec. 3.3
Ireland had strong submissions against the CCTB, arguing that "profit-shifting outside of the EU is not addressed at all by this (CCTB) proposal and will actually increase the incentive for multinationals to shift profits outside the EU."\textsuperscript{124} It is thus crucial to evaluate the effectiveness of the CFC regime by examining whether the issues found in the general CFC regimes have been covered in the specific rules within the ATAD and the CCTB, or if additional loopholes exist.

### 3.2 Objectives of the ATAD and the CCTB

In order to gauge the effectiveness of ATAD and the likelihood that the CCTB would be effective when it is passed as a directive, it is relevant to first spell out the purposes of both acts. This would be one way of measuring if the CFC legislation would be effective and if its goals are even achievable in the first place.

#### 3.2.1 Aims of the ATAD

Firstly, to be in line with the OECD BEPS 15 Action plan and to ensure that there is a regime in place for equitable and efficient corporate taxation within the EU, the EC decided to lay down rules against tax avoidance practices. It is necessary to set out a minimum framework to ensure the level of protection in order to combat against aggressive tax planning within the internal market\textsuperscript{125} and set down rules in this context, i.e. in the area of CFC to counter the erosion of tax bases in the internal market so as to prevent profit shifting out of the internal market.\textsuperscript{126}

\textsuperscript{124} ‘European Parliament committee backs CCCTB plans’ 22\textsuperscript{nd} Feb 2018, \url{<https://www.rte.ie/news/business/2018/0221/942556-corporate-tax/>} (last assessed 30 May)

\textsuperscript{125} ATAD Preamble (3)

\textsuperscript{126} ATAD [2016] OJ L 193 Preamble (5)
Member States are required to transpose the ATAD into their domestic regimes within the transposition deadline.\textsuperscript{127} With an unusually tight transposition deadline where directives typically get a transposition period of around two years,\textsuperscript{128} it signals not only the external pressure the EC is getting from the OECD but the urgency of the issues that are affecting the functioning of the European Single Market.

It should also be noted that in the preamble, in the case of double taxation, the taxpayers should receive deduction for the tax paid in another Member State or third country. However, the deduction method arguably does not provide the right solution.\textsuperscript{129}

\subsection*{3.2.2 Aims of the CCTB}

Like the ATAD, the CCTB regime recognizes that due to the economic environment becoming increasingly globalized, it has become easier to shift profits. The lack of some form of harmonization, coupled with the great diversity of company taxation regimes in the EU and the rest of the world, has led to an eventual mismatch and a considerable amount of aggressive tax planning.\textsuperscript{130} As a result, there has been a distortion of the functioning of the internal market, which is not ideal as the European Single Market intended to establish harmonious economic activities\textsuperscript{131} and to safeguard economies from distorted competition.\textsuperscript{132}

\footnotesize
\begin{itemize}
\item \textsuperscript{127} ATAD Art. 11(1)
\item \textsuperscript{129} See the more extensive reasoning, see sec. 3.5.2
\item \textsuperscript{130} W. Schön, U. Schreiber, C. Spengel, ‘A Common Consolidated Corporate Tax Base for Europe’ (1\textsuperscript{st} edn, Springer-Verlag Berlin Heidelberg, 2008) Pp 1
\item \textsuperscript{131} Art 2 EC treaty
\item \textsuperscript{132} Art 3(1) EC treaty
\end{itemize}
In addition, Member States with their unilateral actions cannot alone protect their domestic tax bases against tax erosion and profit shifting. Thereby, an implementation of an integrated single market could potentially provide the solution for a fairer and more efficient taxation of corporate profits in the hope of eventually eradicating tax obstacles.

Essentially, the main function of the CCTB is to subject group of entities with taxable base in at least one Member State to a single set of rules for calculating their tax base across the EU, thus requiring these entities to be accountable to a single tax administration. Coordination via intra-organizational hierarchy also means greater integration of economies since it encourages better information flow and will lower costs for corporations.\(^\text{133}\)

Another significant objective of the CCTB is related to abusive transfer pricing. In the context of the arm’s length principle, there stands the possibility of double taxation if a Member State does not make the corresponding adjustment after the other Member State has adjusted its transfer price since it was not seen to be at arm’s length.\(^\text{134}\)

Thereby, another aim of the CCTB is to provide a more efficient solution for profit allocation between jurisdictions by using the formula apportionment that the CCTB will introduce.\(^\text{135}\)

### 3.2.3 The comparison of objectives in both acts

After setting down the various purposes of the ATAD and the CCTB, it is evident that the CFC rules by and large should serve a similar purpose. As specifically given in the name of both acts, the goal of


CCTB is directed more towards having a consolidated base whilst the ATAD is directly aimed at anti-taxation purposes. This could explain the need for two different regimes. However, the ATAD is applicable to corporate legal entities and individual taxpayers whilst the CCTB on the other hand, is only applicable to corporate legal entities and so that could provide some explanation to justify the need for two different CFC regimes.

3.3 ATAD and CCTB: Scope and its relevant issues

3.3.1 The proportionate change of scope in the 2016 CCTB

It should be brought to attention that the scope of the CCTB has been altered from the 2011 proposal. As compared to the earlier proposal, this directive will be mandatory for entities belonging to a group with a consolidated revenue exceeding EUR 750 million.\(^{136}\) That is only the beginning of the unraveling of many issues within the CCTB. One question if the capturing of consolidated groups above EUR 750 million, albeit is the vast majority about 64% of turnover,\(^{137}\) is indeed ideal as the minimum capacity amount of EUR 750 million is very high.

Furthermore, this re-launched proposal introduces a super-deduction for R&D costs entitling group R&D expenditure of up to EUR 20 million and a yearly extra super-deduction of 50%.\(^{138}\) This indirectly offsets the taxable revenue base for these high revenue consolidated groups. In this regard, it is safe to say that the EC aims to capture only the top high revenue earners. This way, it could be argued that the CCTB proposal, although appearing to be over-reaching by the EC, ultimately has some leeway and could be held to be proportionate.

\(^{136}\) CCTB Article 2(1)(c)

\(^{137}\) Ibid 136, Pp 5

\(^{138}\) Ibid 136, Pp 10
It is not only that large corporations will benefit. Small starting companies without associated enterprise would also be given an enhanced super-deduction of 100% of their R&D if it does not exceed EUR 20 million. However, it can be noted that under Art. 2(1) of the CCTB, since micro-enterprises and SMEs are out of scope, they are given the option to opt-in to the system and only then are they entitled to the advantages that the CCTB could offer. The limit that the EC has set of EUR 20 million is a relatively generous amount, as the sum seems fairly high for R&D expenditure, considering the size of micro-enterprises and SMEs.

The CCTB is certainly an ambitious project that not surprisingly failed to take off in 2011. Nevertheless, the EC has now decided that the re-launched proposal should include a mandatory scope for corporations above a certain growth size. It is a well-thought-out plan, since after the materialization of the full initiative coupled with the ratification of the consolidation and the apportionment formula, all taxpayers under the regime of the common base would automatically be moved into the CCCTB scheme.

On the other hand, it is reasonable to target entities with high revenues since they would have the needed resources for aggressive tax planning schemes. However, given that the 2011 proposal had no mandatory scope and was already seen as an arduous feat, it appears more doubtful if the re-launched proposal would get a more positive response from the Member States.

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139 Ibid 136, Pp 10
140 CCTB Pp 8
141 Ibid 140, Pp 9
142 Ibid 140, Pp 5
3.3.2 The substantive scope of the ATAD and CCTB with reference to the CFC regime

There have been substantive issues that have been raised in the older proposal that have now been resolved. One of which is in reference to the term “entity” in terms of the lack of clarification, 143 which has now been resolved in the re-launched proposal through the definitions provided in Art 4(30) CCTB. Nevertheless, it does not mean that loopholes are all covered as other issues could arise. Both acts have also inserted that the CFC could also be a PE as it states, “an entity or a PE (…) are not subject to tax or exempt from tax (…) shall be treated as a controlled foreign company (…).” 144 The basis for inserting this additional provision is not straightforward 145 since the exemption of the PE profits is already an aftereffect of Art. 8(e) CCTB. 146

Furthermore, the broad definition of entity as “any legal arrangement […] through either a company or a structure that is transparent for tax purposes” 147 could also compress of PEs. Therefore, this seems to only imply that the additional condition could be deduced as redundant. It is also worth mentioning that the ATAD does not define entity. It is uncertain in this scenario if the CFC regime applies to entities with legal personality or entities without legal personality, for example partnerships or contractual investments like funds and trusts. 148 Although this broad concept of entity could be attributed to

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144 ATAD Art 7(1) and CCTB Art 59(1)
146 Art. 8 CCTB: Exempt revenues. The following revenues shall not be included in the tax base in (e) income of a permanent establishment received by the taxpayer in the Member State where the taxpayer is resident for tax purposes.
the Panama Papers revelations, it is still crucial to note if withholding taxes come under the corporate taxation.\textsuperscript{149} This ambiguity in the ATAD, which was first noted in the earlier CCTB proposal and has now been clarified, should also follow suit. That said, OECD BEPS action 3 proposes that the concept of entity is to be defined broadly.\textsuperscript{150} Therefore, despite the lack of a defined concept in the ATAD, the directive is still considered to be in line with BEPS.

As rightfully argued, it is odd to require the exemption of the foreign PE income within Art 8 and to incorporate all exempt PEs in the ambit of the CFC legislation.\textsuperscript{151} The reason for this is that ‘the income of the PE could similarly raise the same concerns as income arising in a foreign subsidiary and if this is the case, the parent subsidiary could either deny the exemption or to apply the CFC rules to the PE.’\textsuperscript{152} Another alternative would be to include the low-taxed PEs in the scope of the switch-over clause.\textsuperscript{153} Even though the CCTB, unlike ATAD, has implemented the switch-over clause, both acts still have problems with definition.\textsuperscript{154}

It is reasonable that both acts require the two criteria to be fulfilled in order for the CFC regime to be relevant and that those criteria are spelled out identically although paraphrased differently.\textsuperscript{155} The first

\textsuperscript{154} Ibid 153, Pp 165
\textsuperscript{155} ATAD Art 7(1)(a) & (b) and CCTB Article 59(1)(a) & (b)
being a control element and the second one dealing with the effective low taxation which has been charged on the entity or the PE. The control element, as noted in Art. 7(1)(a) ATAD and Art. 59(1) CCTB, has been argued that in order to be in line with fundamental freedoms from a tax policy viewpoint, a more than 50% majority of voting rights is reasonable since the resident shareholder has access to the company’s income and information relating to tax status.\(^{156}\) Yet, there are issues that should be highlighted.

For the purposes of Art. 59(1)(a) CCTB and Art. 7(1)(a) ATAD, paying attention to the meaning of ‘indirect participation’ or ownership of capital and profits, it is not stated within the realm of both acts how the level of ‘indirect participation’ should be calculated.\(^{157}\) In this regard, it is accepted that the CCTB has provided some explanation through Art. 3(2) that deals with parent company and qualifying subsidiaries and the following rules that should be applied when calculating the threshold whilst Art. 56(2) CCTB deals with associated enterprises and the relevant rules in order to calculate them. On the other hand, the ATAD only provided definitions in Art. 2(4) for the associated enterprises but has not gone further like in the CCTB as the latter seeks to specifically clarify indirect participations. That said, the analogy provided by the CCTB could be translated as a disadvantage for the taxpayer.\(^{158}\)

The last remaining issue to be underlined concerns the exceptions that are found under Art. 7(2)-(3) ATAD and Art. 59(2)-(3) CCTB. To this end, Art 52(2) CCTB stated that CFCs that are either a EU Member


\(^{158}\) Ibid 157
State or EEA companies that have been ‘set up for valid commercial reasons reflecting economic reality’ are not subject to the CFC regime. The wording in the ATAD, on the other hand, although reflecting a similar purpose, states that where CFC is EU or EEA companies, Member States ‘may decide to refrain from applying the exceptions.’ Member States in the ATAD seem to be given more deciding authority considering that the CCTB does not have this provision inserted.

The factors that needed to be considered for genuine economic activities are staff, equipment and premises of which makes are in accordance with the ECJ’s judgment in Cadbury Schweppes. It is to be noted that in addition to the factors mentioned, both acts have also added ‘assets’. This potentially raises conflict with Art. 63 TFEU on the freedom of capital movements seeing that the exception from both acts do not extend to third countries outside the EEA.

Additionally, there is a subtle phrase usage in both acts. The ATAD uses ‘substantive economic activity’ whereas the CCTB provides for ‘valid commercial reasons that reflect economic reality’. By and large, both phrases suggest similar outcomes since they deal with what constitute genuine economic activities. However, the CCTB indicates a more realistic approach by inserting the phrase ‘reflect economic reality’. To the extent that tax legislative acts do not reflect the changing nature of business and economic environment, which indirectly has a negative impact on the state’s economy, it is a positive start for the CCTB to adopt such provisions.

159 Case C-196/04 Cadbury Schweppes Plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] ECR-07995 Para 67
Furthermore, in relation to the inconspicuous difference in the wording, ATAD extends the carve-out rule to third countries outside the EEA, which is absent in the CCTB proposal. Since the CFC regime is not completely in line with the fundamental freedoms, the EC acknowledges in the ATAD that for that reason ‘to comply with the fundamental freedoms, the income categories should be combined with a substance carve-out […]’. Furthermore, the ATAD states that ‘it is desirable to address situations both in third countries and within the Union.’\textsuperscript{161}

The EC ideally wants to limit concessions on the freedoms to a minimum and the freedom of capital article is thus assumed not applicable to CFC provisions.\textsuperscript{162} As such, if the freedom of capital is extended to safeguard third countries outside the EEA, it is uncertain why the EC would need to address the third countries in the ATAD especially in the regard of a CFC provision. Nothing to that extent has been discussed in the CCTB. Therefore, it only seems contradictory that the ATAD would insert such an option.

3.3.3 The need for 2 separate CFC regime?
At first glance, it would seem that the two CFC regimes are almost identical. However, as examined earlier, there are discrepancies within the scope of the two acts even before going in depth to the main provisions of the CFC legislation. Within the ATAD, the CFC legislation seeks to effectively re-attribute income of a low-taxed controlled subsidiary to its parent company.\textsuperscript{163} The CCTB CFC rules have generally the same function as the ATAD.

\textsuperscript{161} ATAD preamble 12
\textsuperscript{163} ATAD preamble 12
However, the CCTB sways towards establishing a more competitive European single market by subjecting a group of entities with a taxable base in at least one Member state to a single set of rules for calculating their tax base across the EU. In the long run, it will decrease cost and increase their competitiveness. This can be seen where the CCTB has special deductions for R&D purposes, since after the process of R&D is successfully done, the entities’ competitiveness will likely increase. Nevertheless, there could still be a need for two separate CFC regimes since the objectives of the ATAD and CCTB are not identical. It would be deemed acceptable to have two separate CFC regimes only if they themselves are watertight rules to begin with. It increases the risk of creating inconsistent provisions that would ultimately impact the ATAD and CCTB.

3.4 Issues regarding anti-avoidance rules in the ATAD vs. CCTB

Even the general anti-avoidance rules within the ATAD and CCTB have their limitations, let alone more specific measures such as the CFC regime. A more definite tone has been set in the preamble of the new CCTB in its fight towards aggressive tax planning schemes. Thus, there are amendments made in the new proposal, as noted in the contents of the general anti-avoidance measures. That said, the CFC regime, being one such measure, was already in place in the older proposal.

If the objective of having anti-avoidance measures in the CCTB were essentially the same as that in the ATAD, it would be interesting to note the differences in the wording between these two CFC regimes. On the other hand, it also raises other related questions, such as whether the CFC regime in the CCTB should be exactly the same as the one in the ATAD since this could potentially cause an overlap. In the case of an overlap, one question is which of the CFC regimes
would take effect, which the EC needs to be clear and specify in those circumstances.

In Art. 58 CCTB, the wordings are exactly identical\(^{164}\) as in in Art. 6(2) of the ATAD. However, there is a clear contrast between the GAAR in ATAD and CCTB\(^{165}\) from the wording that tax avoidance must be “for the main purposes or one of the main purposes”\(^{166}\) whereas in the CCTB, it is “for the essential purpose.”\(^{167}\) This translates that the GAAR in ATAD has a broader scope than in the CCTB since, in the latter, tax avoidance must ultimately be the main prevailing intent in order for the arrangement to be set aside.

By contrast, the phrase “one of the main purposes” not only allows for a broader interpretation but at the same time does not require tax avoidance to be the main prevailing objective for the arrangement to be set aside. The subtle difference signals that whilst the CCTB proposal attempts to set down certain tax avoidance rules to combat aggressive tax planning, these rules may not be as effective as the one provided in the ATAD as shown in Art 6(1) that its criteria are more intrusive. For that reason, the EC’s measures in the light of the CCTB seems more over-reaching than that of the ATAD.

The last issue in this section is in reference to the difference in the legal rule that has to be applied in the two acts. The concept of economic substance\(^{168}\) is used in the CCTB, which has not been

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\(^{164}\) ATAD Art 6(2) and CCTB Article 58(2): For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.


\(^{166}\) Council Directive (EU) (2016/1164) laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L 193 Art 6(1)

\(^{167}\) CCTB Art 58 (1)

\(^{168}\) CCTB Article 58 (3)
defined within the context of EU tax law, in any directives or even in the ECJ case law.\textsuperscript{169} This raises red flags for the Member States since such undefined concepts need to be clarified and developed by the EC and the ECJ. In this regard, when economic substance has not even been defined but has only been developed in some jurisdictions,\textsuperscript{170} it only increases the uncertainty that Member States have for this proposal.

3.5 ATAD and CCTB: CFC main provisions and its issues

3.5.1 Attributed income

What is attributable to the CFC is an important issue that should be taken into consideration. BEPS has provided recommendations, albeit not exhaustive ones, but in comparison, the ATAD and CCTB do not seem to have provided a similarly extensive assistance like BEPS. Art. 7(2) ATAD and Art. 59(2) CCTB merely provides what should be attributable in the taxable base. At least, the ATAD attempted to provide some form of guidance as seen in Art. 8(5) and 8(6).

The term ‘income’ in the old proposal\textsuperscript{171} is now amended to ‘profit’. It was argued that the CFC regime did not differentiate between active and passive income.\textsuperscript{172} To begin with, both terms are very different in nature and the reason why the EC would use profit in this proposal might be related to the aims of the ATAD and CCTB against profit shifting. ‘Profit’ has been defined in CCTB as an excess of revenues


\textsuperscript{170} Ibid 169

\textsuperscript{171} Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) COM (2011) 121/4, 2011/0058 (CNS) Brussels, Art. 82(1): The tax base shall include the non-distributed income of an entity resident in a third country where the following conditions are met.

over deductible expenses and other deductible items in a tax year\textsuperscript{173} but not in the ATAD.

However, taking into account the mere change of term, it is still not evident if this current proposal has made any distinction. Nevertheless, like in the past proposal, the fact still stands that it would be necessary to distinguish the income and to which company it should be attributed in order to prevent the same income from being attributed to the companies of the group\textsuperscript{174}.

\textbf{3.5.2 Mechanism of CFC in the ATAD and CCTB}

It was explicitly asserted in the BEPS Action 3 that the CFC regime should provide provisions to make sure that those rules will not lead to double taxation\textsuperscript{175}. As such, in the case of double taxation arising from the application of the CFC legislation that the ATAD and CCTB aims to avoid, there are issues that need to be highlighted.

It should be noted that the issue of whether a tax credit would be available in the taxpayer jurisdiction for the tax levied on the CFC has already been criticized in the earlier proposal\textsuperscript{176}, yet the question remains largely unanswered in the re-launched CCTB proposal. There is a broad rule in relation to the relief that the taxpayer is entitled to in the CCTB. It states that ‘a deduction from the tax liability of a taxpayer shall be allowed where the taxpayer derives income that has been taxed in another Member State or in a third country […].’\textsuperscript{177}

\begin{itemize}
\item \textsuperscript{173} CCTB Art. 4(8)
\item \textsuperscript{175} BEPS Action plan sec. 7.1
\item \textsuperscript{176} M. Tenore, ‘CFC Rule’ in “CCCTB Selected issues”, D. Weber (ed), (Alphen aan den Rijn, 2012) Pp 311
\item \textsuperscript{177} Art. 55(1) CCTB
\end{itemize}
However, that Article addresses explicitly interest and royalties and any other income taxed at source. It is too general and therefore ambiguous if Art. 55 CCTB could be used to avoid taxation arising from the CFC legislation.\textsuperscript{178} Even though Art 8(7) ATAD is clear about this issue, it cannot be assumed that the CFC regime within the CCTB could follow what has been determined in the ATAD. Based on the recommendations in BEPS Action 3, a credit for foreign taxes actually paid should be allowed\textsuperscript{179} so assuming that the CCTB proposal was built around BEPS, it is likely that they would adapt this recommendation. With respect to ATAD, after cross-referencing to BEPS, the relief for foreign corporate taxes could be said to be consistent with the recommendations by the OECD.

It is given that the ATAD has provided whether a tax credit would be available in the taxpayer jurisdiction for the tax levied on the CFC. However, it does not indicate that it provides an answer in the case of double taxation as a consequence of indirect control. This indirect control would trigger Art. 7(1) ATAD relating to the CFC rule when a parent company holds 100% participation in company A and 5% in company B whilst company A holds 49% in company B. Note that in this scenario, all companies are in the EU and company B generates passive income.

In the scenario above, the double taxation would arise from the double CFC tax liability in the other jurisdictions where the controlling entities are incorporated,\textsuperscript{180} but the tax credit in Art. 8(7) does not provide any solution. The reason is that it is ‘the Member

\textsuperscript{179} OECD BEPS Action Plan 3, sec 7.1 pg 65 para 122
State of the taxpayer which will allow a deduction of tax paid by the CFC, but in this scenario, the CFC liability occurs in the jurisdiction of the parent company and in company A as a consequence of the indirect control. The notion of indirect control in the CFC rule is not evidently unfamiliar as it is included within the ambit of a CFC definition in the ATAD. Nonetheless, it is ambiguous how the double CFC liability could be alleviated which could be indicative that in effect, the tax credit may not be a form of solution for double CFC tax liability taxation as a result from indirect control.

Within Art. 60 of the CCTB, there appears to be more emphasis on the income which is to be included or not included in the tax base. By comparison, the ATAD addresses not only the income which is to be included or not included in the tax base but also the mechanisms to ensure that there is no double taxation, as seen in Art. 8(5)- Art 8(7). In this regard, it can be seen that the relief provisions are provided more extensively in the ATAD as compared to the CCTB as noted in Art. 8 and Art. 60 respectively. However, the CCTB proposal needs to explicitly address these criticisms and provide them in the proposal like the ATAD. It could be concluded that that both the ATAD and CCTB fall short in addressing ways of eliminating double taxation.

3.5.3 Recourse argument

Being an EU directive, the ATAD is a hard law which means that those Member States without the CFC rules need to have them transposed in their national domestic legislation. That said, it is only a minimum standard, and so the Member States are allowed to go beyond the prescribed ATAD. On the other hand, the CCTB is a

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181 Art. 8(7) ATAD
183 Ibid 182
184 Ibid 182
mandatory regime and a clear-cut number of explicitly granted options for the Member States.\textsuperscript{185}

There could be situations where the CFC regime overlaps with the application of domestic regime on CFC.\textsuperscript{186} In such a situation, there would be a risk of double taxation since the income of the CFC would be taxed by the company and the individual shareholder.\textsuperscript{187} It has also been argued that “leaving the application (of the CFC rules) for the national legislations without any coordination runs the risk of creating inconsistent provisions, thereby affecting the CCTB.”\textsuperscript{188}

Without any agreement of a common approach, the Member States would essentially be brought back to square one with a distortion of the single European market due to mismatches. Therefore, clarifications would be needed on the interaction between the national CFC rules and the CFC regime. This would also mean that if there is no fall back, i.e. the CFC regime is self-standing, the regime has to be very clear. However, from the analysis conducted above, though this re-launched proposal is more concise than the earlier proposal, the ATAD and the CCTB CFC rules still have their uncertainties, which should be resolved.

### 3.5.4 CFC rules and the third country entities

All of the EU Member States are required to implement CFC rules in their national domestic legislation. That said, according to Art. 3 ATAD, which essentially allows Member States to take a more

\begin{flushleft}
\textsuperscript{187} Ibid 186
\textsuperscript{188} Working Document, “International aspects in the CCCTB” CCCTB/WP/019 (18 November 2005) Para 43
\end{flushleft}
intrusive stance in third countries, it would indirectly create a strong tax bias against such countries.\textsuperscript{189} As rightfully pointed out, with the homogenous implementation of the ATAD in the EU by 31 December 2018 and perhaps even the CCTB proposal in the future, there would be repercussions that have an unprecedented unilateral interference in the international tax policy of the third countries.\textsuperscript{190} For that reason, some attention needs to be paid to how this could potentially impact the third-country entities.

It should also be reminded that the BEPS project plays a major role in the formation of the ATAD and was originally triggered by the tax planning of the largest US MNEs such as Google and Apple.\textsuperscript{191} Indirectly, the ATAD could be seen as a tool for the Member States to gain a competitive advantage over the US. Thus, it is not surprising that the US would have some role to play in the BEPS project and would ensure that BEPS as a whole does not greatly impact them and other third countries in a negative way.

As affirmed by the Commission in its communication papers, the EU Member States are not precluded from the application of CFC rules in relation to third countries and therefore will need to be examined under the ambit of Art. 43 TEC. It was further articulated that “CFC rules determine the tax treatment of the profits of a foreign company controlled by a resident. As the CFC rules are directed at, and thus only affect resident shareholders with definite influence over a foreign

\textsuperscript{191} Ibid 190 Pp 66
company […] their center of gravity lies with the ability of companies to establish themselves, through subsidiaries, in other countries.”

Yet, the notion that there is a prohibited restriction on the movement of capital in third countries is explicitly provided in Art. 56 TEC but not in Art. 43 TEC. Again, there is a dichotomy of the two freedoms, which have been examined in more detail in section 2.4.2. There is a lack of case laws concerning the free movement of capital as compared to the free movement of establishment. One reason is that once the ECJ has decided that the cases should be applied under the free movement of establishment article, the ECJ does not go further in examining the issues within capital. With that in mind, there would therefore be fewer cases that deal directly with the CFC regime concerning third countries and the restriction of the free movement of capital. Furthermore, the ECJ has not explicitly defined the scope of the free movement of capital other than in defining the capital movement in the case of Verkooijen.

The balance between the need to protect the domestic tax base and the maintenance of third-country relations is to a certain extent hard, especially with the CFC rules being an aggressive measure. This could also explain how some of the main CFC provisions within the ATAD and the CCTB are not watertight.

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192 Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on “The application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries” COM/2007/0785 final, Pp 8
4. Other related outstanding issues

4.1 Double taxation conventions

The issues of CFC legislation if it were to be in conflict with tax treaties needs to be mentioned where its application could result in a treaty override. However, nothing explicit has been mentioned in the ATAD or the CCTB. Whilst there is an exception in Art. 53 CCTB, which will allow for the CCTB proposal to avert any possible conflict of the EU and the international law obligations confronted by the Member States, it only relates to the switch-over clause and so it is not in direct reference to the CFC articles. It was put forth in the OCED MC Commentaries that the CFC regime is not in conflict with the tax treaties but was disagreed by Belgium, Ireland, Luxembourg and the Netherlands. However, as rightfully pointed out, the political climate in 2010 is different as compared to the current BEPS era and so the case that national anti-abuse rules cannot override a treaty is a possibility. This translates that in the absence of the exception provided in the switch-over clause, the CFC’s implementation in the domestic law could cause conflict. As such, some form of change would need to be addressed.

Lastly, regarding tax treaty provisions on the elimination of double taxation, with the recommendation in BEPS Action 3, Member States should thoroughly reassess the provisions when designing or amending their CFC legislation so that they are not inadvertently

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obligated to apply the exemption method to the income which they want to tax.\textsuperscript{199} This is because the elimination of double taxation in bilateral treaties may differ considerably from the wordings of Art. 23A and 23B of the OECD MC.

\textbf{4.2 Tax sovereignty}

It is hard to balance tax autonomy and tax harmonization. To a large extent, the balance almost does not seem to exist, tipping more towards the side that Member States might not have a lot of tax autonomy, especially when it has been argued that the CCTB might go beyond the proportionality principle, thereby stripping some states of their tax sovereignty.\textsuperscript{200} It seems that the CFC regime being restrictive in nature is pushing forward the connotation that the EC’s actions in the ATAD and the CCTB could be overreaching.

An argument for supporting that notion would be the effective tax rate threshold in Art. 7(1)(b) ATAD and Art. 59(1)(b) CCTB. Given that direct taxation falls out of the scope for the EC and therefore is only for the domestic competence domain, the proposal of having a 50\% effective tax rate from a 40\% was strongly opposed by Ireland.\textsuperscript{201} Due to this disagreement, the EC decided to amend its final draft, which is reflected in Art. 7(1)(b) ATAD and also in Art. 59(1)(b) CCTB. It should be noted here that the meaning behind the two provisions, although not worded identically, are similar to a large extent.\textsuperscript{202}


\textsuperscript{200} J. Lamotte, ‘New EU Tax Challenges and Opportunities in a (C)CCTB World: Overview of the EU Commission Proposal for a Draft Directive for a Common Consolidated Corporate Tax Base’ IBFD, Eur. Taxn 2012, Pp 278


\textsuperscript{202} ATAD Art. 7(1)(b): the actual corporate tax paid on its profits by the entity or permanent establishment is lower than the difference between the corporate tax that would have been charged on the entity or permanent establishment under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity or permanent establishment.
Yet, after going in depth with the given provisions, the mathematical result of a 50% effective tax rate threshold still remains but with the glaring difference of a convoluting text. In other words, the effective tax rate could be higher than the domestic tax rate in the CFC jurisdiction if the tax base under the legislation of the parent jurisdiction is smaller than the CFC jurisdiction. As such, this provides support in favour of Ireland’s claim that the EC is indirectly trying to coordinate tax rates. It has been argued that in reality, group corporations would not structure themselves in low domestic tax jurisdictions where the advantage of a low tax rate is neutralized by the disadvantage in the tax base computation entirely or partially.

Whilst that viewpoint may be by and large accurate, a partial disadvantage set off in the computation will not be the main justification to prevent them from restructuring to a lower tax jurisdiction since such large corporations do have the resources for aggressive tax planning.

5. CONCLUSION

Finally, there is some form of coordination within the EU regarding tax base erosion and profit shifting. As a single European market, the EU needs to tackle such issues as a whole. With 28 different taxation systems, there is a risk of mismatches and distortion in the internal market. The ATAD has received criticism for being extensive and

CCTB Art. 59(1)(b): the actual corporate tax paid by the entity or permanent establishment on its profits is lower than the difference between the corporate tax that would have been charged on the profits of the entity or permanent establishment in accordance with the rules of this Directive and the actual corporate tax paid on those profits by the entity or permanent establishment.

205 Ibid 204
over-reaching. Nevertheless, the Parliament and the Council have approved the legislative proposal.

The EC has not in its entirety gone out of its way and is overreaching in its actions. It took out the switch-over clause in the ATAD in order for this legislation to be enacted. The EC created only a skeletal framework for the CFC regime provided in the ATAD and the CCTB. After a thorough examination of the CFC skeletal framework in the ATAD and the CCTB, issues have been revealed along the way in relation to the substantive scope of the CFC to the mechanism in the regime and tax sovereignty, only to highlight a few.

Perhaps ironically, certain parts of the CFC regime, especially in relation to the double taxation relief provisions, which have been left out in the CCTB, are found in the ATAD. On the other hand, areas that do not seem to be clear in the CCTB CFC rule seem to be clarified in the ATAD CFC rule. What is certain, however, is that the issues within the CFC articles in the CCTB should be addressed. Two CFC regimes in two different pieces of legislative acts, if anything, would cause more ambiguity if those rules were not robust to begin with.

It seems highly unlikely that the uncertainties of the CFC regime alone would prevent the ATAD from being an effective measure against aggressive tax planning in the internal market. Additionally, it would be interesting to note if there will be any negative impact on the domestic markets of the Netherlands and Belgium and their international tax policies since they are two of the Member States who were against the implementation of the CFC regime.
The role of the CFC regime in the ATAD is clear and would probably fulfill the objectives of the ATAD. However, the CFC regime does not seem to play a similar role in the CCTB as it does in the ATAD. Having anti-avoidance tax measures in a CCTB proposal is a small part of its grand and ambitious scheme and perhaps this could shed some light to justify the gaps in its CFC provisions and the EC’s carelessness. It is still early to know if the CCTB proposal would be approved by all of the Member States and the Parliament. Weighing the benefits against the disadvantages, if the CCTB proposal were to be enacted, it could change tax policies and relations with third countries, especially for the EU and its Member States, hopefully in a positive way.
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