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Submitted by email: CTPCFC@oecd.org

May 1<sup>st</sup>, 2015

**Ref: OECD DISCUSSION DRAFT: STRENGTHENING CFC RULES (BEPS ACTION 3)**

Dear Achim

BIAC thanks the OECD for the opportunity to provide comments on its Discussion Draft on Action 3 (Strengthening CFC Rules) of the Base Erosion and Profit Shifting (BEPS) Action Plan issued 3 April 2015 (the "Discussion Draft").

However, we do believe that the Discussion Draft represents an important opportunity missed. Controlled Foreign Company/Corporation (CFC) rules can play a very important role in preventing base erosion and profit shifting. They can, by effectively imposing home-country taxation on foreign subsidiaries, discourage inappropriate base-eroding transactions. And they can, by complementing the Transfer Pricing rules, discourage certain forms of inappropriate profit shifting transactions.<sup>1</sup> As mechanical rules, they can provide certainty for government and taxpayers alike, as well as relief from certain time-consuming, fact-specific transfer pricing enquiries. They can facilitate greater equity between countries by restricting certain hidden forms of tax competition. And, they can encourage certain types of "virtuous" economic behaviour – for example, true value-creating activity – and discourage other, less productive, activity.

Unfortunately, the Discussion Draft does not advance any of these goals. Because of – we assume – fundamental disagreements between member governments, there is no clear initial articulation of what CFC rules are meant to achieve. This lack of articulation is followed by a myriad of suggestions to create a "*minimum standard*" (although with many options within that standard), which do not, in the end, hold together. The net result is that the Discussion Draft does not effectively target artificial base erosion and profit shifting.

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<sup>1</sup> It is important to note, of course, that not every deductible payment is "base-eroding" in the BEPS sense; nor does every inter-company transaction result in "profit-shifting" as understood in BEPS. Both deductible payments and intercompany pricing are allowed by law, and as applied by taxpayers will generally reflect the economics and substance of the transaction. However, that will not always be the case, and in those circumstances well-focused, clearly-articulated CFC rules are appropriately applied.

The confusion surfaces early on with the expression of the hope that a solution can be found to balance capital export neutrality with capital import neutrality. As the principles are diametrically opposed, this, of course, is hard. But without suggesting where a new balance might lie, the Discussion Draft then seems to reject the long-standing balance previously struck between the two, of imposing current taxation on “passive” income while not currently taxing “active” income until repatriation to the parent jurisdiction (also known as “deferral”).

The Discussion Draft departs from this foundational active/passive distinction of CFC taxation with proposed models that look at new concepts such as “excess returns”. That potential rule would reallocate taxing rights over genuine economic activity to the parent jurisdiction, regardless of the level and nature of the activity which generated the income. BIAC has objected to proposals in other discussion drafts that might inappropriately shift taxing rights to what are often (if, perhaps, imprecisely) called “source” countries. It seems only right that, by the same token, BIAC object to proposals that inappropriately shift taxing rights to “residence” countries, as the routine application of the “excess profits” approach would do.

Further suggestions that fact-based determinations should be much more widely used in CFC rules would diminish the advantage of the objective, mechanical aspect of those rules. As a result, rather than complementing Transfer Pricing rules, they would fulfil a similar (and quite possibly duplicative) role, where everything is subjective, and, thus, almost always, more complicated. This would clearly be another burden on business – but just as much on revenue authorities, many of whom, in a resource-constrained environment, are already being asked to do “more with less”. Surely there must be a limit to how far that maxim can be stretched before it breaks?

Despite our disappointment at this missed opportunity to clarify (and even simplify) CFC rules, we have, of course, and as requested, responded in detail to the Discussion Draft. Nevertheless, in light of such clear lack of agreement on even the fundamentals, we do suggest that a better way forward might be to survey existing national CFC regimes. This process might truly identify best practices, rather than seeking to come up with “minimum standard” recommendations which – especially given the very short amount of time left – can only be agreed to at the very highest of levels (and with the potential, below that very high level consensus, for a completely uncoordinated set of legislative responses by different countries).

As always, we acknowledge the amount of time and effort that member governments (and the Secretariat) have put into this project, and we are very grateful for the opportunity to comment on these proposals while still in draft. However, we do, in this case, believe that it might be better to set less lofty goals and a slightly longer time horizon in order that – at the end of the process – a broader, more detailed consensus can be reached on this critical area of international tax policy.

Sincerely,



Will Morris  
Chair, BIAC Tax Committee

## General Comments

### Establishing a Clear Policy Objective

BIAC is concerned that the OECD's Discussion Draft on CFCs lacks the clearly articulated policy objectives that are necessary to develop the coherent, targeted and proportionate CFC measures called for in the 2013 Action Plan on BEPS. At present, it seems that the Discussion Draft is attempting to satisfy multiple competing objectives. In other areas, for example the rules on permanent establishments, there is general agreement on the purpose of the PE rules, even if there is disagreement on, say, the appropriate thresholds to be applied. In the area of CFCs, however, there seems to be no broad consensus on what CFC rules are even meant to achieve. Before refining the existing recommendations, therefore, it is critical to determine exactly what the purpose of CFC rules should be: for example, is the concern about passive income diverted away from a parent entity; or is it that there should be a more mechanical and objective backstop to transfer pricing rules; or is only protection of the home country tax base important/justified or are foreign-to-foreign transactions implicated; or is the system theoretically underpinned by capital export neutrality? If these fundamental design questions are not agreed upon, then this project will, almost inevitably, result in confused and problematic recommendations.

Given the apparent difficulties on reaching a consensus on the purpose of the rules, we believe that a more useful approach, at least as an initial matter, and pending further work, might be to review the effectiveness of different existing CFC rules (based on the setting in which they are applied), to determine what best practices might look like for countries operating substantially different tax systems. A more thorough analytical examination of the options available to countries under each 'building block' could help countries to understand how rules might *i)* help to tackle BEPS related activity and *ii)* impact the competitiveness of a country, including as it relates to inbound and outbound investment. In addition, delivering narrowly focused 'best practice' options could contribute to more consistent international rules.

One of the dangers inherent in a number of the BEPS items is recommendations that are unintentionally broader than is necessary to prevent the harm being aimed at. BIAC believes that, the most basic principle of any CFC regime must be that it is not intended to tax "active" income. We are also concerned that the proposals could fundamentally alter the allocation of taxing rights in certain situations and undermine legitimate sovereign tax policy choices made by countries.

Although BIAC supports the development of "best practice" recommendations, rather than a minimum standard, if the OECD does propose a minimum standard for income inclusion, it should be developed to protect legitimate active income resulting from real and substantive business activity. The Discussion Draft, as it stands, risks substantially increasing the compliance burden faced by business, and bringing into scope legitimate transactions that ought not to be subject to CFC rules.

### Complexity and Interaction with other BEPS Actions

The OECD's proposals and options risk creating substantial complexity for taxpayers and tax administrations alike. Many recommendations and options would require additional detailed guidance to fully understand how they could be implemented and applied in practice. Without such guidance, proposals may be interpreted and implemented by countries in different ways – presenting taxpayers with an increasingly complex web of rules.

Having a broad range of substantially different CFC rules, even if loosely based on the same 'minimum standard', would substantially increase compliance costs for taxpayers, and would risk creating double taxation. A method to ensure proper and effective relief for such double taxation will be critical for the success of this Action and the wider BEPS project. In relation to Action 3, the establishment of a clear common hierarchy of rules that would apply across different CFC regimes and between CFC and Transfer Pricing rules should be developed. This would be required in addition to clear ordering rules to ensure that, for example, credit for foreign taxes paid is properly provided. Effective dispute resolution continues to be important to ensure that any failure of such an ordering rule would still be rectified. There must be a clear commitment to effective double taxation relief and dispute resolution mechanisms.

In addition, we are concerned about the lack of any impact assessment to determine the expected effect that the proposals might have on trade and investment. For example, tightening of CFC rules in ways that require more substance in a particular jurisdiction may well result in the perhaps unintended consequence of the shifting of substance, including jobs, to jurisdictions with low tax rates.

The BEPS Action Plan will deliver a range of recommendations that will be implemented in various ways (for example, a new multilateral tool, bilateral treaties, domestic legislation and Transfer Pricing Guidelines). We are increasingly concerned that, when all the recommendations are taken together, taxpayers will be presented with a massively increased compliance burden, which diverts resources from real commercial activity. And this should be of concern to tax authorities as well, who will be presented with huge volumes of new filings that could risk muddying the water, rather than providing clear and effective tools to target real risks.

Indeed, the Discussion Draft states that the work on CFCs is closely associated with other BEPS Action Items (including Actions 1, 2, 5, 8-10, 11, 14 and 15). Although BIAC fully understands the time pressures of the project, we continue to be concerned about the apparent lack of ongoing coordination between the OECD Working Parties and Focus Groups developing proposals under these Action Items. Due to the overlapping nature of the Action Plan, specific abuses may be targeted (and addressed) through multiple recommendations. A detailed review process which looks at the project in its entirety is critical prior to delivering the package of actions to develop clear agreement over *i)* which abuses should be targeted by which Actions, and *ii)* how the proposals should be implemented and ordered so to mitigate unnecessary rules, overlaps and compliance costs. BIAC looks forward to opportunities to work with the OECD to address these concerns.

### **Targeting BEPS: Transfer Pricing vs. CFC rules**

The Discussion Draft explains that Transfer Pricing and CFC rules can be closely related in several ways, and that both types of rules can exist side-by-side to fulfil different roles. Although we agree with much of that analysis, we are concerned that the CFC proposals could undermine the detailed work being undertaken by Working Party 6, for example, in the area of risk and capital, and go beyond tackling base eroding or profit shifting activities.

Targeted CFC rules that can be clearly and objectively applied may well be an appropriate solution to target 'cash box' (i.e. highly capitalised low substance) entities, where the target is passive income, but we are concerned that very broad rules could implicate commercial transactions with

appropriate substance, simply because the tax-rate applied is low when compared to the parent country. One of the primary objectives of the BEPS Action Plan is to realign profits with substance - well drafted Transfer Pricing guidance should be capable of doing this in many instances, without the need for additional rules (and associated compliance burdens). In this regard, the Discussion Draft states that the Excess Profits Approach would only “*apply to income that remained after transfer pricing rules had been applied,*” suggesting that countries do not have confidence that work being delivered by Working Party 6 will provide the tools to challenge transfer pricing issues through the application of Article 9. We are concerned that countries could seek to apply such an approach to Transfer Pricing results solely based on the applicable tax rate, rather than because profits and substance have been misaligned.

We believe that it would be helpful to restate that CFC rules can help support Transfer Pricing rules, by removing the requirement for fact-intensive development in cases where it is clear that passive income is, for example, being shifted from a home country. The role of mechanical, (relatively) simple to use CFC rules, however, is not to provide an alternative fact-based, case-specific route to allocating tax between various related parties based up respective economic contributions. It is to remove certain, quite narrow, classes of intercompany transactions from the (in these narrow classes, unnecessary) subjective enquiries required under the Transfer Pricing rules.

### **An Excess Profits Approach**

BIAC believes that the Excess Profits Approach should not be included in the OECD’s recommendations. It seems to drift very far from commonly understood CFC principles, especially as related to the distinction between active and passive income. It runs counter to the OECD’s core mission of removing impediments to facilitating cross-border trade and investment. The implication of this, were it to be adopted, could be wide-ranging and highly detrimental to economic growth.

We are particularly concerned about:

- **Timing differences and distortions** (including any differences in the parent-jurisdiction vs. local-jurisdiction accrual of income, deductions, or the treatment of Net Operating Losses) – Any attempt to use multi-year averaging to correct for such differences will be complex may not correct for longer-period timing differences (e.g., different depreciation rates, or a growing asset base).
- **Determining the “excess profits” with accuracy** – Although proposed as a mechanical approach, the Discussion Draft identifies sets out a number of complicated calculations, where a range of answers could be possible.
- **Overriding exemption or deferral systems** – In its application, the Excess Profits Approach will risk overriding the intended application of exemption or deferral tax systems to legitimate transactions in many cases.
- **Anti-competitive consequences** – No country has yet adopted such a rule. Absent broad multilateral adoption, implementation of an Excess Profits Approach would likely have substantial anti-competitive effects. Given the untested nature of this proposal, it should not be considered a ‘best practice’.

We are also concerned that this approach would place MNEs headquartered in higher tax rate jurisdictions at a disadvantage. For example, the (excess) profits of a subsidiary of such an MNE, owning and exploiting IP and operating in a lower tax jurisdiction, may be subject to tax in the headquarter jurisdiction, whereas a domestic entity, owning and exploiting comparable IP in the lower tax jurisdiction would pay a lower rate of tax on all of its profits, potentially putting it at a competitive advantage.

Although we strongly disagree with the Excess Profits Approach, if governments did decide to develop it further, any taxable inclusion should be computed on an aggregate basis (taking into account all income, losses and taxes of an affiliated group of CFCs). Such an approach would better reflect the largely integrated nature of many global supply chains, which commonly cut across multiple jurisdictions. An aggregate approach would take account of the total taxation of supply chain (and intangibles), help to mitigate distortions created by timing differences in particular countries and would help to reduce some of the complexity (for example, the need for separate accounting per-country). That being said, we would reiterate that such an approach would still represent an entirely new standard, and would create substantial difficulties in application, and would risk overriding other important international tax rules (including the application of the Arm's Length Principle through Article 9). We fully believe that this would be a mistake.

### A Secondary Rule

Following from the previous point, the Discussion Draft notes that some countries have proposed a "secondary rule" that could be "*applied to income earned by CFCs that did not give rise to sufficient CFC taxation in the parent jurisdiction.*" We are concerned that such a proposal would cut against the original intention of the BEPS Action Plan, and would reallocate taxing rights purely based on the level of taxation imposed in a particular country. Tax rate differentials – as opposed to double non-taxation – was never meant to be the primary focus of the BEPS project<sup>2</sup>. We do not believe that CFC rules applying to substantive activity simply because the applicable tax rate is low is the right approach. Such an approach could have a substantial impact on competition and cross-border trade.

### Restricted Timeframe

The timeframe to provide comments has been exceptionally short. BIAC has attempted to gather comments from its members to respond to the OECD's Discussion Draft, but we note that it has not been possible to fully consider all of the proposals made and their impact. As the OECD develops its recommendations, we hope there will be opportunity for more extensive stakeholder feedback and engagement, so that the full impact of the proposals can be explored. The comments provided below are based on our initial review of the Discussion Draft, and do not necessarily represent all of our feedback or concerns. We look forward to having further opportunities to provide our input.

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<sup>2</sup> OECD BEPS Action Plan: "No or low taxation is not per se a cause of concern, but it becomes so when it is **associated** with practices that artificially segregate taxable income from the activities that generate it" (emphasis added).

## Specific Comments

### CHAPTER 1: POLICY CONSIDERATIONS

1. BIAC understands the key principle of the BEPS project to be the realigning of taxation with economic activity. We are, therefore, particularly concerned about several proposals that suggest including “active” income unless threshold tests are met. The BEPS project was not meant to be about protecting high-cost jurisdictions against low-cost jurisdictions, and preventing or discouraging the relocation of economic activity to the latter. We strongly encourage the OECD to undertake an economic impact analysis of its final minimum standard proposals to understand how they might impact trade and investment patterns.
2. To expand on the concern expressed in the last paragraph a little more, we are very concerned about the example in paragraphs 123 and 124. This asks nothing about the correctness of the pricing of the intangible sale; asks nothing about the other elements of the cost base in Country B (wages, burden of regulation, productivity, etc.); asks nothing about the activity going on in Country B. It simply assumes a rate of return, deems anything above that to be “excess”, and then returns that to the – quite possibly much less productive – parent country. In economics terms this is quite remarkable. Carried to its logical extreme this would greatly disadvantage lower-tax economies – including most developing countries – in the short-term and higher cost countries in the medium term as productivity languishes, and over the longer terms as businesses decide not to locate their headquarters there.
3. Turning to other issues, we welcome consideration of the impact of EU Law on the OECD’s proposals, and the need to bear the EU freedoms in mind when developing minimum standard rules. We strongly agree that MNEs not based EU Member States should not be at a competitive disadvantage compared to those that are. That being said, we are disappointed that the Discussion Draft already indicates the possibility of parallel standards, stating in Paragraph 13 that “*EU Member States may need to modify these recommendations to comply with EU law*”. We encourage the OECD to develop its minimum standard in a way that is EU Law compliant, so that it is capable of consistent adoption.
4. From a policy perspective, if CFC regimes are intended to target BEPS activities, we believe that only one set of CFC rules should apply at any one time to any entity (i.e. if a number of countries adopt new CFC rules, there should be clear guidance to avoid multiple CFC rules applying to the same entities at the same time). This highlights the importance of establishing a clear order of how and when different jurisdictions’ CFC rules should apply. Clarifying which rules should apply (for example only applying the rules of the ultimate parent jurisdiction) may well be easier in a European context, but we should strive for clarity and cohesion in the way new rules apply to avoid double taxation and dispute over who has taxing rights over CFC income. BIAC reiterates here that we do not believe that further secondary rules should be pursued as part of this project. In addition to cutting against the purpose of the BEPS Action Plan, such secondary rules would further increase the complexity of application.
5. BIAC agrees that effective rules should not unduly increase compliance costs and administrative burdens to taxpayers and tax administrations, and that “*CFC rules must strike a balance between the reduced complexity inherent in mechanical rules and the effectiveness of*

*more subjective rules.*" (Paragraph 15). With that in mind, we are concerned that many of the options and recommendations identified in the Discussion Draft lean towards more subjective tests that would vastly increase the difficulty of application. We also note that in a significant number of areas, the OECD has not made clear recommendations, providing countries with full flexibility to adopt substantially different approaches.

6. BIAAC believes that a fundamental feature of good CFC regimes is an appropriate number of simple or low-compliance threshold tests to exclude entities presenting an acceptably low CFC risk. Using such an approach would ensure that more extensive compliance work can be focused on higher risk entities, reducing the burden for taxpayers and tax administrations. Adequate flexibility in the ordering of the threshold tests would be necessary, so if one test would exclude an entity from a CFC charge, then that test should be applied first, rather than having to follow a pre-determined order. Whether a threshold test is easy or difficult to apply will depend on the profile of a particular business model and entity in question.. This means that more subjective (e.g. substance) tests might be more easily applied by some taxpayers, whereas mechanical options could work better for others.
7. BIAAC supports the need for a discussion on the interaction between CFC rules and Transfer Pricing (Paras 21-28), and, as noted above, it would be helpful to restate that CFC rules can help support Transfer Pricing rules, by clearly targeting where passive income is, for example, being shifted from a home country. We also believe, that the Discussion Draft should more broadly consider the expected impact of the Transfer Pricing proposals (through BEPS Actions 8-10), and how work in that area may impact CFC rules. We are concerned that some of the OECD's CFC proposals would have the impact of undermining legitimate and substantive transactions that have been priced and evidenced in accordance with Article 9 and the OECD's Transfer Pricing Guidelines.
8. Paragraph 24 identifies an important limitation of CFC rules, in that they *"only restore (or transfer) taxing rights to parent jurisdictions, which are not necessarily the jurisdictions which have suffered the profit shifting"*. We believe this is a particularly important consideration for Developing Countries, where income may have been artificially shifted to a CFC, but then be picked up by a Developed Country parent, rather than being repatriated to the real location of substantive economic activity (which is the intended purpose of the project). Particular consideration should be given to how different interpretations of the OECD's minimum standard across Developing and Developed Countries could impact on the alignment of profit with substance, and whether the implementation of potentially conflicting CFC rules are indeed likely to have positive spill-over affects. This again highlights the importance of clearly establishing the purpose of CFC rules, and how such rules should interact with Transfer Pricing principles. Transfer Pricing rules ought to be the tool used by countries to align taxation with substance, with CFC rules applied to clearly targeted cases where passive income is diverted away from a parent entity.

## **CHAPTER 2: DEFINITION OF A CFC**

9. Chapter 2 considers a modified hybrid mismatch rule to address *"differences in the way the parent and CFC jurisdiction characterise instruments and entities"* (Paragraph 35) to bring certain payments into the scope of CFC rules. The broader approach is considered (in

Paragraph 38) to “be more consistent with existing CFC rules since CFC rules typically do not require a payment to be base eroding in order to take account of the payment.” Earlier in the Discussion Draft, Paragraph 1 notes that “the objective is to develop recommendations for CFC rules that are effective in dealing with base erosion and profit shifting.” Given that broader rules are likely to bring more income into scope, creating additional compliance burdens and risk of double taxation, we would recommend narrow approaches are recommended that clearly target BEPS related issues.

### CHAPTER 3: THRESHOLD REQUIREMENTS

10. Paragraph 51 states that there is no general recommendation for or against *de minimis* thresholds, but that anti-fragmentation rules should be considered best practice if jurisdictions choose to have such a threshold. Annex 1 of the Discussion Draft includes information on existing thresholds, and we encourage the OECD to consider the benefits and disadvantages of those to make a clear best practice recommendation. Making such a recommendation will increase the prospect of having more consistent rules, mitigating some of the potential compliance burden of differing regimes. Even if countries cannot agree to a best practice monetary threshold, agreeing to the principle of how such a limit should be determined would be beneficial.
11. In addition to monetary thresholds, we also encourage the OECD to consider alternative options, such as time thresholds. Due to differences in threshold requirements between CFC regimes, and/or the impact of calculating an effective tax rate using the parent jurisdiction tax laws, a newly acquired company, which may not have been treated as a CFC under its previous owner, may be treated as a CFC under the new parent jurisdiction regardless of the existence of BEPS activities or risk. An exemption/transitional period would be welcomed following such transactions (as, for example, is provided for in the UK rules) for MNEs to properly integrate activities and undertake any necessary reorganizations after an acquisition. As we have indicated earlier in this response, appropriate simple threshold tests are critical to the success of the OECD’s recommendations.
12. As noted above, the purpose of CFC rules has not been clearly articulated in the Discussion Draft. This fact makes it very difficult to suggest clear and appropriate thresholds. The BIAC recommendations that follow, however, are intended to ensure that CFC rules do not interfere with efficient structures, creating unnecessary compliance burdens for taxpayers.
13. In paragraph 52, the Discussion Draft disregards the use of an anti-avoidance threshold requirement as it would increase the administrative burden. CFC rules were initially designed as anti-avoidance legislation, and BIAC believes that an anti-avoidance threshold could be a useful compliment to the rules. This would help to target the rules at actual abuse, rather than potentially bringing into scope a number of non-abusive transactions.
14. Paragraph 57 recommends the use of the effective tax rate (ETR) of a CFC to determine the low-tax threshold. Paragraph 58 goes onto suggest that the ETR would need to be calculated based on rules of the parent/shareholder’s country or International Financial Reporting Standards (IFRS). For MNEs operating a substantial number of subsidiaries, perhaps owned by intermediary holding companies in different jurisdictions, the application of different rules

and accounting standards would substantially increase the cost of complying with CFC Rules – as we have identified in previous discussions on Country-by-Country Reporting, even differing definitions of income can cause substantial difficulties and anomalies. Clear and effective threshold rules would be welcomed to remove many low-risk entities from the scope of such calculations.

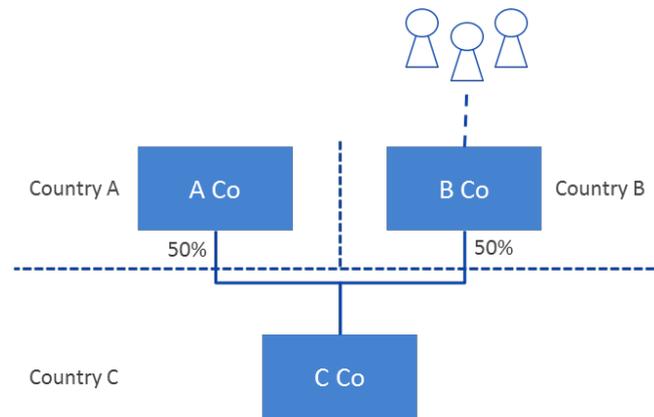
15. In determining the ETR, Paragraph 60 states *“that the definition of the numerator [i.e. tax paid] could be more straightforward if it instead focuses just on the final tax burden (including, for example, subsequent rebates of taxes paid and non-enforcement of taxes).”* Although the policy objective here may be clear, there are a number of practical issues that would need to be considered before such an approach could be applied – clear guidance would be required to deal with timing differences, and other legitimate reasons why a CFC’s ETR may fluctuate significantly from one year to the next (for example, many countries offer reduced tax rates for natural resource exploration activities, after which the applicable tax rate increases substantially). One solution could be to adopt a rolling average approach to smooth the ETR, although careful consideration would be required to determine an appropriate rolling period. Such a rolling period may not work for all industries (for example, extractives), and further detailed work would be necessary to determine how such an approach could be effectively implemented without causing substantial compliance difficulties for taxpayers.
16. As Paragraph 61 notes, there will also be substantial complications in determining the denominator under different standards. If an ETR approach is adopted, we would recommend flexibility to permit the use of local GAAP.
17. Paragraph 63 goes on to explore the ‘unit’ of the calculation, considering an income stream, entity, or country based approach. Calculating an ETR per income stream would appear to create an almost impossible compliance burden for MNEs, and should be avoided. Although an entity approach may be considered preferable by some countries from a policy perspective, we would welcome further consideration of how other reporting requirements could be used to help determine CFC risk in an efficient way, ruling out lower-risk entities.
18. CFC rules are used to override foreign tax rules (specifically those that apply low rates of taxation) through domestic legislation. This is understandable in cases of wholly artificial structures. However, the OECD’s proposals go beyond this objective. For example, where a source country permits a tax neutral reorganization, the parent jurisdiction could still tax any locally non/low taxed reserves. CFC rules should be targeted at abusive transactions, not legitimate commercial arrangements.

#### **CHAPTER 4: DEFINITION OF CONTROL**

19. Paragraph 65 recommends that *“CFC rules should at least apply both a legal and an economic control test so that satisfaction of either test results in control.”* We agree that objective legal and economic tests (including control based on consolidation) can be effective in determining control, but we would encourage the OECD to strengthen its recommendation to establish the use of such tests as a best practice, removing the words “at least.” We believe that combining legal and economic control tests should, in the vast majority of cases, identify CFCs in an appropriate way. An approach based on consolidated accounts may also be appropriate for

some taxpayers, but could also produce unusual results for others that are required to consolidate minority owned entities (over which they have little actual control).

20. As the Discussion Draft notes, de facto tests tend to be more subjective in nature and burdensome to apply – the OECD also states in Paragraph 67 that *“If a de facto control test could be designed to arrive at accurate results without these significant administrative and compliance burdens, it could also be included in a recommendation,”* but does not identify such tests that would satisfy this requirement. Such a recommendation should only be made if reasonable options are identified for countries to adopt. The potential approaches set out in Paragraph 67 would require substantial work to determine control, which would also require monitoring on an ongoing basis.
21. Paragraph 65 states that *“a CFC should be treated as controlled where residents hold, at a minimum, more than 50% control, although countries that want to achieve broader policy goals or prevent circumvention of CFC rules may set their control threshold at a lower level.”* Again we believe that the OECD should establish a clear best practice in this regard, and that more than 50% would appear to represent a reasonable threshold. Through having consistency in key measures like control, the compliance burden for business will be somewhat reduced.
22. The Discussion Draft also recommends that rules be adopted to target taxpayers *“acting-in-concert,”* either using a fact based approach (Paragraph 71), by looking the relationship of the parties (Paragraph 73), or by using a concentrated ownership requirement (Paragraph 75).
23. We are concerned that the application of *“acting in concert”* tests could add complexity to the rules, and could be open to subjective interpretation, potentially bringing into scope unintended entities.
24. As suggested by paragraph 71 of the Discussion Draft, the *“acting-in-concert”* approach is heavily reliant on fact-based analysis and would create significant administrative and compliance burdens for taxpayers. We believe that any benefits of a more fact based approach would be outweighed by the substantial cost of its application. In contrast, the application of the *“relationship of the parties”* approach (as set out in Paragraph 73) to determine joint control of a CFC seems reasonable.
25. Although we understand the motive behind the *“concentrated ownership”* approach, the Discussion Draft doesn’t consider cases where a listed company intermediary exists in the ownership structure. Practical difficulties arise in determining the level of control based on the direct/indirect economic ownership and voting rights, which is illustrated below.



26. Under the CFC rule of Country A, a control test is imposed based on a ‘more than 50%’ ownership threshold, alongside a concentrated ownership requirement. Under the general rule, C Co would not appear to be a CFC or A Co or B Co, but it is understandable that a concentrated ownership requirement could be appropriate to deal with cases of artificial fragmentation. Although we agree that artificial cases should be targeted, such rules should not bring into scope where there is no real relationship between the owning parties. In the above example, A Co and B Co each has a 50% interest in C Co. Both A Co and B Co are listed companies. The shareholders of B Co are not disclosed except large shareholders owning more than certain percentage of shares. None of the disclosed shareholders are resident in Country A. Although there may be a small number of individual shareholders of B Co resident in Country A, A Co is unable to obtain such shareholder information from generally available public sources.
27. Since it is very unlikely that A Co would be “acting-in-concert” with individual shareholders of B Co, and considering the practical difficulties of application, we believe it would be appropriate not to consider the shareholders of such a listed company to determine whether the concentrated ownership requirement is met. Therefore, in the above example, C Co should not be treated as a CFC under the CFC regime of Country A. Clear guidance would be required to deal with such cases where listed companies intermediate in the ownership structure.

## CHAPTER 5: DEFINITION OF CFC INCOME

28. BIAC is concerned by the note added at the start of Chapter 5, emphasising that that the approaches to defining CFC income do not reflect a consensus view. We are concerned that the options identified in this Chapter represent substantially different perspectives and underlying theories regarding the purpose of CFC rules, and that there is not sufficient time remaining in the BEPS process to arrive at a consensus position with broad stakeholder input on the specifics of the proposals. The differences in proposals appear to stem from fundamental differences in tax regimes (e.g., territorial vs. worldwide systems) and opposing views as to what the role of CFC rules should be, including how such rules should interact with Transfer Pricing.
29. As already noted, the result of a minimum standard with substantial optionality delivered under BEPS Action 3 could be the adoption of new CFC rules by a number of countries. Based on the Discussion Draft’s recommendations, we believe there is a substantial risk that

resulting CFC rules could include more income than would be required to combat BEPS. Prior to widespread adoption of broad rules, BIAAC would recommend further economic analysis (perhaps conducted as part of BEPS Action 11), to understand how such rules might impact trade and investment. Any avoided tax recovered by such rules should not be outweighed by the cost created through friction to international trade. We support the OECD's focus on *"more narrowly targeted partial-inclusion systems that only attribute income that raises profit shifting concerns"* (Paragraph 83).

30. We agree with the statement in Paragraph 85 that *"If CFC rules are designed to apply only to stripping of the base of the parent jurisdiction, then income should not be attributed if it arises from value-creating activity in any jurisdiction other than the parent jurisdiction."* We believe that this should indeed be the focus of CFC rules, and such rules should not attribute income to a parent entity that relates to substantive activities undertaken elsewhere. It is clear that Developing Countries are in focus here, and the Discussion Draft does comment on the potential for positive spill over effects on source countries, potentially due to the disincentive that appropriate CFC rules can create for tax avoidance. In this regard, we worry that the use of broadly crafted CFC rules to address such concerns would be an indirect approach, and such issues would be better targeted through more direct measures, for example, improvements to the Transfer Pricing Guidance and expanding capacity-building work.
31. Paragraphs 83 and 89 suggest that substance-based tests may need to be incorporated into CFC rules applying between member states to address EU Law restrictions. As noted earlier in these comments, we believe that the OECD's minimum standard should represent a minimum standard for all jurisdictions, and should not create a two-tier system for MNEs operating inside and outside the EU.
32. BIAAC agrees that using only-form based tests to determine income inclusion would be overly-broad. Substance-based tests are a necessary addition, but it is important to consider the compliance burden that such subjective requirements create. In this regard, we would encourage the use of practical 'threshold tests' that could be applied prior to detailed substance-based tests, to reduce the population of entities/activities that more burdensome requirements would apply to. In this way, only activities presenting a CFC risk would be subject to further analysis to determine what portion of its income should be subject to the rules.
33. In this regard, we are concerned that the *"viable independent entity analysis"* and *"employees and establishment analysis"* would likely override the application of the Arm's Length Principle. The *"viable independent entity analysis"* assessing income for CFC purposes after transactions have been rigorously assessed and priced based on the OECD's new Guidelines. If there is inadequate substance, the transaction should have already been either re-priced or recharacterised to reflect an Arm's Length Result. Of the three approaches suggested, the *"substantial contribution analysis"* may represent a more reasonable balance between the intended outcome of the application of Transfer Pricing principles and an approach that can be applied in practice (so long as there is sufficient clarity over what "level" of activity is considered sufficient in different circumstances).

34. Although the *“employees and establishment analysis”* may be more mechanical and objective in its application, BIAC is concerned that it would ignore ownership of intangible assets and the management and control of risk. Again, this is fundamentally inconsistent with the proposals on intangibles and risk and moves to a formulary approach to determining income.
35. These issues speak directly to the overlaps of BEPS Actions, and the challenges of delivering multiple recommendations at the same time. If the OECD chooses to move away from the Arm’s Length Principle, then that should be done in a clear and deliberate way, rather than indirectly eroding its application through conflicting recommendations.
36. Paragraph 96 sets out five broad categories of income that CFC rules could apply to, but Paragraph 97 suggests that countries may wish to implement broader rules. Where optionality is identified, we would welcome some exploration of the reasons why countries might want to implement broader rules, and what the economic impact could be.
37. Paragraphs 98 and 99 establish possible rules for dividend income, and suggest that such income should generally be treated as passive unless certain tests are satisfied. Germany is an example of a country that begins by treating dividend income as active. We would encourage further analysis of the benefits and disadvantages of active and passive assumptions, including the additional burden that a passive assumption places on taxpayers, and to what extent specific BEPS issues are likely to be targeted through a negative vs. positive presumption.
38. Paragraph 101 states that *“interest and other financing income could therefore be attributed by categorising this income first as passive but excluding it from CFC income if the CFC was in the active trade or business of financing and it was not overcapitalised.”* We believe it is important that active financial services businesses should be treated in the same way as any other active business (subject to suitable safeguards) – in this regard, interest income earned by regulated banking entities should not generally be considered passive. We do also believe that clear guidance is required to assess when a CFC should be considered to be engaged in such an *“active trade or business”*. Without clear guidance, different countries may interpret this proposal in different ways. In addition, we would welcome further guidance on what should be considered interest income for the purpose of best practice CFC rules. Banks have many forms of income, and clarity will be required to understand its proper treatment.
39. BIAC also believes that footnote 48 of the Discussion Draft would benefit from clarification. This footnote states that *“the UK CFC rules include a safe harbour for banking income under which a CFC is not considered to be overcapitalised if the tier one capital ratio (i.e., tier one capital over the total risk weighted assets) of the CFC does not exceed 125% of its UK banking group’s capital ratio.”* We believe that this sentence is misleading, as the 125% ratio is just one part of an over-capitalisation safe harbour applied in the UK rules. The OECD’s explanation should be extended to consider the different aspects of that safe harbour.
40. Paragraph 102 goes on to express concerns that profits of insurance companies might be easily shifted to low-tax jurisdictions and away from jurisdictions where the insured risks are located, and that CFC rules can play a role in preventing BEPS in this context. We are concerned that such a generalised view does not reflect the real structure of many insurance operations which are heavily influenced by regulation and efficient capital management. In

addition, the insurance industry is one of the world's oldest and, in general, should not be described as overly complex. Therefore, we believe the following sentence in paragraph 102 of the Discussion Draft should be deleted: *"Further, due to the complexity of the insurance of risks generally, taxing authorities may not have the capacity or ability to successfully challenge the extent to which companies have actually transferred the risks to related CFCs."*

41. We believe it should be clarified what "overcapitalization" means in an insurance context, and which capital should be considered – for example, would the focus be on Solvency I regulatory capital of the country of residence, solvency II risk capital, a comparable average capital of competitors in the market or another formulation?
42. We are concerned about the option suggested in Paragraph 106 and 110 that *"CFC rules may therefore be more effective if they eliminate the distinction between sales and services income and IP income and treat all sales and services income as passive unless the CFC had engaged in the substantial activities (including the development of the IP) required to earn the income."* Although we understand that there are concerns about the use of invoicing companies and the recharacterisation of IP income, applying such a broad approach risks bringing into scope a huge spectrum of legitimate transactions that should not be subject to CFC inclusion. Having such a negative assumption of abuse would create a disproportionate compliance burden for many taxpayers. More pragmatic threshold approaches to identifying risky entities and would be preferable – therefore we support an active presumption for services and sales income, unless specific thresholds are breached.
43. In many sectors, services represent the totality of the activity performed, and for these to be presumptively passive seems troubling. Furthermore, services are often an integrated part (or, at least, adjunct) to manufacturing activity. To treat such income as presumptively passive is to ignore the economic and commercial reality of much of modern business.
44. Following our comments above, we note that Paragraph 110 states that *"CFC rules may therefore be more effective if they apply just one rule to sales and services income and IP income that would treat all sales, services, royalty, and other IP income as passive unless the CFC had engaged in the substantial activities required to earn the income."* If CFC rules are to be appropriately targeted, we believe it is essential to recognise that not all IP income is passive in nature. IP can often have a relatively short life and requires significant on-going cost and active management to continuously maintain, update and replace it. We are concerned that, if income from sales, services and IP are to be conflated and assumed passive, that this could substantially increase the compliance burden faced by taxpayers in situations that do not represent a BEPS risk. More targeted proposals would be welcomed, to better include BEPS related income.
45. Noting our concerns about the categorisation of income above, we do believe that a Categorical Approach to attributing income is preferable to and Excess Profits Approach. Businesses have experience in applying categorical type approaches that adopt form and substance based analyses – in this regard, it should be possible to identify a number of best practice approaches that can be used to develop substance tests that are both administrable and effective in identifying income that should be attributed. We would like to reiterate here

that income from operational activities should clearly be prevented from CFC inclusion, so a categorical approach should include sufficiently robust and easy to apply filters to exclude substantive activity and active income.

46. We are concerned that an Excess Profits Approach, through its mechanical application, risks bringing into scope a substantial amount of active income, and undermining the application of Article 9 and the Arm's Length Principle. Paragraph 117 suggest that this approach could be used as an add-on to more traditional CFC rules, but we are concerned about the substantial compliance burden that this could create.
47. We are also concerned that the excess profits approach goes beyond targeting BEPS, and would bring into scope income solely based on the tax rate applied by particular jurisdiction. The BEPS Action Plan stated that *"no or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it,"* which suggests that a low tax rate should only be concerning when it is accompanied by BEPS activity. The Discussion Draft (Paragraph 118) states that *"an excess profits approach is intended to target situations that give rise to BEPS by characterising as CFC income excess profits in low tax jurisdictions,"* suggesting excess profits in low tax jurisdictions is, by itself, a BEPS issue. The Discussion Draft goes on to suggests that an Excess Profits Approach might be appropriate as *"intangibles and risk-shifting transactions among related parties could be susceptible to systematic mispricing, leading to a profit in excess of the normal returns that would not occur if the same transactions were undertaken with unrelated parties."* In this regard, we are concerned that identifying a 'normal' return for intangible related transactions is an incredibly a difficult task given the unique nature of IP. Indeed, the OECD has explored the difficulties in pricing returns to such assets (and identifying appropriate comparables) in its work on the Transfer Pricing of intangibles.
48. BIAC agrees with the statement in Paragraph 121 that *"an excess profits approach will include income irrespective of whether it arises from genuine economic activity of the CFC and where there is appropriate substance,"* therefore going beyond the traditional scope of CFC rules. The mispricing of intangible related transactions would be better addressed through the OECD's work on Transfer Pricing, and perhaps even through Special Measures if they are considered necessary, for example, through the commensurate with income proposal. That being said, we note that the Discussion Draft states (in Paragraph 122) that *"transfer pricing rules would apply prior to the application of the excess profits approach, so this would only apply to income that remained after transfer pricing rules had been applied,"* suggesting that certain countries believe that the Transfer Pricing Guidelines and potential Special Measures will be incapable of addressing BEPS concerns. Although that may prove to be the case over time, we would encourage the adoption of one approach before the other, to avoid targeting the same issue with multiple solutions. In this regard, we are concerned that the approach discussed in Paragraph 122 would make adjustments without reference to economic reality and proper allocation of value. Transfer Pricing should be considered a preferable option as it would rectify pricing issues between two parties, regardless of whether there is a parent-subsidiary relationship.

49. In addition to the policy concerns associated with an excess profits approach, there will also be substantial administrative difficulties in determining eligible equity and the rate of return. In particular, from a taxpayer perspective, determining eligible equity would be complicated by the broad definition (paragraph 119) where *“intangible property would be defined broadly to mean something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and which increases the value received by the company, over and above normal returns. Under this definition, intangible property should include intangibles that are not legally protected, such as trade secrets, know-how, customer lists, management systems, networks, data, goodwill, and other similar items.”* This approach would potentially require the assessment of eligible equity based on assets that “not recognised on the balance sheet at all,” creating further substantial difficulties.
50. It may be that an Excess Profits Approach is largely being considered as an appropriate tool for countries operating worldwide tax systems with deferral. We believe that such an approach would be extremely problematic in any type of tax system, not only due to the inherent complexity, but also due to the substantial economic distortions it could create.
51. If such an approach is pursued, a substance based exclusion would be critical to *i)* ensure that the issues targeted do relate to BEPS, and *ii)* increase the likelihood of compliance with EU Law.
52. In terms of determining whether an entity or transactional approach should be pursued, we believe that a narrowly targeted partial inclusion system could be achieved through an entity or transactional approach, so long as adequate filters and thresholds are available to exclude lower risk entities from further assessment. This would focus the administrative burden on the activities/entities that pose the greatest risk.

## CHAPTER 6: RULES FOR COMPUTING INCOME

53. Paragraph 131 of the Discussion Draft recommends the use of parent jurisdiction rules to calculate a CFC’s income. It should be clarified that this applies only to passive income.
54. Although BIAC believes that CFC loss restrictions may be appropriate, we believe that explicit recommendations should be included in the Discussion Draft so that losses continue to be available following a change in ownership of a CFC. We do recognise that this is a complicated issue, and further work will be needed to determine an appropriate best practice response.

## CHAPTER 7: RULES FOR ATTRIBUTING INCOME

55. Paragraph 143 of the Discussion Draft recommends that the tax rate of the parent jurisdiction should be applied to the income. It should be clarified for each jurisdiction which tax rate should be applied, and whether other trade taxes should be included.
56. Paragraph 146 suggests a best practice that either ties “the attribution threshold to the control *threshold*” *the use of “another attribution threshold that attributed income to, at a minimum, taxpayers who could influence the CFC”*. We are concerned by the potential range of approaches that could result from this recommendation, and would encourage the establishment of a clear best practice that could be adopted by a broad range of jurisdictions.

In this regard, methods to determine whether minority interests could influence a CFC could represent a compliance burden that is disproportionate to the benefit. BIAC recommends tying attribution to the broader control threshold.

57. Although BIAC agrees that the parent country tax rate should apply to appropriately attributed CFC income as the most effective way to target BEPS issues, we do not believe that CFC rules should automatically apply simply because the parent country tax rate is higher than a subsidiary. We understand that a lower ‘top-up tax’ may have been proposed to counter some of the other recommendations that could result in the inclusion of active income. As noted previously, the inclusion of active income will have a damaging impact on competition and trade, and should be avoided as a matter of policy. Seeking to rectify the over-inclusion of income through the application of a lower tax-rate should be avoided, and could even lead to separate issues of further tax competition.

## CHAPTER 8: RULES TO PREVENT OR ELIMINATE DOUBLE TAXATION

58. As discussed previously, as it stands, an OECD minimum standard that permits substantial flexibility risks creating a myriad of different conflicting CFC rules that will be difficult to administer for taxpayers and tax administrations alike (as is noted in Paragraph 159). One natural outcome of conflicting rules is an increase in double taxation. The issues identified in Paragraph 154 are expected to be exacerbated by these proposals.
59. The Discussion Draft states that a number of double tax concerns could be addressed by allowing a credit for foreign taxes actually paid, including CFC tax assessed on intermediate companies. However, if multiple different versions of the OECD’s recommendations are enacted in different countries, we are concerned that a lack of uniformity will result in some of those countries not recognising credits for foreign taxes collected by virtue of competing rules. The same issue could easily also be faced in relation to the exemption of dividends and gains on disposition of CFC shares. In addition, we believe that the Discussion Draft that foreign tax credits should include both corporate income tax and trade taxes.
60. Paragraph 159 recommends that *“in order to provide such a credit countries may need to change their double taxation relief provisions in order for CFC tax paid in an intermediate country to qualify as a foreign tax eligible for relief,”* and that *“there should also be a hierarchy of rules to determine which countries should have priority,”* which could *“prioritise the CFC rules of the jurisdiction whose resident shareholder is closer to the CFC in the chain of ownership”*. As noted already, we are concerned that the proposed ‘minimum standard’ will result in a number of CFC regimes that bear little resemblance to each other. Expecting countries to coordinate their double tax relief efforts in relation to rules that are applied in an inconsistent manner is likely unrealistic, and the prospect for double taxation is significant. Only through the recommendation of consistent rules would such relief be realistic.
61. Paragraphs 164 – 168 identify other complex areas where double taxation might arise, and the application of mechanical reliefs will once again become more difficult here as countries adopt different and conflicting rules. Those areas include how to relieve double taxation on the distribution of previously included CFC income and adjust foreign taxes when there is additional withholding tax on income that was previously included as CFC income. Although

issues are raised, no clear recommendations are provided. Much more work is required to develop effective solutions to these issues. Double taxation can also be caused by other timing differences not mentioned in the Discussion Draft, for example, through dividend add-back rules (similar to those operated by France), and through thin capitalisation restrictions (where a deduction may be restricted at the payor level but full income may be subject to CFC inclusion).

62. In addition, the Discussion Draft requires companies to determine effective tax rates taking into account rebates or refunds of foreign taxes, which would seem to require a form of tracking of taxes to income and years. Such complications, especially in the context of multiple overlapping rules, create additional double taxation risk.
63. BIAC believes that a much more comprehensive assessment of how the risk of double taxation risk can be mitigated, and to fully understand the potential negative implications of the proposals on trade and investment.

## Annex 1: Non-Consensus responses by individual BIAC members to OECD Questions for Consultation

### CHAPTER 2: DEFINITION OF A CFC

1. Would any particular practical issues arise from treating transparent entities as separate entities in the cases listed above? If so, what are they and how could they be dealt with?

This is unlikely to be an issue where there are no transparent entities other than partnerships and trusts, and where the legal and tax frameworks interact well.

2. Should the recommendations consider any other issues related to determining which entities could be considered to be CFCs?

PEs should not be included in the CFC definition, a similar and far less complex result can be achieved by denying the exemption for PEs where the PE income is passive or derived via related services/sales income without any real work being added. For example, Australia has an exemption that works in this way.

3. Are there any practical problems with either the narrow or the broad version of the modified hybrid mismatch rule mentioned above?

Hybrid mismatch rules should be counted by ensuring all CFCs income is recalculated under the resident countries tax rules removing any influence of hybrids from the CFC regime unless the resident country chooses to allow hybrid entity and the relevant tax outcomes that might prevail.

For example, Australia's CFC rules contain specific foreign hybrid limited partnership measures, designed to provide certainty and remove unintended consequences for taxpayers that would otherwise result from the taxation treatment of foreign hybrids under the CFC regime.

### CHAPTER 4: DEFINITION OF CONTROL

7. What practical problems, if any, arise when applying a control test?

Some control tests currently used are broad enough to include most foreign companies that can be controlled as CFCs. There is no look through and watering down from the parent company. Once it is a CFC, the entities below it are considered in isolation assuming the CFC is wholly owned. Inclusion in the system should, by its nature, be wide, as long as further exclusions ensure easier compliance when you get to attributable income. Control should only be a gateway into the regime.

8. Are there particular practical problems that arise when applying a control test that considers interests held by unrelated or non-resident parties? If so, what are they, and how can they be dealt with?

Australia's current regime indicates a combined control test as a gateway. For instance it includes as a CFC, a foreign company that is held 50% or more by 5 or fewer Australian residents, therefore it is controlled from Australia. It also includes if any Australian shareholder owns 40% -50% and no other controller exists within the shareholders and an effective control test. These are only gateway tests. There is a further exemption in assessing the level of attributed income, and then what owners

should attribute (normally having to have an attributable (equity) interest of 10% or more). The Australian tests are more than robust in determining the right outcomes.

## CHAPTER 5: DEFINITION OF CFC INCOME

9. What are the practical problems with any of the three substance analyses set out above? How could these practical problems be dealt with?

In a practical sense, a higher threshold activity test reduces the effectiveness of any CFC regime and therefore a lower threshold regime is more likely to get the results trying to be achieved. However, the lower the test the more compliance work that will need to be done, and the large amount of taxpayers actually get caught up in the system.

11. How can CFC rules accurately attribute income that raises concerns about BEPS (i) in a business that is licensed under an appropriate regulatory body and is market-facing in a particular jurisdiction, (ii) in a reinsurance business carried on by a CFC of a multinational insurance group or (iii) in a “captive” insurance business of a CFC that is not part of an insurance group? Are there practical problems with current rules that distinguish between these two situations? If so, what are they and how can they be dealt with?

This could be done in two ways. 1. As a CFC if owned from the domestic country, and 2. They have an insurance tax levied on the payer of insurance premiums and assume a 10% net income at 30% tax. 3% on the premiums paid. This seems to be the best way to capture insurance sold into a country from a foreign insurer regardless of if they are captives or just a MNE insurer with no presence in country. It reduces the overall impact of captive insurance initiatives in terms of tax anyway. Of course further to this tax if the revenue authority can determine the full profit of the foreign insurer it could have the ability to take that full profit.

12. Are there practical problems with applying the same rule to sales and services income and IP income?

There are no practical problems in applying CFC rules to services sales or IP related income, other than the additional compliance cost to determine what is or isn't included in the CFC income calculations.

15. Is it clear how the two approaches above would work? If not, what further detail is required to clarify the approach?

An excess profits approach does not seem appropriate or necessary. Limiting the categories of income included in attributable income is important in saving compliance costs and keeping most immaterial amounts out of the system.

## CHAPTER 6: RULES FOR COMPUTING INCOME

24. Do the rules on computing the income of a CFC present any difficulties in practice? If so, what are these and how could they be dealt with?

If all CFC incomes shall be recalculated in accordance with the parent jurisdictions' relevant tax rules from scratch under Option 1 proposed in paragraph 132 of the Discussion Draft, a significant compliance burden would be placed on taxpayers. In this regard, the second half of Option 1

mentions that *“jurisdictions could achieve a broadly similar outcome by starting with the income calculated according to the rules of the CFC jurisdiction and then adjusting the income in line with the rules of the parent jurisdiction”*, which would reduce compliance burdens for taxpayers. We are of the view that this approach should be explicitly mentioned in the recommendation (paragraph 131 of the Discussion Draft) as an appropriate method to calculate the CFC incomes.