Comments to the OECD Discussion Draft on BEPS Action 3 "Strengthening CFC Rules"

The International Chamber of Commerce (ICC), as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, appreciates the opportunity to provide comments on the public discussion draft on BEPS Action 3 on strengthening Controlled Foreign Company (CFC) rules. ICC focuses its feedback on the most fundamental issues raised in the draft.

General comments

ICC is concerned about the introductory statement of the draft which mentions "secondary rules" that countries could introduce and apply "to income earned by CFCs that did not give rise to sufficient CFC taxation in the parent jurisdiction". Different options for such rules which would "introduce a secondary form of taxation in another jurisdiction (for example the source country of the income earned by the CFC)" are obviously being considered by the responsible Working Party 6 primarily with regard to transfer pricing issues in the area of BEPS Action 8 – 10. ICC is highly troubled that deliberations on possible "secondary rules" in connection with CFC rules are dealt with outside the scope of the discussion draft. Should these proposals be taken forward, an opportunity ought to be ensured for stakeholders to comment.

Furthermore, ICC notes overlap and confusion with Action 3 and is concerned about the lack of coherence with other Actions, most notably with Action 2 (hybrid mismatch arrangements), Action 4 (interest deductions), Action 5 (harmful tax practices) and Action 8-10 (transfer pricing). Furthermore, ICC believes that some of the proposed rules are coming close to transfer pricing rules. Finally, given the fundamental differences in national tax systems, even a harmonised implementation of CFC rules throughout the G20/OECD countries would result in significant discrepancies.

Chapter 3: Threshold Requirements

A low tax threshold based on an effective tax rate causes significant problems. The following elements are causing problems for the computation of the effective tax rate: timing differences, different periods for the tax effectiveness of accruals and related costs, different periods for tax loss carry backs and tax loss carry forwards, etc: e.g. when the source country allows for a tax neutral business reorganisation, this should not be subject to CFC legislation in the parent jurisdiction. ICC therefore believes that only tax free or non deductible income with a permanent effect should be considered for the computation of the effective tax rate. Furthermore, CFC rules were historically designed as anti-avoidance legislation. ICC would therefore welcome the implementation of an anti-avoidance requirement.

Chapter 5: Definition of CFC Income

General comment

As set out in the note for consultation, chapter 5 does not yet include recommendations for the building block on the definition of CFC income. Instead, the chapter discusses several possible options that jurisdictions could implement. Obviously, the definition of the income earned by the CFC that should be attributed to shareholders or controlling parties is a key question for the entire system of CFC rules. ICC is concerned that the draft merely reflects a very early stage of discussions between countries with highly opposing views on how to best proceed. Chapter 5

seems to be far from a political consensus and therefore will most likely result in a menu of options for individual domestic issues rather than recommendations. With regard to the different approaches to defining CFC income and the individual options pointed out in the draft, the business community is concerned that it is not clear how these different rules are supposed to interact. Consequently, ICC believes that there is a strong need for more technical guidance, even if countries should agree on common recommendations in the 2015 report on Action 3, as envisaged in the introductory note for consultation.

Categorical vs. Excess profits approach
The categorical approach has some disadvantages as mentioned in the discussion draft such as a higher administrative and compliance burden, however, the problems arising from it should not be more difficult to address than in many already existing CFC systems. In general, ICC welcomes the approach of defining which CFC income should be considered as passive income instead of an active income approach. However, it is worrisome that the draft seems to be proposing rules for particular business sectors instead of clearly focusing on anti-avoidance. The purpose of CFC rules is defined by the draft as preventative measures which should be designed as “deterrent”[1]. It is important to strike the balance between this objective and the risk of over-inclusion i.e. not to include income when the CFC engaged in substance.

ICC strongly opposes the excessive profits approach. The determination of the normal return as suggested in the draft would be highly complex and exposed to arbitrariness. To determine the risk free rate of return, the premium reflecting the risk associated with an equity investment and the eligible entity would be as intricate as an enterprise valuation process. In addition, ICC agrees with the objections raised by some countries that the excess profits approach would be overly broad and some design features could include profits in the CFC regime that were not shifted. The excess profits approach would therefore not only target BEPS situations. According to the BEPS Action Plan no or low taxation is not per se a cause of concern, but becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. The excessive profit approach would go far beyond this objective. Moreover, it would cause a high degree of legal uncertainty.

Chapter 8: Rules to Prevent or Eliminate Double Taxation
Preventing double taxation is a crucial objective. It therefore needs to be ensured that the national credit potential is high enough to actually and effectively avoid double taxation. ICC therefore welcomes the OECD’s recommendation to introduce a “meaningfully lower” threshold compared to the statutory tax rate of the parent jurisdiction. By the same token, ICC believes that countries should refrain from any limitation of the creditable amount, such as per year or per country limitations to eliminate double taxation.

[1] Discussion draft, paragraph 16.

The International Chamber of Commerce (ICC)

Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy.
Founded in 1919, and with interests spanning every sector of private enterprise, ICC's global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.