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## **Confederation of Swedish Enterprise - Comments on the OECD Public Discussion Draft entitled: "BEPS Action 3: Strengthening CFC Rules" 03 April 2015 – 01 May 2015**

The Confederation of Swedish Enterprise is Sweden's largest business federation representing 49 member organizations and 60 000 member companies in Sweden, equivalent to more than 90 per cent of the private sector.

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled "BEPS Action 3: Strengthening CFC Rules" 03 April 2015 – 01 May 2015 (hereinafter referred to as the Draft).

### **General Comments**

The Confederation of Swedish Enterprise appreciates the opportunity to give comments on the OECD discussion draft regarding the strengthening of CFC-rules.

We agree with BIAC that the Draft seems to lack a clearly articulated policy objective. Different alternatives to CFC rules are presented without a proper analysis as to their effectiveness. Such an analysis would greatly facilitate countries possibilities to select the rules best suited for that country's tax system. As the Draft is outlined now, it is difficult for countries to reach any conclusions on what is the most appropriate CFC rules for their particular situation. There is a clear risk that if the recommendation only sets out different policy options, the Draft will not result in a clear and consistent implementation and interpretation of CFC rules, resulting in increased compliance costs and uncertainty for taxpayers.

In the BEPS Action Plan under Action 3 it is stated that the work will be coordinated with other work as necessary. In para 5 of the Draft it is stated that such

coordination has indeed been conducted. The Confederation of Swedish Enterprise would appreciate a more detailed account in the Draft on how the co-ordination between Action 3 and other Action Items have been dealt with. There is little doubt that the BEPS action plan will lead to increased compliance burden for taxpayers. Consequently, coordination between different action points is essential in order to reduce unnecessary and duplicative initiatives.

A Secondary Rule is mentioned in the Draft that would be applied to income earned by CFC's that did not give rise to sufficient CFC taxation in the parent jurisdiction. The Confederation of Swedish Enterprise is strongly opposed to such a rule since it would increase the complexity and administrative costs for businesses and lead to additional uncertainty.

## **Chapter 1: Policy Considerations**

The Confederation of Swedish Enterprise welcomes the discussion in chapter 1 regarding capital export and import neutrality. However, there is need for further consideration to conclude whether CFC rules can actually achieve both objectives at the same time.

We also welcome the comments on the need to take into consideration EU law when developing CFC rules. However, the OECD seems to open up for two sets of standards. Para 13 states that "EU member states may need to modify these recommendations to comply with EU law". Instead of having parallel standards, one for EU members and one for non EU members, the OECD should develop minimum standards that are compliant with EU law and thus is capable of consistent adoption.

It is important that a clear order of how and when CFC rules should apply is established. Without it there is a risk that several CFC rules are applied simultaneously. In order to avoid disputes over what jurisdiction has taxing rights, with the risk of potential double taxation, we recommend that the OECD clarifies who has taxing rights over CFC income

In a number of areas the OECD has not made a clear recommendation in the Draft, but are rather giving countries the possibility to adopt rules of their choosing. This will lead to that countries have substantially different approaches in their CFC rules, increasing the compliance burden for taxpayers. The Confederation of Swedish Enterprise therefore urges the OECD to make clear recommendations in all areas of the Draft, assuring a uniform adoption.

In the Draft the interaction with transfer pricing rules are mentioned and it is found that such rules can exist side-by-side with CFC rules. We share the view that transfer pricing rules and CFC rules can coexist, but we request a deeper discussion on how the transfer pricing rules dealt with in Action Points 8-10 will be effected by

the proposed CFC rules. We are concerned that transactions in accordance with the transfer pricing rules may still be targeted by the CFC rules.

## 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?
2. Should the recommendations consider any other issues related to determining which entities could be considered to be CFCs?
3. Are there any practical problems with either the narrow or the broad version of the modified hybrid mismatch rule mentioned above?

In Chapter 2 a hybrid mismatch rule is proposed. Two options are compared; a broader adoption of the rule or a more narrow approach. The broad version may be easier to apply in practice since there is no need to analyze whether there is a base-eroding mismatch. However, the broad version will bring more income into scope, not necessarily BEPS related, creating additional compliance burden and risk of double taxation. On that basis we would prefer the narrow version.

We do however question if there really is a need for a hybrid mismatch rule for CFCs if the recommendation for Action 2 (hybrid mismatch arrangements) were to be implemented in both the parent and CFC jurisdictions. We recommend the OECD to explain the coordination with action 2 and why there is a need for a special hybrid mismatch rule to be applied on CFCs.

## Chapter 3: Threshold Requirements

4. What practical problems, if any, arise when applying a low-tax threshold based on an effective tax rate calculation?
5. How could these problems be addressed or mitigated?
6. Does the discussion above correctly address the situation of permanent establishments that are subject to a different tax rate than CFCs?

A low-tax threshold based on an effective tax rate (ETR) gives rise to a number of concerns. To be able to calculate the ETR it is crucial to have access to relevant data. This can be hard if the data is required at an early date before local accounting and tax reporting has been completed. It would thus be helpful if the CFC calculations were conducted at a later stage after the accounting year.

An ETR may fluctuate widely depending on when it is calculated due to e.g. differences in the capitalization, amortization, tax depreciation and timing of revenue recognition. One way of dealing with the volatility of the effective tax rate is to use a rolling average effective rate. The length of such a period must be carefully considered before determined. In addition, it may not be possible to use the same rolling period for all industries. It must also be evaluated how such an approach can be implemented without causing substantial difficulties for taxpayers.

Para 58 of the Draft suggests that the ETR is calculated according to the rules of the parent jurisdiction or an international standard such as IFRS. For MNEs operating a number of subsidiaries owned by parents in different jurisdictions, the compliance burden for complying with CFC rules would increase when different rules and accounting standards need to be applied.

Para 63 mentions the possibility to calculate ETR per income stream. Due to the enormous compliance burden this would cause MNEs we strongly believe that calculating ETR per income stream should be avoided.

In para 51 it is stated that no general recommendation is made regarding the de minimis threshold, but if such a threshold is applied it should be combined with an anti-fragmentation rule. We encourage the OECD to evaluate the different thresholds presented in Annex 1 and present one as a clear best practice recommendation. A best practice would mean a more consistent rule and a lowering of the compliance burden for taxpayers.

Regarding an anti-fragmentation rule it should be acknowledge that such rule can cause difficulties when separate businesses operates with separate accounting or reporting systems. In such a case it can be hard to present consolidated or aggregated information, since the financial reporting system do not make the information readily available.

In addition to the thresholds mentioned in the Draft we encourage the OECD to evaluate other types of thresholds, such as a time threshold. Such threshold can be useful when a subsidiary is sold from a parent in one jurisdiction to a new parent in another jurisdiction. To give the entity time to adapt to the new CFC rules applied in the country of the new parent, a time threshold that creates an exempt period from the time of the acquisition could be applied.

#### **Chapter 4: Definition of Control**

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

The Confederation of Swedish Enterprise shares the view expressed in para 65 that legal and economic tests can be effective in determining control. De facto control is difficult to establish and would mean significantly higher costs and complexity compared to a legal or economic test. A de facto control test would in most scenarios include a subjective element which means less certainty for taxpayers. We encourage the OECD to strengthening its wording in the recommendation and recommend a combination of an economic and legal test as best practice.

## 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?
10. Do you have experience with applying substance analyses in existing CFC rules? If so, how can these be made more mechanical while still accurately attributing income?

Chapter 5 of the Draft does not include recommendations for the building block on CFC income. Instead several different options are discussed. The chapter do raise some concerns as the options presented represent different perspectives. Given the fundamental differences between the options we are worried that there might not be possible to reach consensus in this area, especially given the very tight time schedule for the BEPS project. We are also concerned about paras 83 and 89 of the Draft, stating that EU member states may need to incorporate a substance based test in order to be in compliance with EU law. As much as we agree that CFC legislations should be EU compliant, we believe that the OECD should make that recommendation for all countries, not only for EU member states. If not, there will be two parallel systems with increased complexity as a result.

Regarding the substance analysis we agree with the OECD that such tests are a necessary addition. However, all three options have some practical problems and the compliance burden must be carefully considered before making any conclusions. Although there may be some common ground between substantial contribution analysis and functional analysis required for transfer pricing documentation, there are however differences and it should thus not be assumed that a substantial contribution analysis can be developed from the existing transfer pricing documentation.

Of the three options, the viable independent entity analysis has the most subjective approach. This option will therefore be the one with the highest risk of causing disputes and uncertainty. The employees and establishment analysis is in theory more mechanical and easier to apply. However, since there is a need to determine whether the CFC has establishment and employee functions, the analysis is rather similar to the viable independent entity analysis.

The Confederation of Swedish Enterprise recommends that MNEs are given the opportunity to use its own preferred method to initially determine and document which CFCs have sufficient substance. MNEs should be able to use one or a combination of the three options of analysis.

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?
12. Are there practical problems with applying the same rule to sales and services income and IP income?
13. Are there existing CFC rules that accurately attribute any or all of these categories of income while also reducing administrative and compliance burdens?
14. Does the discussion above consider all categories of income that should be attributed under CFC rules?

As stated in para 114 of the Draft, sales and service income is assumed to be passive income. Only if the substance analysis requirements is met can the income be treated as active. We would welcome a deeper analysis as to the benefits and disadvantages of active and passive assumptions. This could lead to more pragmatic threshold approaches that would identify risk entities in a more accurate way. Since a passive assumption for sales and services will increase the compliance burden for taxpayers in situation that do not represent a BEPS risk, we support an active presumption for sales and services.

15. Is it clear how the two approaches above would work? If not, what further detail is required to clarify the approach?
16. What practical problems arise with applying the categorical approach and the excess profits approach?
17. How could the practical problems be addressed or mitigated?
18. Which approach is most likely to accurately attribute income that gives rise to BEPS concerns? Is one approach likely to be more effective than the other in terms of dealing with IP income?
19. Could the excess profits approach be applied to income other than IP income and what would be the practical implications of this?
20. What other approaches could be considered for determining excess profits or excess returns?

to an Excess Profits Approach. We are concerned that the Excess Profits Approach would not only target BEPS situations, but also profits that has not been shifted. The risk of bringing active income into scope will cause legal uncertainty for taxpayers. In addition the determination of normal return, as suggested in the Draft, would be highly complex and exposed to arbitrariness. It is also questionable if the Excess Profits Approach is consistent with the Arm's length principle and in compliance with EU law.

In para 117 it is proposed that the Excess Profits Approach could be used to complement more traditional CFC rules. To use it as an add-on would heavily increase compliance burden for taxpayers. To motivate such a solution it would be necessary to explain why this approach is needed, especially under the circumstances that all other recommendations of the BEPS Action Plan were to be implemented.

Confederation of Swedish Enterprise believes that the Categorical Approach could address BEPS concerns in a more accurate way than the Excess Profits Approach, and that approach is therefore recommended.

21. What difficulties or practical problems arise in applying an entity approach or a transactional approach?
22. What concerns arise from the two approaches in terms of administrative burdens and compliance costs?
23. How could these concerns and/or practical problems be dealt with while still ensuring that the CFC rules achieve an accurate result and attribute income that raises BEPS concerns?

The most significant problem related to a transactional approach is the difficulty in obtaining accurate data. Obtaining the relevant information on an entity level is not associated with the same difficulties and we therefore propose a best practice based on the latter.

## **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?
25. Does this chapter accurately reflect the issues that could arise with losses or are there any other situations that need to be considered?

The Draft recommends the use of the parent jurisdictions' rules to calculate a CFC's income. This means that many businesses have to prepare duplicate accounting and tax reporting for the CFC to compute income under the same principles as the parent. Often the data needs to be maintained for several years due to balance carry forwards and tax adjustments. If action 3 leads to that more countries implement CFC rules, there would be an increased complexity for taxpayers. Many CFCs are owned by parents in several jurisdiction, making the calculation more complicated.

## **Chapter 7: Rules for Attributing Income**

26. What difficulties, if any, arise under existing CFC provisions for attributing income?
27. Does the description of a top-up tax set out all the advantages and disadvantages of such an approach?

We believe that additional analysis is needed for the top-up tax to be readily applied and how it might work in practice. The advantages and disadvantages for this approach should also be elaborated more closely. The top-up tax would probably only be relevant for those jurisdictions that operate a worldwide taxation approach.

## **Chapter 8: Rules to Prevent or Eliminate Double Taxation**

28. Are there any other double taxation issues that arise in the context of CFC rules that are not dealt with here?
29. What administrative or practical difficulties arise currently in respect of double tax relief rules and how could these be mitigated or dealt with?



The Confederation of Swedish Enterprise is very concerned over the lack of clear recommendations regarding the elimination of double taxation. The Draft only proposes a “minimum standard”, giving countries vast flexibility in the implementation of their rules to eliminate double taxation. There is an obvious risk that different conflicting CFC rules are created, which would increase the risk of double taxation.

We are also concerned that the lack of cohesion will lead to that some countries may not recognize credits for foreign taxes collected by virtue of competing rules.

The Confederation of Swedish Enterprise urges the OECD to create a clearer recommendation regarding the elimination of double taxation. Without such clarification, countries may adopt CFC rules that could have a very negative impact on trade and investment.

On behalf of the Confederation of Swedish Enterprise

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