

EU Anti-Tax Avoidance Directive

Implementation of controlled
foreign company rules

March 2021

This document provides insights on the impact and implementation of the controlled foreign company (CFC) rules in the [EU Anti-Tax Avoidance Directive 2016/1164](#) (ATAD) into the domestic legislation of the EU member states.

This slide deck is a high level overview of the rules and should not be relied on as tax advice. The surveys used to prepare this deck included certain assumptions, so the actual facts and circumstances should be evaluated on a case-by-case basis.

The survey questions were framed in the context of the choices individual EU member states are expected to make (or have made), and responses are based on developments known as of March 2021. The responses reflect the views of Deloitte colleagues to the extent they are aware of relevant developments in their jurisdictions.

Contents

Introduction	1
Model A or Model B	3
Exemptions under Model A	4
Exemptions under Model B	5
Substance carve-out for third country situations	6
Stricter definition of CFC	7
Listed, conditionally listed, safe listed	8

Introduction

ATAD CFC rule

- The ATAD is part of the [Anti-Tax Avoidance Package](#) presented by the European Commission in January 2016. The directive, formally adopted by the Economic and Financial Affairs Council of the EU on 12 July 2016, aims to provide a minimum level of protection for the internal market and ensure a harmonized and coordinated approach in the EU to the implementation of some of the recommendations under the [OECD BEPS project](#). The ATAD provides for the minimum harmonization of rules in the areas of CFCs, hybrid mismatches, and interest deductions, and requires the introduction of a corporate general anti-abuse rule (GAAR) and an exit tax (the latter two measures are not part of the BEPS project).
 - The CFC rules in the ATAD aim to discourage multinational companies from shifting profits from their parent company in a high tax country to controlled subsidiaries in low or no tax countries to reduce the group's tax liability. The CFC rule will allow the EU member state where the parent company is located to tax certain profits that the company shifts to a country that imposes low or no tax.
 - The ATAD CFC rules attribute undistributed income of a foreign company or a permanent establishment (PE) to a domestic parent company, i.e., such income will have to be included in the taxable income of the domestic taxpayer. Article 7(1) of the ATAD provides that an entity or a PE whose profits are not subject to tax or are exempt from tax in a member state will be treated as a CFC if the following requirements are met:
 - A domestic taxpayer/parent company (alone or together with its associated enterprises) holds directly or indirectly more than 50% of the voting rights, capital, or entitlement to the profits of the entity; and
 - The actual corporate tax paid by the entity/PE on its income is lower than the difference between the corporate tax that would have been paid on the same profits in the member state of the domestic taxpayer/parent company and the actual corporate tax paid by the entity/PE in the source state.
 - Several approaches are available to member states under the ATAD when implementing the CFC rules (e.g. providing a stricter definition of a CFC, the income on which a CFC charge can be imposed, exemptions from the rules).
 - The ATAD provides two options under which member states can choose to impose the CFC charge:
 - **Model A:** Certain predefined categories of undistributed passive income (e.g. dividends, interest, royalties, and income from financial activities) of the CFC are attributed to the taxpayer/ parent company.
 - **Model B:** Undistributed income of the CFC from non-genuine arrangements that have been put into place for the essential purpose of obtaining a tax advantage is attributed to the taxpayer/parent company.
 - **Exceptions under Model A:** If a member state implements the CFC rules using the undistributed passive income option, it should not include CFC income in the domestic taxpayer's tax base where the taxpayer can demonstrate that the CFC carries on "substantive economic activities," as evidenced by sufficient staff, equipment, assets, and premises.
 - A member state may opt not to apply the substantive economic activities exception to CFCs in non-EEA countries.
 - A member state may opt not to treat an entity/PE as a CFC if one-third or less of its income falls within predefined (passive) income categories or, in the case of certain financial undertakings, if one-third or less of the predefined (passive) income categories comes from transactions with the taxpayer or its associated enterprises.
- Income to be included under the CFC rules in Model A is calculated in accordance with the rules of the member state in which the taxpayer is resident and according to its participation in the CFC.

- **Exceptions under Model B:** If a member state implements the CFC rules using the non-genuine arrangements option, it should not include CFC income in the domestic taxpayer's tax base if such income arises from arrangements that have not been put in place for the essential purpose of obtaining a tax advantage. In determining whether an arrangement (or series of arrangements) is (are) genuine, the significant people functions relevant for the income-generating assets and risks undertaken by the CFC must be taken into account.

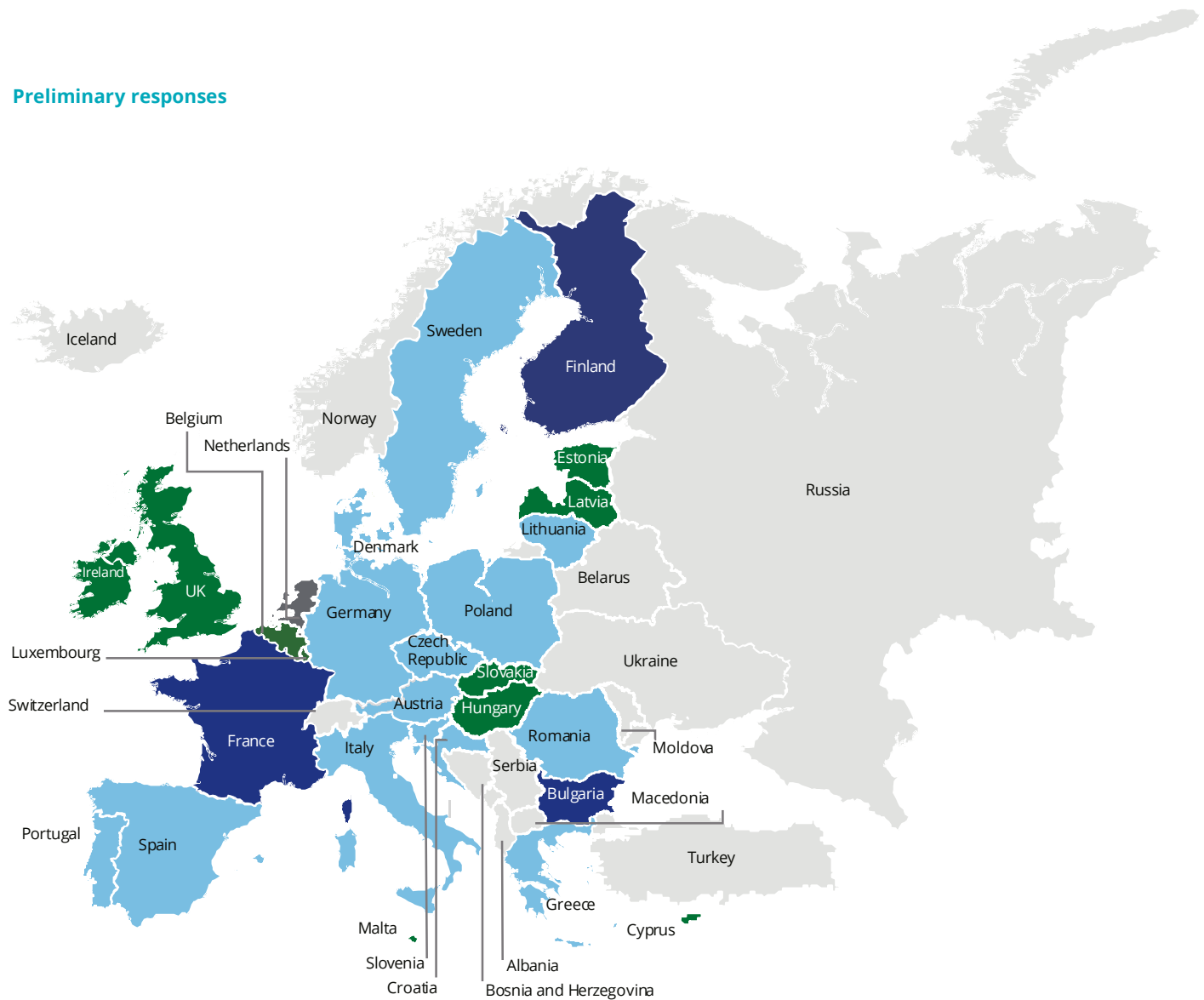
Further, a member state may choose to exclude such income from a taxpayer's tax base if the CFC has accounting profits: (i) of no more than EUR 750,000 and nontrading income of no more than EUR 75,000; or (ii) amounting to no more than 10% of its operating costs (excluding the cost of goods sold) for the tax period.

Income to be included under the CFC rules in Model B is limited to amounts generated through assets and risks that are linked to significant people functions carried out by the controlling company. The attribution of CFC income will be calculated in accordance with the arm's length principle.

- EU member states were required to transpose the CFC rules into their domestic law by 31 December 2018, with the new measures to be effective on 1 January 2019. Not all member states fully transposed the ATAD into their domestic law by 31 December 2018. If a member state fails to comply with EU law, the European Commission may open an infringement procedure, and if necessary, it may bring the case before the Court of Justice of the European Union. The European Commission initially launched infringement procedures against nine EU member states for failure to fully/correctly implement the directive. Seven of those infringement procedures are still pending (i.e., Austria, Denmark, Germany, Ireland, Portugal, Romania, and Spain).
- Some EU member states already had CFC regimes before the ATAD was adopted. It should be noted that EU directives set a minimum level of protection, so EU member states are required to implement only the minimum scope required under the directives, but they are free to introduce or retain rules that are more stringent than the rules prescribed in the directives, provided the rules do not otherwise offend EU law. As a result, where a member state already has rules in the areas covered by the ATAD, these rules have to be amended only to the extent they do not meet the minimum prescribed by the ATAD. Rules that are stricter than those in the ATAD do not have to be modified. If a member state does not have CFC rules, it will be required to introduce rules that give effect to the ATAD CFC rules.
- The UK withdrew from the EU on 31 January 2020 and following the end of the EU-UK withdrawal agreement's transition period on 31 December 2020, EU law generally no longer applies to the UK. However, as the UK was a member state at the time of ATAD, and was subject to obligations for the timely transposition of the ATAD into domestic law, this slide deck continues to comment on the status of the CFC rules under UK domestic law. Changes to EU law (e.g., revisions to the Directive) with an implementation date on or after 1 January 2021 will not result in an obligation for the UK to make changes to its domestic law.

Model A or Model B

Preliminary responses



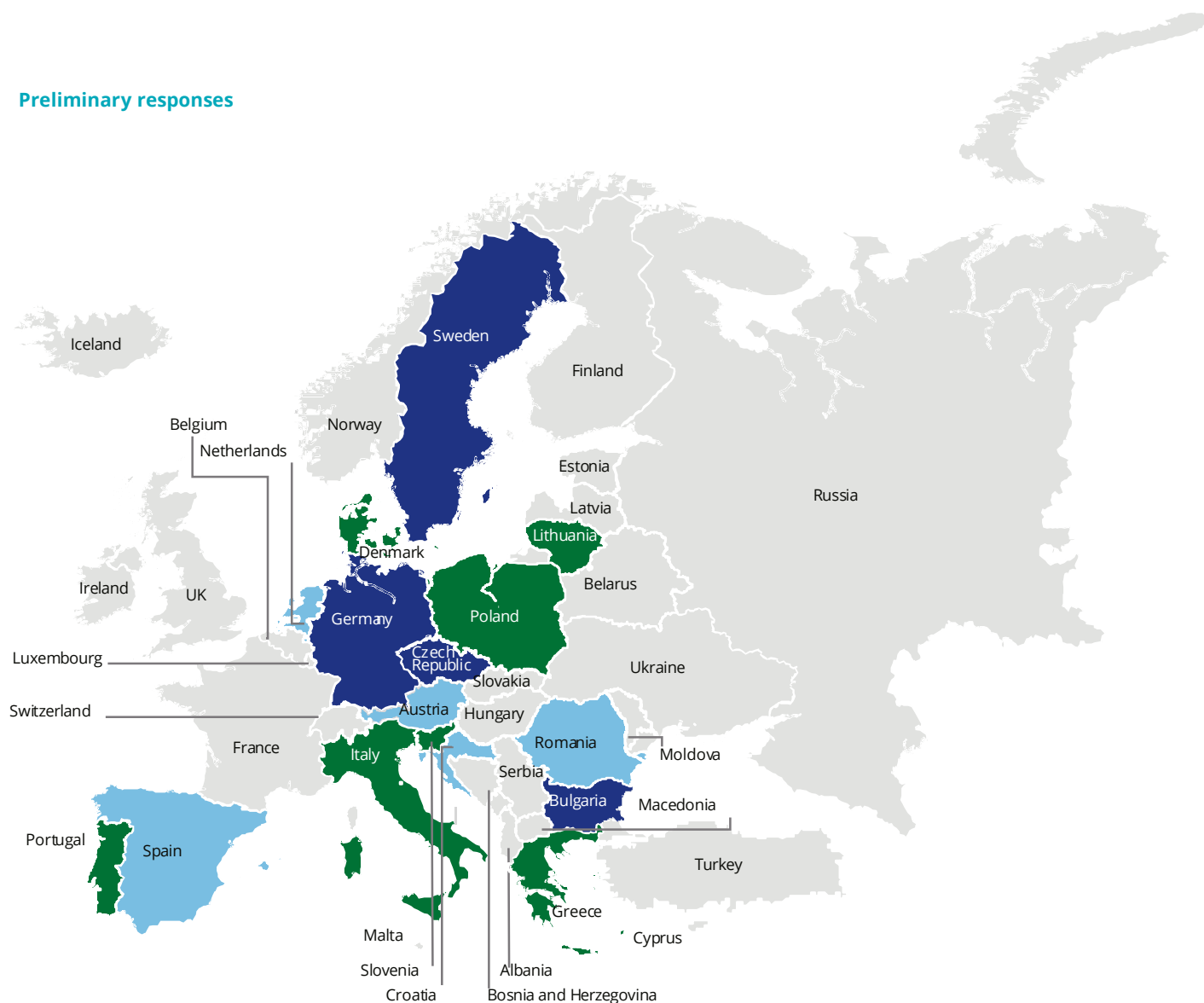
The CFC rule in the ATAD attributes predefined categories of undistributed (passive) income (Model A) or, alternatively, undistributed income from nongenuine arrangements (Model B) to the domestic taxpayer/parent company.

Legend:

14	Model A
10	Model B
1	Combination
3	Neither Model A nor Model B

Exemptions under Model A

Preliminary responses



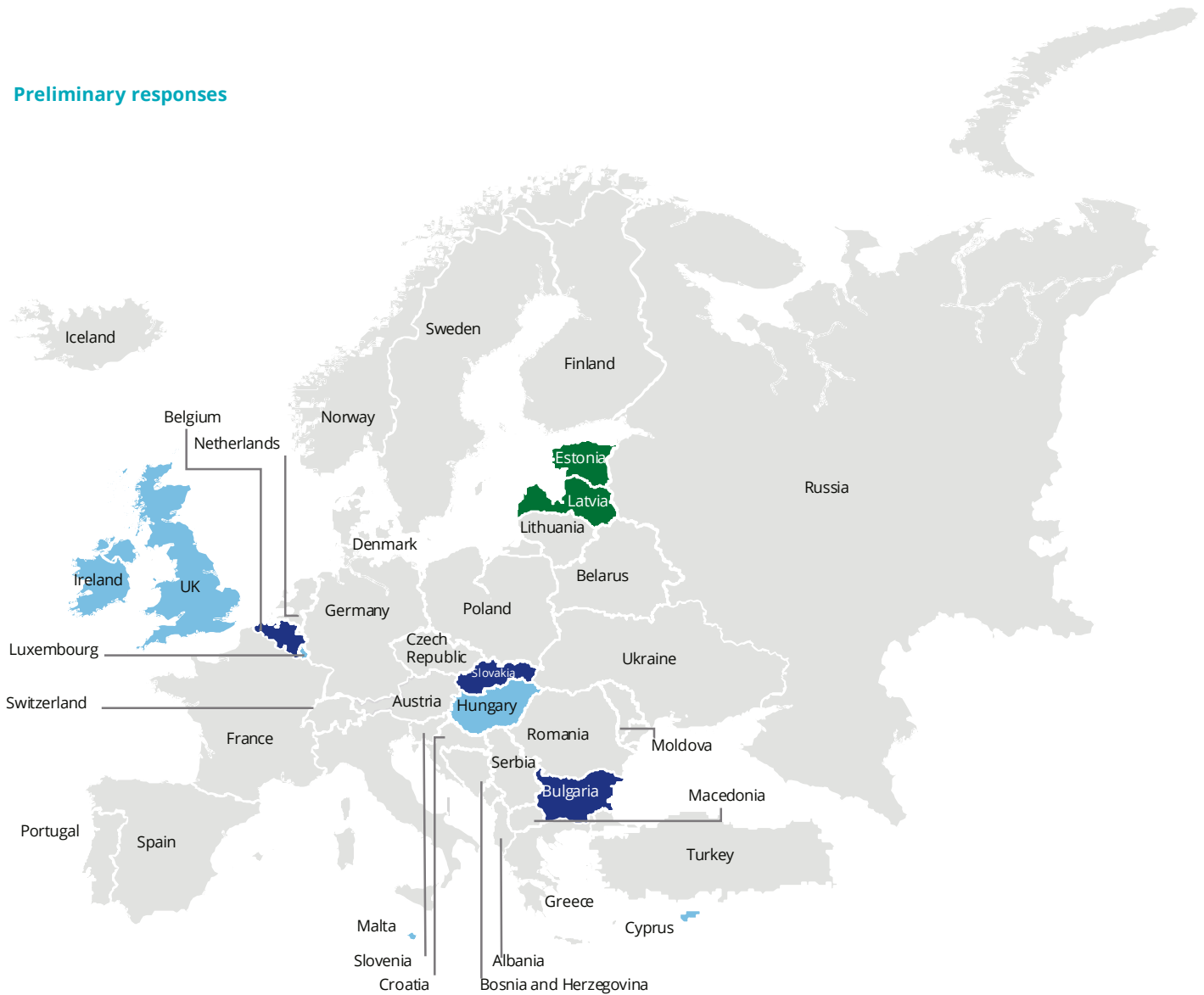
A member state implementing the CFC rules using Model A may elect not to treat an entity/PE as a CFC if one-third or less of its income falls within predefined (passive) income categories or, in the case of certain financial undertakings, if one-third or less of the predefined (passive) income categories comes from transactions with the taxpayer or its associated enterprises.

Legend:

5	Both one-third and financial undertakings exemptions
7	One-third (or less) qualifying income exemption
0	0 Financial undertakings exemption
4	Neither one-third nor financial undertakings exemption

Exemptions under Model B

Preliminary responses



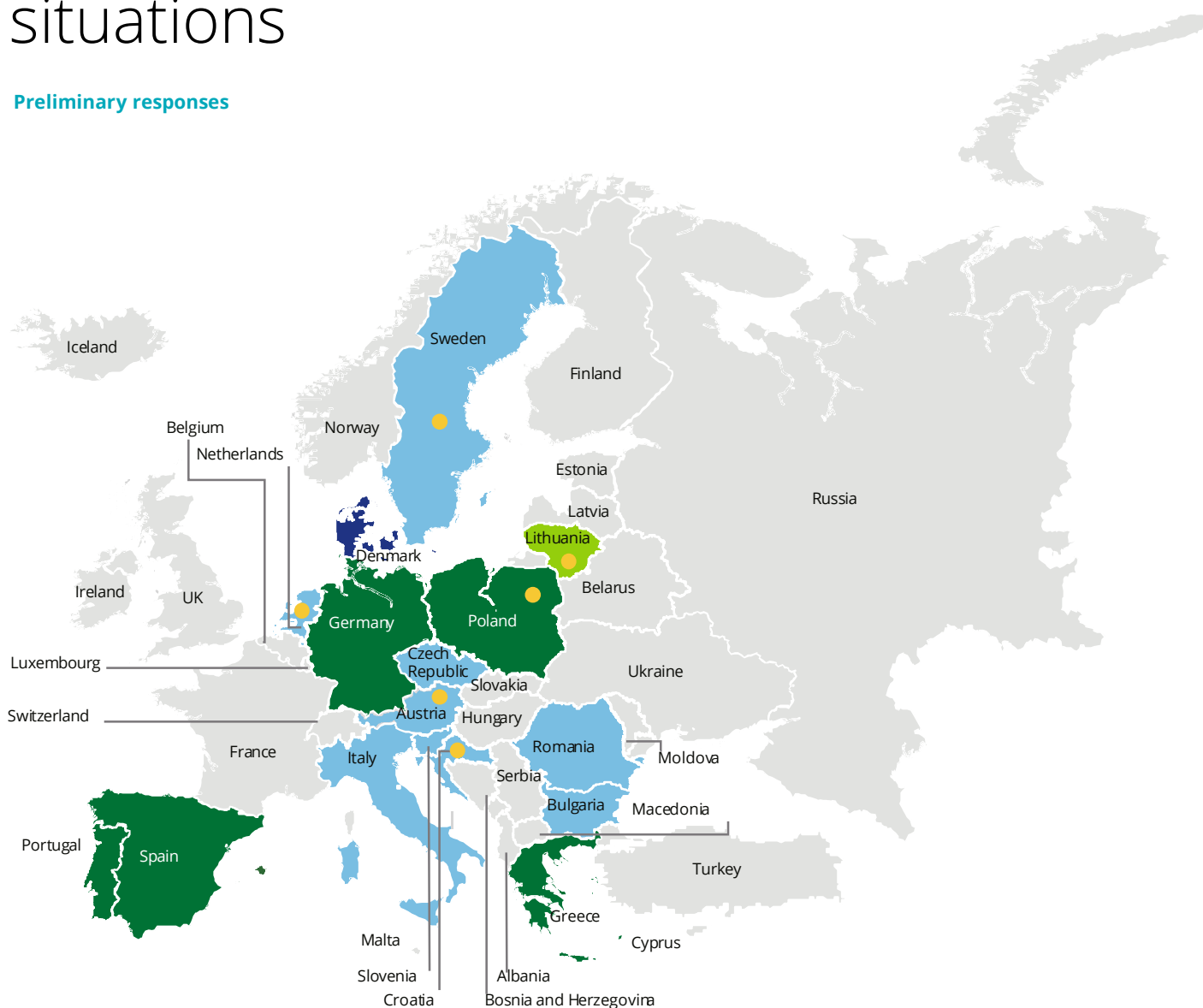
A member state implementing the CFC rule using Model B may choose to exclude such income from a taxpayer's tax base if the CFC has accounting profits: (i) of no more than EUR 750,000 and nontrading income not exceeding EUR 75,000; or (ii) amounting to no more than 10% of its operating costs (excluding the cost of goods sold) for the tax period.

Legend:

6	Both accounting profits exemptions
2	Accounting profits <EUR 750,000
0	Accounting profits <10% of operating costs
3	No exemptions

Substance carve-out for third country situations

Preliminary responses



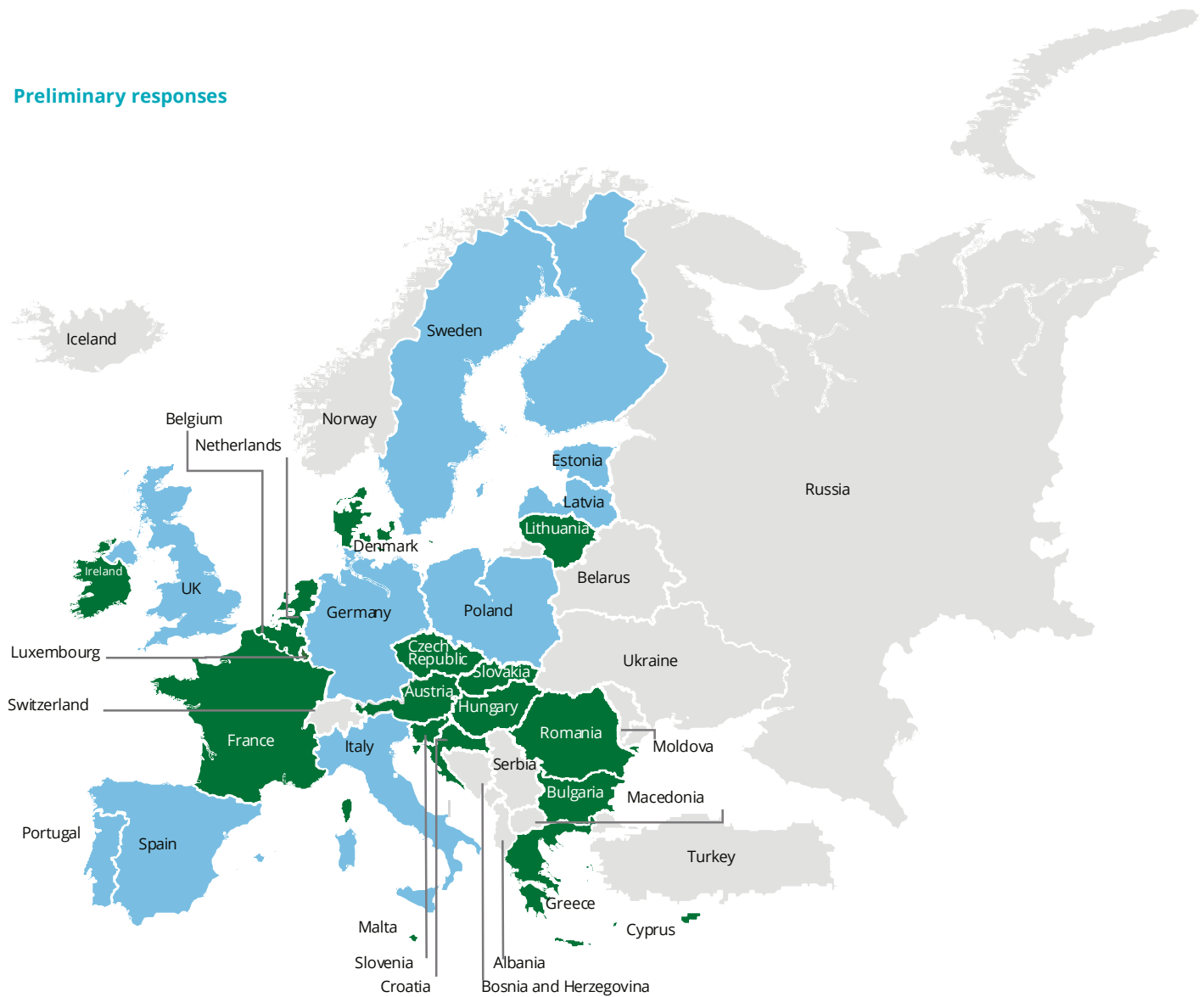
A member state implementing the CFC rules using Model A may choose to refrain from applying the substance carve-out as described in article 7(2)(a) when a CFC is resident or situated in a third country that is not party to the EEA agreement.

Legend:

- 9 Substance carve-out if third country
- 5 No substance carve-out if third country
- 1 No substance carve-out
- 1 No substance carve-out if CFC in listed country
- Guidance interpretation substance carve-out

Stricter definition of CFC

Preliminary responses



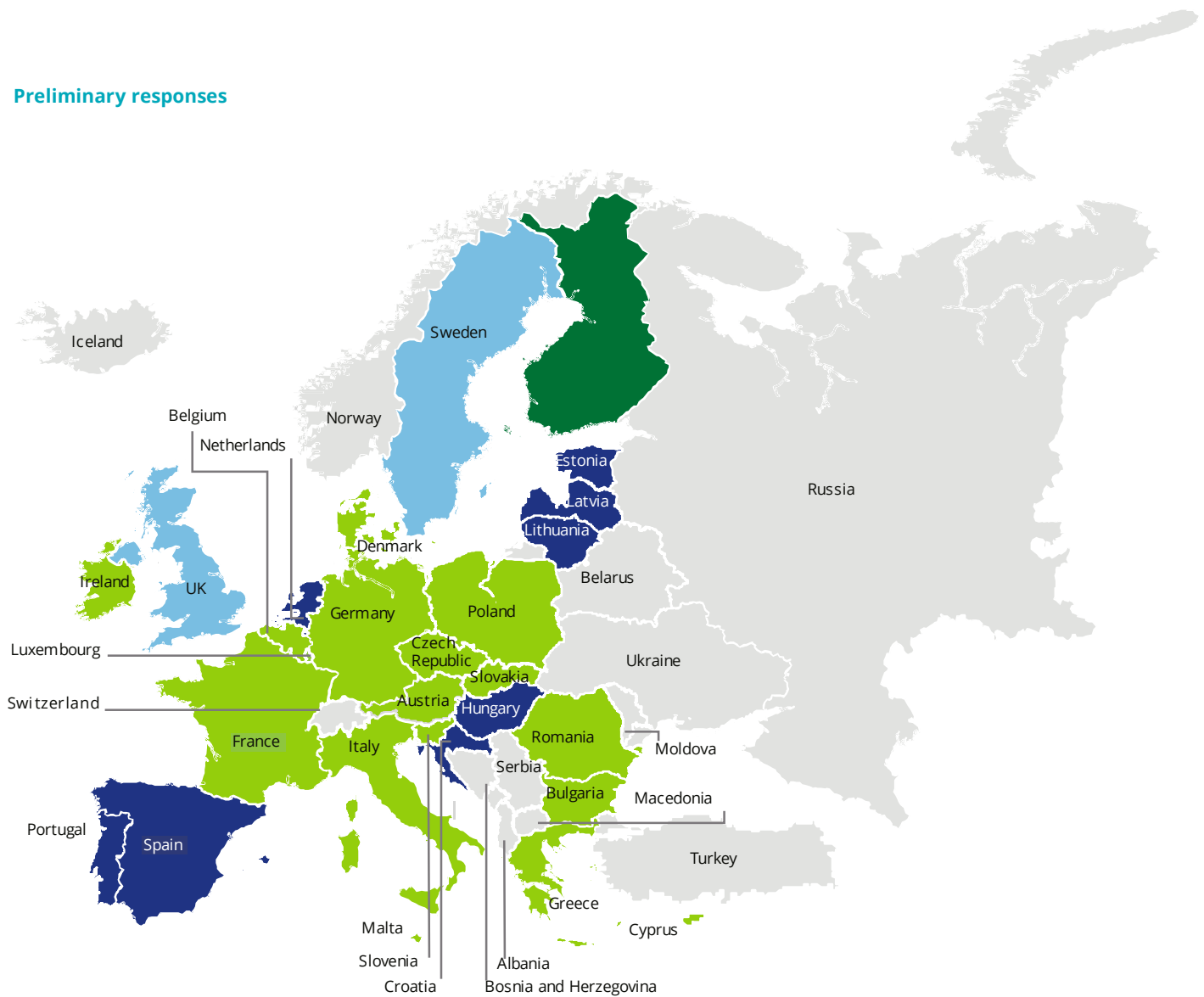
To ensure a higher level of protection, member states may reduce the control threshold or set a higher threshold when comparing the actual corporate tax paid with the corporate tax that would have been charged in the member state of the domestic taxpayer.

Legend:

10	Yes
18	No

Listed, conditionally listed, safe listed

Preliminary responses



In transposing the CFC rules into national law, member states can use (conditional) lists of third countries, which may be based on criteria set out in the ATAD and may include the corporate tax rate level, or use safe lists of member states compiled on that basis.

Legend:

- 2 Safe list
- 0 Conditional list
- 8 List of third countries
- 1 Safe list and list of third countries
- 17 No lists



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