

Controlled Foreign Company Regimes Essentials 2012



Introduction

Controlled foreign company (CFC) regimes are used in many countries as a means to prevent erosion of the domestic tax base and to discourage residents from shifting income to jurisdictions that do not impose tax or that impose tax at low rates. While the rules applicable to CFCs and the attributes of a CFC differ from country to country, the hallmark of CFC regimes in general is that they eliminate the deferral of income earned by a CFC and tax residents currently on their proportionate share of a CFC's income. Typical conditions for the application of such regimes are that a domestic taxpayer "control" the CFC; that the CFC be located in a "low tax" jurisdiction or a jurisdiction that imposes a tax rate lower than the rate (as specifically defined) in the shareholder's country, or alternatively that the CFC be located in a "black" or

"grey" list jurisdiction (as opposed to favored "white" list jurisdictions); and that the CFC derive specific types of income (e.g. in some regimes, passive income, but in others, all types of income). While most countries provide for exemptions from their CFC regimes, even where such exemptions apply, shareholders with interests in CFCs may still face complex reporting requirements.

CFC Regimes Essentials surveys the regimes in the Deloitte International Tax Source (DITS) jurisdictions (www.dits.deloitte.com). This resource is supplemented by the Taxation and Investment Guides, Country Highlights, tax alerts and rate, holding company and transfer pricing matrices available on DITS (<http://www.deloitte.com/dits>).

Argentina

General

The CFC rules are in subparagraph a) of sections 133 and 148 of the Income Tax Law; section 165 VI 1-6 of the Regulatory Decree also addresses CFCs.

The CFC rules require resident shareholders to include in their taxable income the taxable profits derived by a company resident in a low tax jurisdiction from dividends, interest, royalties, leases and other passive income, but only if the passive income is higher than active income.

When applicable

The CFC rules apply to passive income derived from specified low tax jurisdictions.

Argentina has a black list that includes countries considered low tax jurisdictions, and for countries not on the black list, a list of "special low tax regime" countries. The following jurisdictions are on the black list: Albania, American Samoa, Andorra, Angola, Anguilla, Antigua & Barbuda, Antilles, Aruba, Ascension, Azores, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Brunei Darussalam, Campione d'Italia, Cape Verde, Cayman Islands, Channel Islands, Cook Islands, Djibouti, Dominica, French Polynesia, Gibraltar, Greenland, Grenada, Guam, Guyana, Hong Kong, Isle of Man, Jordan, Kiribati, Kuwait, Labuan, Liberia, Liechtenstein, Luxembourg (with respect to holding companies), Macao, Madeira, Maldives, Marshall Islands, Malta, Mauritius, Monaco, Montserrat, Nauru, Niue, Norfolk, Oman, Ostrava (free zone), Palau, Panama, Pitcairn, Puerto Rico, Qatar, St. Kitts & Nevis, St. Lucia, St. Vincent & the Grenadines, San Marino, Santa Elena, Seychelles, Solomon Islands, Sri Lanka, Swaziland, Svbalbard, Tonga, Trieste (Italy), Trinidad & Tobago, Tokelau, Tristan de Cunha, Tunisia, Turks & Caicos, Tuvalu, United Arab Emirates, U.S. Virgin Islands, Uruguay (regime applicable to financial corporations), Vanuatu, Western Samoa and Yemen.

Type of income attributable and when included

The CFC regime applies only to passive income that comprises at least 50% of the income of the foreign subsidiary. In other words, if 49% of the subsidiary's income is passive income, the CFC rules are not triggered. The following income is considered passive income: dividends, interest (unless obtained commercially, such as where the subsidiary is a

bank), royalties, rent from real property (unless commercially exploited), and gains from the sale of shares, participations and bonds, as well as operations involving derivatives and similar financial instruments (unless made for hedging purposes).

The passive income of the CFC to be included in the taxable income of an Argentine shareholder is that derived by the CFC in the CFC's fiscal year ending in the fiscal year of the Argentine shareholder.

Credit for foreign taxes

Since the CFC rules only apply to tax haven companies, no tax credit is available because no tax would have been paid.

Mechanics for ensuring attributed income not taxed again on distribution

Only dividends exceeding already taxed passive income are included as taxable income, with the determination made on a first in, first out (FIFO) basis.

Supplementary rules to catch investment in entities not caught by CFC rules

In general terms, non-corporate investments are taxed on an accrual basis regardless of where they are located, so no additional rules are necessary.

Exemptions

Current taxation will not apply if at least 50% of the profits of the low taxed company are related to active income.

Tax treatment on sale of CFC

There are no specific provisions regarding the taxation of a sale of a CFC; the net gain is taxed in the regular manner at the standard corporate income tax rate of 35%. Because there are no provisions equivalent to those ensuring that only dividends in excess of already taxed passive income are included in taxable income, double taxation may arise on the sale of a CFC (to the extent the taxable gain is attributable to already taxed income of the CFC that is the subject of the sale).

Other features of CFC regime

None

Proposed changes

None

Australia

General

Australia's CFC rules are found in Part X of the Income Tax Assessment Act 1936 (ITAA 1936). A major rewrite of the CFC laws is in progress. Initial exposure draft legislation was released on 17 February 2011 for public comment and it is expected that legislation will be introduced into Parliament in 2012, with further public consultation before the legislation is introduced into Parliament. The start date of the new rules is not yet known (earliest likely start date is 1 July 2012).

Qualifying Australian shareholders ("attributable taxpayers") are subject to taxation on an accruals basis on their proportionate share of a CFC's "attributable income." For a foreign company to be a CFC, either: five or fewer Australian residents (including associates) must hold 50% or more of the company; or, subject to additional considerations, a single Australian entity must hold not less than 40%; or five or fewer Australian entities (including associates) must effectively control the company. Where the CFC rules apply, the Australian shareholder includes its share of the CFC's attributable income in its assessable income for the year of income in which the end of the CFC's statutory accounting period occurs.

Income can be attributed under the CFC rules only if the Australian shareholder is an attributable taxpayer (i.e. if it has an associate-inclusive control interest in the CFC of at least 10% or other specific conditions are satisfied).

When applicable

The rules that determine a CFC's attributable income (see below) vary depending on whether the CFC is a resident in a "listed" or an "unlisted" country. There are seven listed countries: Canada, France, Germany, Japan, New Zealand, the U.K. and the U.S. All other countries are unlisted countries.

Type of income attributable and when included

In broad terms, only certain passive income is attributed under the CFC rules; active income is generally not attributed. The attributable income of a CFC is calculated using the same tax rules applicable to Australian resident companies, subject to certain modifications. Amounts attributed are subject to Australian income tax in the hands of an Australian attributable taxpayer.

If less than 95% of a CFC's turnover is active, the CFC fails the "active income test" and there may be

attribution of "adjusted tainted income" (passive income, tainted services income and tainted sales income). Where the CFC is resident in a listed country, however, the attributable income is limited to certain adjusted tainted income that is concessionally taxed (referred to as "eligible designated concession income").

If the CFC passes the active income test, no adjusted tainted income will be attributed. However, certain types of income are specifically attributed even if the active income test is passed.

As noted above, where the CFC rules apply, the Australian attributable taxpayer includes its share of the CFC's attributable income in its assessable income for the year of income in which the end of the CFC's statutory accounting period occurs.

Credit for foreign taxes

Under the foreign income tax offset rules, a foreign tax credit will be available in Australia to attributable taxpayers that are Australian resident companies for (i) foreign income taxes paid by a CFC in relation to attributed amounts; (ii) Australian taxes (income tax or withholding tax) paid by a CFC; and (iii) direct withholding taxes on the eventual repatriation from first tier CFCs.

Mechanics for ensuring attributed income not taxed again on distribution

Dividends paid out of previously attributed amounts under the CFC rules and Foreign Investment Fund (FIF) rules (now repealed – see below) generally are treated as exempt income under sections 23AI and 23AK, ITAA 1936, respectively.

Supplementary rules to catch investment in entities not caught by CFC rules

In addition to the CFC rules, Australia's transferor trust rules (TTR) may subject foreign income to accruals taxation in the hands of resident Australian taxpayers. The TTR are found in Div 6AAA Pt III of the ITAA 1936. Under the TTR, an Australian resident is subject to tax on an accruals basis on the attributable income of a foreign trust to which the Australian resident has transferred property or services. Where the TTR apply, the Australian resident includes its share of the transferor trust income in its assessable income.

Australia's FIF regime and deemed present entitlement rules (DPER) were repealed with effect from 1 July 2010. Under the former FIF rules, Australian investors that had an interest in a foreign

company (where the CFC rules did not apply) or a foreign trust at the end of a year of income, and those that held a foreign life assurance policy at any time in the income year, were subject to taxation on an accruals basis on the income attributable to the interest in the FIF. Where the former FIF rules applied, the Australian investor included its share of the FIF income in its assessable income for the period in which it was a resident. Under the former DPER, if at any time during an income year a taxpayer had an interest in a nonresident trust (including contingent interests and those arising at a future time), the taxpayer was considered a beneficiary who was presently entitled to a share of the income from the trust (i.e. the deeming rules applied where the taxpayer effectively did not actually enjoy present entitlement to a share of the income of the nonresident trust). Where the former DPER applied, the taxpayer included its share of the net income of the nonresident trust in its assessable income.

Following the repeal of the FIF regime, the Australian government released draft legislation in April 2010 to introduce a specific anti-avoidance provision to address the potential risk of tax deferral in respect of non-controlled foreign investment. The new anti-roll-up fund rule would only target offshore accumulation or roll-up funds. Further draft legislation was released on 17 February 2011 for public comment and it is expected that legislation will be introduced into Parliament in 2012, with previous public consultation. The start date of the new rules is not yet known (earliest likely start date is 1 July 2012).

Exemptions

Under the CFC rules, a de minimis exemption may apply for a CFC that is resident in a listed country if the attributable income does not exceed the lesser of AUD 50,000 or 5% of the CFC's gross turnover.

As discussed above, where a CFC resident in a listed or an unlisted country passes the active income test, no adjusted tainted income will be attributed. However, certain types of income are specifically attributed even if the active income test is passed.

Tax treatment on sale of CFC

There is no separate taxation regime for the disposal of shares in a CFC. Capital gains or losses made by an Australian company on the disposal of shares in foreign companies, including CFCs, with an active business may be partly or wholly disregarded under the capital gains tax (CGT) participation exemption. Broadly, the exemption applies if the Australian

company holds a direct voting percentage of 10% or more in the foreign company for a certain period before the disposal takes place. The gain or loss is reduced by the active asset percentage. If the percentage is 90% or more, the gain or loss is totally disregarded. If the percentage is less than 10%, there is no exemption. If the percentage is between 10% and 90%, there is a proportionate exemption. Active assets generally are those used in carrying on a business other than assets such as financial instruments, assets whose main use is to derive passive income and cash and cash equivalents. This CGT participation exemption regime also applies to disposals by CFCs.

Where the gain on the disposal of shares in a CFC is not reduced under the rules outlined above, and the gain is attributable to the retention of amounts that have been previously attributed to the taxpayer, the consideration for the disposal of the shares by the taxpayer can be reduced to the extent of the amount previously attributed.

Other features of CFC regime

None

Proposed changes

The Australian government announced in its Federal Budget in May 2009 an overhaul of Australia's anti-deferral regimes. A consultation paper on the CFC reforms was issued in January 2010 and a second paper was issued in July 2010. Initial exposure draft legislation was released on 17 February 2011. As mentioned above, legislation to repeal the FIF regime and deemed present entitlement rules came into effect on 1 July 2010.

The proposed key reforms to the CFC rules (likely, but not yet confirmed, to be implemented from 1 July 2012) include the following:

- Adopting a broad, economic concept of control as the key test to define a CFC;
- Amending the definition of an "attributable taxpayer" to refer to Australian residents that either control the CFC or are associates of such a controller;
- Amending the definition of passive income to include income from "debt interests," "equity interests" and "financial arrangements";
- Allowing passive income to be exempt from attribution when it is derived in the course of an active trade or business;

- Allowing passive income derived from within a CFC group to be treated as active (i.e. non-attributable);
- Tainted sales income and tainted services income will no longer be attributable;
- Basing an attribution interest on the concept of a “participation interest,” which in turn is based on an “equity interest”;
- Exempting complying superannuation funds from having to attribute CFC income;
- Amending the foreign dividend exemption to apply only to “equity interests”; and
- Extending the foreign dividend exemption to cover cases where the dividend is received via an interposed partnership or trust.

It has also been proposed that the TTR be amended, although details have not yet been released.

Brazil

General

The CFC rules are based on Provisional Measure No. 2,158-35/2001 and Normative Instruction No. 213/2002.

Profits earned by CFCs and certain foreign affiliates (non-controlled subsidiaries) of Brazilian entities will be included in the base for calculating the corporate income tax and social contribution tax on profits liability of a Brazilian controlling or parent company. Profits earned by CFCs and non-controlled subsidiaries of Brazilian companies will be considered available to the controlling/parent company in Brazil and be subject to taxation at the end of each fiscal year. Losses generated from CFCs may not be offset against profits of the controlling company generated in Brazil. Such losses may be offset only against profits generated within that CFC on an entity-by-entity basis. The domestic rule on net operating loss (NOL) limitations (i.e. 30%) does not apply to CFCs.

When applicable

The CFC rules apply to companies subject to the "equity pick-up method" for accounting purposes, including controlled, affiliated companies, the same economic group or companies under common control. Brazilian corporate law defines an affiliated company as one in which (i) the investor holds significant influence, meaning right to participate in the decisions of the invested company; or (ii) the investor holds more than 20% of the invested company, without controlling it.

Type of income attributable and when included

Net income, which includes all types of income, is attributed at year end (31 December of each calendar year).

Credit for foreign taxes

Brazil uses the credit system to avoid double taxation, whereby taxes paid abroad on income derived by a

Brazilian resident taxpayer may be credited against Brazilian tax liability up to the Brazilian statutory corporate income tax rate of 34%. There is no tax credit carryforward unless the Brazilian company was in an NOL position at the time the foreign income was taxed. A foreign tax credit is possible regardless of the existence of a tax treaty.

Mechanics for ensuring attributed income not taxed again on distribution

Since there is no deferral, the income is taxed when generated. Under Brazilian domestic tax law, dividends received are not subject to tax, so double taxation might not be an issue when the income is repatriated via dividends.

Supplementary rules to catch investment in entities not caught by CFC rules

If an investment does not meet the equity pick-up criteria, only the amount of cash repatriated (dividends, loans or other method or form of moving the cash out of the foreign company) to Brazil is subject to Brazilian taxation.

Exemptions

None

Tax treatment on sale of CFC

Capital gains derived from the sale of a CFC are taxed as the difference between the sales price and the book basis of the foreign CFC, according to Brazilian accounting standards. Capital gains are taxed at the ordinary corporate income tax rate (no separate basket).

Other features of CFC regime

None

Proposed changes

None, although there is an issue before the Brazilian Supreme Court as to the legality of the CFC rules.

Canada

General

Canada's Foreign Affiliate (FA) rules include anti-deferral provisions known as the "foreign accrual property income" (FAPI) rules. The FA rules are contained primarily in sections 90-95 and 112-113 of the Income Tax Act and Part LIX (sections 5900-5919) of the Income Tax Regulations.

Canadian residents must pay Canadian income tax on a current basis to the extent of their share of FAPI earned by a controlled foreign affiliate (CFA). The definition of controlled foreign affiliate is broad, and an anti-avoidance rule may apply if shares are acquired or disposed of and the principal purpose is to avoid this status.

When applicable

The FAPI rules apply to CFAs earning certain types of passive and "deemed passive" income. A CFA is an FA controlled by the Canadian entity. An FA is a nonresident corporation in which the Canadian entity holds at least a 10% equity percentage together with related persons, with at least 1% held by the Canadian entity itself. *De jure* control exists where one or more persons hold a sufficient number of shares carrying voting rights to constitute a majority in the election of the board of directors. Such control need not be exercised by the taxpayer alone, but also persons with whom the taxpayer does not deal at arm's length.

While there are no black or white lists, the FA rules do provide something like a "participation exemption" for active business income earned by an FA in a designated treaty country. Canada currently has treaties in force with 88 countries. Dividends paid from active business income of affiliates located in non-treaty countries that enter into a tax information exchange agreement with Canada also may qualify for the exemption.

Type of income attributable and when included

"Passive income" and certain other "designated" income are considered to be FAPI earned by an FA of a Canadian taxpayer. FAPI is included in the Canadian taxpayer's income in the year it is earned, as if the taxpayer had earned the income directly, regardless of whether the income is distributed to the Canadian taxpayer. Canada provides a grossed-up deduction from income for any tax paid by the controlled foreign affiliate in respect of the FAPI.

Attributed income is included in the tax year of the Canadian entity in which the year that income is earned by the CFA ends.

Credit for foreign taxes

Canada provides a grossed up deduction from income for tax paid by the CFA in respect of the FAPI, which effectively results in a credit for foreign taxes.

Mechanics for ensuring attributed income not taxed again on distribution

The FA rules allow a deduction from income for dividends paid out of FAPI that was previously included in income.

Supplementary rules to catch investment in entities not caught by CFC rules

The previously proposed foreign investment entity (FIE) rules were withdrawn in the 4 March 2010 Federal Budget and replaced with new draft legislation introduced in August 2010.

Exemptions

All income of a foreign affiliate is characterized as (1) income from an active business; (2) income from property; or (3) income deemed to be from a business other than an active business. The latter two categories of income are included in a CFA's FAPI. Income from property may be recharacterized as active business income under certain circumstances.

Tax treatment on sale of CFC

The sale of an FA generally would give rise to a capital gain (or loss). One-half of a capital gain is included in taxable income. Upon an eventual disposition of the FA's shares, the Canadian entity can elect to have the proceeds deemed to be a dividend out of surplus accounts and thereby possibly avoid (all or part of) any capital gain.

Other features of CFC regime

For taxation years beginning after 2008, there are tighter restrictions on the exception from FAPI in respect of certain payments received by an FA from related persons.

Proposed changes

An updated extensive package of proposed technical amendments to the FA legislation and regulations was released in December 2009. The March 2010 Budget and draft legislation released in July and August 2010 and August 2011 also include amendments, with the 2011 proposals having a pervasive impact once enacted. In particular, they deal with the computation of FAPI, the computation of capital gains realized by foreign affiliates and the liquidation and reorganization of foreign affiliates, as well as a new deemed dividend rule in respect of loans made by foreign affiliates.

China

General

The CFC rules are found in the Enterprise Income Tax Law (Order of the President [2007] No. 63, "EIT Law") and its Implementation Rules, with further guidance in the Implementation Regulations for Special Tax Adjustments (Guoshuifa [2009] No. 2, "STA Rules").

According to article 45 of the EIT Law, a Chinese shareholder may be taxed currently on its proportionate share of undistributed profits of CFCs located in certain low tax jurisdictions where there are no valid business reasons for the decision not to distribute.

When applicable

A CFC is defined as a foreign enterprise that is "controlled" by Chinese resident enterprises, or collectively by Chinese resident enterprises and Chinese individual residents, and is established in a country (or region) where the actual tax burden is "obviously lower" than the tax rate prescribed in article 4(1) of the EIT Law (i.e. 25%). The Implementation Rules define the term "obviously lower" to mean an effective tax rate in the foreign jurisdiction that is lower than 50% of the tax rate in China (i.e. a rate of less than 12.5%).

Article 117 of the Implementation Rules provides an explanation of the term "controlled" as used in article 45 of the EIT Law:

- A resident enterprise or an individual resident in China holds, directly or indirectly, 10% or more of the total voting shares, and jointly holds more than 50% of the total shares of the foreign enterprise;
- If the percentage tests are not met, a substantial control provision will apply, i.e. if the Chinese resident exerts substantial control over the foreign enterprise with respect to shareholding, financing, business, purchases and sales, etc.

The STA Rules require Chinese resident enterprises to file an annual reporting form on overseas investment, with the annual tax return. The competent tax authorities will issue a confirmation notice where a CFC is identified based on a review of the reporting information.

China does not have a black list of countries. White list countries include Australia, Canada, France, Germany, India, Italy, Japan, New Zealand, Norway, South Africa, the U.K. and the U.S.

Type of income attributable and when included

All income included in the accounting profits of the foreign enterprise (including passive income) is attributable to the Chinese resident enterprise under the CFC rules and taxed at the standard EIT rate of 25%. Income attributable to a Chinese individual shareholder is taxed at the individual income tax rate of 20%.

The income of the CFC to be included in the taxable income of a Chinese enterprise shareholder is that derived by the CFC in the CFC's fiscal year ending in the fiscal year of the Chinese enterprise shareholder.

Credit for foreign taxes

China allows a foreign tax credit for foreign taxes attributed to the CFC profits subject to Chinese taxation. Both direct and indirect foreign tax credits are allowed.

Mechanics for ensuring attributed income not taxed again on distribution

Income that already has been attributed and taxed under the CFC rules should not be subject to Chinese tax again when it is later distributed by the CFC to the shareholders.

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

Exemption provisions are applied in the following cases:

- The CFC is located in a white list country;
- The CFC's income is derived mainly from active business activities;
- The annual profits of the CFC are lower than RMB 5 million.

Tax treatment on sale of CFC

The Chinese resident enterprise must pay EIT at 25% on gains derived from the sale of the CFC. Individual residents of China pay individual income tax of 20% on the gain.

Other features of CFC regime

None

Proposed changes

None

Denmark

General

Denmark's CFC legislation is in section 32 of the Corporate Tax Act (section 16 H in the Tax Assessment Act for individuals).

When applicable

A Danish resident company or a Danish PE of a foreign company may be subject to tax on the total income of a subsidiary or foreign PE of a Danish company in the following cases:

- The subsidiary is controlled directly or indirectly by the Danish resident company;
- The CFC income of the subsidiary constitutes more than one-half of the taxable income of the subsidiary; and
- The subsidiary's financial assets on average constitute more than 10% of its total assets in the income year.

CFC income is defined as:

- Taxable net interest income;
- Taxable net gains on receivables and debts and financial instruments;
- Dividends that would be taxable under Danish law;
- Net capital gains on shares that would be taxable under Danish law;
- Royalties and capital gains on intangible assets (except from royalties received from third parties for the use of intangible assets developed through the subsidiary's own R&D), unless the intangible assets are developed through the subsidiary's own R&D;
- Taxable finance leasing income; and
- Taxable income from insurance, banking and other financial activities for which no CFC exemption has been granted under the exemption regime applicable to financial institutions.

Denmark does not have a white or black list of countries. Subsidiaries in all jurisdictions (including Denmark) may be caught by the CFC rules.

Type of income attributable and when included

If a subsidiary or PE is considered a CFC, the total income of the CFC (not just the financial/CFC income) will be attributed to the Danish parent company and taxed at the normal Danish corporate tax rate of 25%. The Danish parent company is taxable in proportion to the ownership share and ownership period.

The attributed income must be included in the taxable income of the Danish parent in the income year of accrual.

Credit for foreign taxes

A tax credit is granted for taxes paid by the subsidiary.

Mechanics for ensuring attributed income not taxed again on distribution

The ordinary participation exemption applies, which generally means that dividends received are tax exempt if the parent company holds 10% or more of the share capital of the subsidiary and the dividends are covered by the EU Parent-Subsidiary Directive or a tax treaty between Denmark and the country of the subsidiary (subsidiary shares), or if the parent company and the subsidiary qualify for international joint taxation under Danish tax law, irrespective of whether such an election has actually been made (group shares).

Supplementary rules to catch investment in entities not caught by CFC rules

Certain investment companies are covered by section 19 of the Act on Taxation of Capital Gains on Sale of Shares. Shares in investment companies are taxed on a mark-to-market basis.

Exemptions

The CFC rules do not apply when the group has chosen to apply the rules on international joint taxation, nor do they apply to investment companies covered by section 19 of the above act. The National Tax Board can exempt subsidiaries carrying out insurance, mortgage credit or banking activities from the CFC rules.

Tax treatment on sale of CFC

The sale of a CFC is subject to the ordinary rules on capital gains on shares. Moreover, a direct or indirect sale of a CFC may mean that the CFC is deemed to have disposed of a proportionate amount of all financial assets and liabilities covered by the Act on Capital Gains and the Act on Capital Gains on Sale of Shares at fair market value. These rules should ensure that CFC taxation is not avoided by investments in assets where the yield comes in the form of an appreciation in value rather than a current yield (dividends, interest, etc.).

Other features of CFC regime

None

Proposed changes

None

Egypt

General

The CFC rules are found in Egyptian Income Tax Law No. 91 (2005) in Article 70, paragraph 6 B, of the Executive Regulations.

The profits of Egyptian-owned CFCs are brought into tax in Egypt using the equity method of revenue recognition.

When applicable

An Egyptian company will be subject to the CFC rules on the income of its CFC if the following requirements are met:

- The profits of the CFC are not subject to tax or are exempt from tax in its country of residence or are subject to tax at a rate less than 75% of the Egyptian corporate income tax rate;
- The Egyptian entity owns more than 10% of the CFC; and
- More than 70% of the CFC income is derived from dividends, interest, royalties, management fees or rental payments.

Type of income attributable and when included

Net income, including all types of income, is attributed at the fiscal year end. Impairment losses will not be attributed in the base of such income.

Credit for foreign taxes

Egypt uses the credit system to avoid double taxation, whereby taxes paid abroad on income derived by an Egyptian resident taxpayer may be credited against the Egyptian tax liability in proportion to revenue recognized abroad. The Egyptian corporate income

tax rate is 25% on income above EGP 10 million and 20% on income less than that amount. There is no foreign tax credit carryforward.

Mechanics for ensuring attributed income not taxed again on distribution

Income is taxed when it is generated. According to the Egyptian tax code, dividends are not subject to withholding tax.

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

None

Tax treatment on sale of CFC

The sale of a CFC is subject to the ordinary corporate income tax rules as a part of the Egyptian company's income. In other words, income derived from the sale of a CFC is part of an Egyptian company's income base. The net income (the company's income added to capital gains) is subject to the normal corporate income tax rate.

Other features of CFC regime

None

Proposed changes

In light of the current political and economic situation in Egypt, there is a significant possibility that the tax laws could change in the near future. However, there have been no specific proposed amendments to the CFC rules to date.

Estonia

General

The Estonian CFC rules apply only to resident individuals; anti-avoidance rules apply to Estonian resident companies (e.g. a higher tax burden on service fees paid to low tax territories and taxation of loans and investments made to companies situated in low tax territories).

When applicable

An Estonian resident individual must pay income tax on CFC income regardless of whether the CFC has distributed profits in the following cases:

- The foreign company is located in a “low tax territory,” i.e. a foreign state or territory with an independent tax jurisdiction that does not impose a tax on profits earned or distributed by a legal person, or where the tax is less than one-third of the income tax that an Estonian resident individual would pay on a similar amount of business income. The Estonian tax rate is 21%, so any tax rate below 7% would be deemed to be low;
- The foreign company is “controlled” by Estonian residents (i.e. Estonian tax residents own at least 50% of the capital of the company); and
- The Estonian resident individual owns directly or together with associated persons at least 10% of the shares of the CFC.

The government has issued an official white list of jurisdictions that are not considered low tax territories. The list is comprised mainly of EU member states, tax treaty partners and certain other OECD countries.

Type of income attributable and when included

All types of income are included. The difference between income and expenses is taxable on an annual basis, even if the CFC did not distribute its profits. An Estonian resident individual must declare his/her proportionate share in the annual tax return.

Credit for foreign taxes

An Estonian resident individual is entitled to a tax credit for income tax paid by the CFC or withheld in proportion to the individual's share (or voting power) in the CFC.

Mechanics for ensuring attributed income not taxed again on distribution

The part of the profits that already have been taxed is tax exempt upon actual distribution.

Supplementary rules to catch investment in entities not caught by CFC rules

A 21% withholding tax is levied on service fees paid to a nonresident legal person located in a low tax territory, regardless of where the services were provided or used. This only applies to resident legal persons and to self-employed persons as tax withholders. In the case of individuals, a legal person located in a low tax territory itself should declare the relevant income in Estonia.

The following payments are nondeductible for corporate income tax purposes (immediate tax liability of 21/79 on the net payment):

- Acquisition of securities issued by a legal person located in a low tax territory unless the securities meet the requirements in the Estonian Investment Funds Act;
- Acquisition of a holding in a legal person located in a low tax territory;
- Payment of a fine for delay or a contractual penalty, or extra-judicial compensation for damages, to a legal person located in a low tax territory; and
- The grant of a loan or the making of an advance payment to a legal person located in a low tax territory or the acquisition of a right of claim against such person in any other manner.

Exemptions

A foreign entity will not be deemed to be located in a low tax territory if more than 50% of its annual income is derived from actual economic activities, or the tax authorities of the low tax country provide information to the Estonian tax authorities on the income of the person under the control of the Estonian resident.

Tax treatment on sale of CFC

Capital gains from the sale of a CFC are generally included in taxable income and taxed at the normal personal income tax rate.

Other features of CFC regime

None

Proposed changes

None

Finland

General

The Finnish CFC regime is found in the Act on the Taxation of Shareholders in Controlled Foreign Corporations (Statute number 16.12.1994/1217).

A resident of Finland may be subject to income tax on its share of the profits of a CFC regardless of whether the profits are distributed by the CFC to its shareholders. The CFC regime applies to any foreign corporate entity, fund, trust, etc. The scope of the regime extends to a PE of a foreign entity that is situated in a country other than the country in which its head office is situated where the income of the PE is not taxed in the head office country; in that case, the CFC regime applies as if the PE was an independent taxable entity.

Finland's CFC regime was amended as a result of the European Court of Justice (ECJ) decision in the *Cadbury Schweppes* case. The amendments mainly apply as from tax year 2009, except for certain changes relating to PEs that include a grandfathering rule until the end of 2014.

A gray list of countries issued by the Ministry of Finance (applicable as from 1 January 2012) includes the following countries, all of which have a tax burden significantly lower than the burden in Finland and, therefore, companies in these jurisdictions will not be able to qualify for the tax treaty exemption for application of the CFC regime: Barbados, Bosnia-Herzegovina, Georgia, Kazakhstan, Macedonia, Malaysia, Moldova, Montenegro, Serbia, Singapore, Switzerland, United Arab Emirates and Uzbekistan.

When applicable

The following conditions must be satisfied for the CFC regime to apply:

- The foreign entity must be controlled by Finnish residents that have unlimited tax liability for Finnish income tax purposes (i.e. legal persons or individuals resident in Finland). One or more Finnish residents must hold together, directly or indirectly, at least 50% of the capital or voting rights of the foreign entity or otherwise be entitled to at least 50% of the profits of the foreign entity (the control requirement also is met if there is at least 50% Finnish control in each tier of the ownership chain of the foreign entity).

- The Finnish shareholder must hold, directly or indirectly, at least 25% of the capital of the CFC or, as a beneficiary, be entitled to at least 25% of the profits of the entity. Any holdings through associated persons of the taxpayer are taken into account in calculating this threshold.
- Fulfillment of the above thresholds is examined, and the applicability of the CFC regime is determined, based on the situation at the end of each tax year.
- The foreign entity is subject to a tax that is lower than 3/5 of the corresponding Finnish tax. The Finnish corporate tax is currently 24.5%, so the minimum effective tax should be 14.7% on the foreign entity's income calculated according to the Finnish GAAP and tax law. The basic idea is that the foreign taxes actually paid are compared to the tax that would have been due had the foreign entity been resident for Finnish tax purposes.

Type of income attributable and when included

If the CFC regime is applicable, all types of income of the CFC are attributable on a pro rata basis. The income of the CFC is considered either business income or other income based on the classification of the CFC shares for purposes of the shareholder taxation (income from the CFC basically retains its original classification for purposes of the shareholder taxation). The attributed income from the CFC must be declared annually in connection with the filing of the income tax return. A separate tax return for CFC income must be submitted to the tax authorities.

Credit for foreign taxes

Foreign income taxes (i.e. generally only federal, not local taxes) actually paid by the CFC in its country of residence and to other countries may be credited against tax imposed under the CFC regime up to the amount of Finnish tax payable on the foreign-source income. Any unused credit may be carried forward and deducted in the following five tax years from the amount of tax imposed based on the same type and source of income derived from the foreign jurisdiction. Tax losses of a CFC may be carried forward for 10 years for Finnish tax purposes and utilized against CFC income.

Mechanics for ensuring attributed income not taxed again on distribution

If dividends are distributed on profits that have been taxed as CFC income in the hands of the dividend recipient in the same or five previous tax years, the dividends are exempt.

Supplementary rules to catch investment in entities not caught by CFC rules

There are no other particular rules targeting investments in low tax jurisdictions, although general anti-avoidance rules may apply if the CFC regime is not applicable.

Exemptions

The CFC regime does not apply in the following cases:

- *Exempt activities*: The foreign company is engaged in its home country in activities listed as exempt activities, i.e. the income of a foreign entity is mainly derived from (i) industrial or comparable production activities or from shipping activities and business is conducted in the foreign entity's state of residence; or (ii) sales or marketing activities that support the industrial or comparable production activities or shipping activities, and the sales and marketing activities are primarily conducted in the state of residence of that company provided the activities directly serve a corporate entity engaged in activities that are not covered by the CFC regime.
- *Tax treaty exemption*: The country where the CFC is resident has concluded a tax treaty with Finland that is applicable to the income generated by the entity and the entity has not benefited from any special tax relief in its home country. The CFC regime can be applied, however, if the level of tax actually paid in a non-EU treaty country is substantially lower as compared to the corresponding Finnish tax on the income. The difference is substantial if the foreign tax is, on average, lower than 3/4 of the corresponding Finnish tax (i.e. lower than approximately 18.4% in 2012). As noted, above, companies in gray list jurisdictions are not eligible for this exemption.

- *EEA/treaty country exemption*: The entity is resident in an EEA or a tax treaty country (except for jurisdictions on the gray list) with whom Finland is able to exchange information on tax matters. Further, the entity must actually be established in the host member state and carry on genuine and actual economic activities there. When determining whether an entity carries on genuine and actual economic activities, the following should be taken into account:

- Whether the entity has at its disposal the premises and equipment necessary to carry on its activities;
- Whether the entity's personnel has sufficient authority to independently carry out the business of the company; and
- Whether the entity's staff makes independent decisions regarding the day-to-day business of the entity.

Tax treatment on sale of CFC

There are no particular rules regarding the sale of a CFC compared to the sale of other foreign entities. As to corporate entities resident in Finland, capital gains derived from the sale of a CFC are subject to tax unless the participation exemption applies. The corporate income tax rate in Finland is currently 24.5%.

Other features of CFC regime

None

Proposed changes

None

France

General

France's CFC regime is found in article 209-B of the French Tax Code.

Under the CFC rules, a French entity is subject to French corporate income tax on profits in certain foreign entities that benefit from a beneficial tax regime. The profits of a legal entity (as opposed to a branch) will be treated as a deemed distribution paid to the French entity in proportion to its share, interest, voting or financial rights held directly or indirectly in the foreign entity. Profits generated by a foreign branch also is taxable in France as foreign income.

When applicable

Article 209-B applies to entities subject to French corporate income tax provided:

- They hold directly or indirectly more than 50% of the shares, voting rights or financial rights of a foreign legal entity or PE. An anti-abuse provision reduces the participation threshold to 5% for each direct or indirect French shareholder where more than 50% of the shares in the foreign entity are owned by other French entities or by entities that are considered nominees of the French shareholder.
- The foreign entity benefits from a privileged tax regime, i.e. it is subject to an effective tax rate that is at least 50% lower than the rate in France.

France does not have a white or black list of countries for purposes of applying this rule and all types of enterprises and legal entities (not only branches and subsidiaries) satisfying the above conditions are included within the scope of the CFC rules, e.g. even non-profit entities such as trusts and associations.

Type of income attributable and when included

The entire profit of the foreign entity or branch for a given year is taxable in France if the entity or branch is viewed as benefiting from privileged tax treatment within the meaning of the Tax Code. There is no isolated taxation of only certain income (e.g. passive income) received by the foreign entity or the PE.

Credit for foreign taxes

France allows a credit for the foreign tax due on the CFC's income provided it is comparable to France's corporate tax.

Where the CFC has paid withholding taxes on passive income received from a third country not listed as a non-cooperative jurisdiction and that has concluded a tax treaty with France that has an administrative

assistance provision, a credit is available up to the withholding tax rates provided in the relevant treaty.

Mechanics for ensuring attributed income not taxed again on distribution

Dividends further distributed by the foreign subsidiary may be 95% exempt in the hands of the French company when the foreign subsidiary's income already has been taxed pursuant to France's CFC rules and if the conditions to benefit from the French participation exemption regime are satisfied.

Supplementary rules to catch investment in entities not caught by CFC rules

As from 2010, rules target investments in non-cooperative jurisdictions (a black list will be published annually by the French authorities for the application of the new provisions). Under these rules, dividends, interest, royalties and payments for services made to companies located in a non-cooperative country will be subject to a 50% withholding tax. Dividends received from entities located in non-cooperative countries cannot benefit from the participation exemption regime.

Exemptions

If the CFC is located in the EU, the CFC rules will not apply unless the French company's shareholding in the CFC is deemed to be an artificial arrangement designed to circumvent French tax legislation. If the CFC is outside the EU, the rules will not apply if the CFC carries on industrial and commercial activities in the jurisdiction in which the CFC is located, unless (1) more than 20% of the profits of the CFC are derived from passive income; or (2) more than 50% of the profits are derived from passive income and income from intragroup services (including financial services). In both cases, the French company can still avoid the application of the CFC rules if it can demonstrate that the activities of the CFC have a main effect other than allowing the localization of taxable income in a jurisdiction where it benefits from a privileged tax regime.

Tax treatment on sale of CFC

Capital gains receive a 95% exemption if certain conditions are satisfied.

Other features of CFC regime

None

Proposed changes

None

Germany

General

Germany's CFC legislation is found in sections 7-14 of the 1972 Foreign Tax Act (AStG), and updated in the Annual Tax Act 2010.

Under the Foreign Tax Act, certain profits considered passive income of a CFC resident in a low tax jurisdiction controlled by German resident shareholders may be attributed proportionally to those shareholders and included in their taxable income.

The CFC rules were amended as a result of the ECJ decision in the *Cadbury Schweppes* case. The CFC rules generally remain in effect, but taxpayers have the right in certain cases to demonstrate that an EU/EEA-resident CFC carries out genuine commercial activities and that the Mutual Assistance Directive (or a comparable exchange of information agreement) applies. CFC income attribution will not apply if the taxpayer can demonstrate that these requirements are met.

Special exit taxation rules for transfers of functions out of Germany were introduced in the Foreign Tax Act with effect from 1 January 2008.

The definition of what constitutes "low taxation" for German CFC purposes was expanded in the Annual Tax Act 2010 to take into account tax credits and refunds at the shareholder level when determining whether the effective tax rate abroad falls below the 25% threshold. This change specifically targets taxpayers that earn passive income via corporate entities in Malta, because these entities previously were outside the scope of the German CFC rules as a result of certain features of the Maltese tax system.

When applicable

The CFC rules apply if the following conditions are satisfied:

- A German resident taxpayer (i.e. an individual or company that is subject to German unlimited tax liability) holds more than 50% of a foreign company (the threshold is reduced to 1% (or less) if the foreign company is engaged in the business of certain financial transactions);
- The foreign company receives "passive income"; and

- The passive income is subject to tax at an effective tax rate of less than 25% (see above on the law change in the Annual Tax Act 2010 that became effective on 1 January 2011).

Germany does not have a black or white list of countries.

Type of income attributable and when included

Section 8 of the AStG describes income sources that are not considered passive income. As a result, all income that is not specifically described as being active income automatically qualifies as passive income under the CFC rules. Active income includes income derived from:

- Profit distributions of corporations;
- The sale of shares to another corporation, as well as the dissolution or reduction of its capital;
- Trading and services (unless captive);
- Banking or insurance business (unless captive);
- The leasing of movable and immovable assets and licensing (only of self-developed intangibles);
- The taking on of debt and on-lending to a German business or to a foreign active business;
- Agriculture and forestry; and
- The exploitation of natural resources, energy generation, manufacturing and processing of goods.

The most common types of income that qualify as passive income are:

- Income generated from the use of capital of the foreign resident company; and
- Income from intercompany deliveries and services provided the structure of the foreign company is not sufficient for carrying out the deliveries or rendering the services.

The attributed income is taxed at the level of the German shareholder regardless of whether a dividend is distributed. Income that is taxed under the CFC rules at the level of the German shareholder does not qualify for the 95% participation exemption for dividends to corporate shareholders (40% participation exemption for individual shareholders).

The income must be included in the taxable income of the German shareholder in the fiscal year following the fiscal year in which the income is earned by the foreign subsidiary.

Credit for foreign taxes

A tax credit is available for local country taxes when the income is taxed at the level of the German shareholder under the CFC rules.

Mechanics for ensuring attributed income not taxed again on distribution

Dividend distributions made by the foreign subsidiary to the German parent company are treated as follows:

- *For individuals:* 100% tax-free if the income already was taxed at the level of the German shareholder under the CFC rules in the last seven years; and
- *For corporate shareholders:* 95% tax-free (resulting in a 5% double taxation).

Supplementary rules to catch investment in entities not caught by CFC rules

Other provisions in the Foreign Tax Act (e.g. sections 7 (3), 14 and 20 (2)) dealing with the treatment of partnerships, branches and indirect shareholdings in CFCs can apply.

Exemptions

The requirements for the application of the German CFC rules are very narrow and described in detail in the Foreign Tax Act. The main exemptions apply for EU-resident companies, real estate investment trusts and certain investments.

Tax treatment on sale of CFC

There are no special rules for the calculation of income from the sale of a CFC. To the extent capital gains result from profits that were taxed under the CFC rules at the level of the German individual shareholder in the last seven years, the capital gains are treated as tax free at the level of the German shareholder. Capital gains from the sale of the shares in a CFC should be 95% tax exempt for corporations under the participation exemption.

Other features of CFC regime

The income of a CFC must be calculated based on German tax accounting principles in determining whether the income qualifies as low taxed income. Income attributable to the German shareholder under the CFC rules also must be calculated based on German tax accounting principles.

The Act to Combat Tax Fraud introduced stringent additional reporting obligations and provisions that, in general, would lead to the nondeductibility of expenses in transactions with countries that do not apply information exchange according to the latest OECD standards. Increased information reporting requirements and the shifting of the burden of proof in certain cases have been introduced into the Foreign Tax Act. According to a circular published by the German tax authorities, as from 1 January 2010, there are no uncooperative jurisdictions to which these provisions will apply.

Proposed changes

None

Hungary

General

The CFC rules are found in articles 4, 7, 8 and 18 and Annex 3 of the Corporate Income Tax Law.

The CFC regime targets companies that are ultimately owned by Hungarian tax resident private individuals. Therefore, although the rules have become more complex, they are generally not relevant for non-Hungarian controlled groups (except in very limited and unlikely situations). Thus, a group not controlled by Hungarian private individuals is likely to be eligible for all benefits that previously were limited (including but not limited to qualifying under the participation exemption rules or avoiding any income pick up regardless the location or residence of its affiliate).

When applicable

A nonresident "person" is considered a CFC if Hungarian resident private individual(s) ultimately controls the majority of the foreign entity or the majority of its income is Hungarian-source income; and the foreign entity's effective tax rate is less than 10% (in the case of losses, the domestic statutory tax rate should reach 10%).

Hungary has a white list of countries that are not considered low tax jurisdictions for purposes of the CFC rules (i.e. EU and OECD member states and countries that have concluded a tax treaty with Hungary) if the foreign entity has real business presence in that country.

Type of income attributable and when included

The following items are taxed under the general rules applying to companies:

- Qualifying non-distributed after-tax profits of directly owned CFCs;
- Dividends received (unless already taxed as qualifying profits under first bullet) from, and capital gains realized on, CFCs (these would otherwise be exempt under the Hungarian participation exemption if certain requirements are met);

- Liquidation gains and gains realized on capital redemptions (unless already taxed as qualifying profits under first bullet);
- Consideration paid to a CFC unless the company demonstrates that it was necessary for its business activities;
- Costs and expenses related to free services, gifts, free asset transfers and debt forgiveness granted to CFCs;
- Losses in the value of a CFC, foreign exchange losses or capital losses realized in relation to a CFC are not recognized for corporate income tax purposes. In addition, the tax base cannot be reduced based on transfer pricing principles if the related party is a CFC; and
- Deviation from the arm's length prices in a direction where the Hungarian entity presents higher income (deemed expense is not available).

Income is included in the fiscal year in which a directly owned CFC realizes the income and does not distribute it. If the CFC distributes the profit in the year of realization, dividend income is taxable when it is accounted for purposes of Hungarian GAAP.

Credit for foreign taxes

A tax credit is not granted for tax paid on the income of the CFC (qualifying taxed income is taxable in Hungary). Tax withheld on dividends distributed by the CFC is creditable. In the absence of an applicable tax treaty, 90% of the withholding tax paid abroad may be credited. Withholding tax credits are always capped at the effective average corporate income tax rate of the taxpayer.

Mechanics for ensuring attributed income not taxed again on distribution

Dividends are tax exempt if the undistributed profits were already included in the company's taxable income.

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

The CFC regime does not apply if the Hungarian taxpayer is ultimately controlled by non-Hungarian tax residents and no affiliate realizes the majority of its income from Hungary. The CFC rules also do not apply if the foreign entity is resident in a white list country, i.e. an EU member state, an OECD country or a country that has concluded a tax treaty with Hungary and it has real economic presence in that country.

Subsidiaries of an entity listed for at least five years on a qualifying stock exchange should not be considered a CFC.

Tax treatment on sale of CFC

There are no special rules that apply to gains derived from the sale of a CFC; such gains are included in ordinary income and taxed at the standard corporate tax rate. If the sale gives rise to a loss rather than a gain, the loss is not deductible from income.

Other features of CFC regime

None

Proposed changes

None

Iceland

General

The CFC regime, set out in article 57 a) of the Iceland Income Tax Act (ITA), is designed to prevent tax evasion by targeting companies that primarily have financial earnings, such as holding companies and funds. The new rules took effect in assessment year 2011.

If the CFC rules apply, the Iceland entity will be taxed on the income of the CFC, regardless of whether profits of the nonresident entity have been distributed.

When applicable

The CFC regime is triggered when a taxable Iceland resident entity owns or controls, directly or indirectly (e.g. through another company), at least 50% of a company, fund or institution that is resident in a low tax jurisdiction, regardless of whether the profits of the company, fund or institution are distributed to the Iceland resident. The same applies if an Iceland resident controls a foreign company resident in a low tax jurisdiction if the Iceland resident benefits, directly or indirectly, from the company.

A low tax jurisdiction for purposes of the CFC rules is a country in which the company income tax rate is less than two-thirds of the Icelandic rate (currently 20%). As a result, countries with a company tax rate below 13.3% will be considered a low tax jurisdiction.

The following countries are included on a list of low tax jurisdictions issued by the Finance Minister: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahrain, Belize, British Virgin Islands, Cook Islands, Dominica, Gibraltar, Grenada, Netherland Antilles, Liechtenstein, Liberia, Maldives, Marshall Islands, Monaco, Montserrat, Nauru, Niue, Panama, Samoa, St. Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, Seychelles Islands, Tonga, Turks & Caicos Islands and Vanuatu.

If the country is not on the black list, it is not considered a low tax jurisdiction, irrespective of the income tax rate in the jurisdiction.

Type of income attributable and when included

A tax entity resident in Iceland is required to pay income tax on the profits of a company, fund or institution domiciled in a low tax jurisdiction in proportion to its ownership share of the entity without regard to whether profits have been distributed. The same applies for an Iceland entity that controls a company, fund, institution or a portfolio in a low tax country from which the Iceland tax entity benefits,

either directly or indirectly. The income is taxable in the same way as if the operations were in Iceland, i.e. 20% for limited liability companies, 36% for unlimited liability companies and from 37.31% to 46.21% for individuals. Losses are deductible only if the Iceland taxpayer can document the calculation of the loss to the satisfaction of the tax authorities.

Credit for foreign taxes

None

Mechanics for ensuring attributed income not taxed again on distribution

To prevent double taxation, if a company, institution, fund or establishment pays dividends to an Icelandic taxable entity from profits previously taxed under the CFC regime, the dividends will not be regarded as taxable income, unless they are higher than the profits previously taxed under the regime.

Supplementary rules to catch investment in entities not caught by CFC rules

In addition to the CFC regime, under the anti-avoidance rule in article 57 of the ITA, if an Iceland taxable entity negotiates its transactions in a way that differs significantly from common practice in the relevant business sector, income that would have been attributed to another party in the absence of the contract constitutes income for the Iceland entity. Article 57 also provides that if a taxable Iceland entity purchases an asset for an abnormally high price or sells an asset for an abnormally low price, the tax authorities can assess a price that is deemed to be a normal or sale price. The difference between purchase or sale price and assessed the value is regarded as taxable income for the benefactor of such trade.

It is also worth noting that, under article 2(2) of the ITA, the Director of Internal Revenue can rule that a limited liability company or an unlimited liability company registered abroad is a resident in Iceland for tax purposes if its effective management is situated in Iceland. This article is not limited to low tax jurisdictions; it can apply to taxable entities in all other countries. Article 2(2) has a broader scope than the CFC regime and can apply to situations that do not fall within the scope of the regime.

Exemptions

The CFC regime does not apply if the low tax jurisdiction where the company, fund or institution is located has concluded a tax treaty with Iceland and the treaty has an exchange of information provision, or the income of the relevant entity is not comprised

mainly of property income. The regime also does not apply where the company, fund or institution is founded and listed in another EEA member state and has real operations there, and the Icelandic tax authorities can obtain all necessary information on the basis of a tax treaty. If there is no treaty, the reporting requirement is on the taxable Iceland entity.

Tax treatment on sale of CFC

Capital gains from the sale of shares of a company in a low tax jurisdiction are not deductible (in Iceland, a company can deduct capital gains from income if certain conditions are satisfied). The capital gains will be taxed as “other income,” i.e. at a rate of 20% for limited liability companies, 36% for partnerships and 37.31%-46.21% for individuals.

Other features of CFC regime

The CFC regime includes a disclosure component that applies to taxpayers with interests in foreign subsidiaries, who must report all commercial transactions relating to those subsidiaries, as well as to auditors and legal advisors, who are required to maintain lists of clients with such reportable interests, and which may be accessed by the tax authorities. In addition, financial companies must provide the tax authorities with information on business transactions of companies that have branches or subsidiaries in low tax countries.

Proposed changes

None

Indonesia

General

Indonesia's CFC rules are in article 18(2) of Income Tax Law No. 7, as amended by Income Tax Law No. 36 and Minister of Finance Regulation No. PMK 256/PMK.03/2008. Further implementing guidelines on the reporting procedures for the receipt of offshore dividends, tax calculation and the tax credit mechanism have not been issued by the Directorate General of Taxation.

When applicable

A CFC is a foreign company in which an Indonesian resident company or an individual holds at least 50% of the registered capital (either alone or together with other resident taxpayers). The CFC rules apply only to unlisted foreign companies. Indonesia does not have a white or black list of countries.

Type of income attributable and when included

If the CFC rules apply, the Indonesian Minister of Finance is authorized to determine when a dividend is deemed to be derived by the Indonesian resident shareholder if no dividends are declared. If no dividends are declared or derived from the offshore company, the resident taxpayer must calculate and report the deemed dividend in its tax return; otherwise, the Ministry of Finance will do so. The dividend is deemed to be derived either in the fourth month following the deadline for filing the tax return in the offshore country or seven months after the offshore company's tax year ends if the country does not have a specific tax filing deadline.

Credit for foreign taxes

Indonesia grants a tax credit for foreign taxes attributed to the CFC's profits subject to Indonesian taxation.

Mechanics for ensuring attributed income not taxed again on distribution

The CFC calculation is based on the self-assessment system. If the amount of actual dividends is more than the reported deemed dividends, the taxpayer should only report the difference.

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

None

Tax treatment on sale of CFC

An Indonesian corporate tax resident shareholder must report gain on the sale of shares as ordinary taxable income. The taxable income will be combined with other income and the total taxable income will be deducted as a business expense. The net profit will be subject to corporate income tax at 25%. An Indonesian individual tax resident shareholder must report gain on the sale of shares, subject to income tax at a maximum rate of 30%.

Other features of CFC regime

None

Proposed changes

None

Israel

General

Israel's CFC regime is contained in section 75b of the Israeli Income Tax Ordinance (ITO).

Under the CFC rules, an Israeli resident that controls a foreign corporation that derives most of its income or profits from passive income is subject to tax on a pro rata portion of the foreign corporation's undistributed profits as if the profits were distributed as a dividend.

When applicable

The CFC rules are triggered where an Israeli resident holds at least 10% of the means of control of a CFC that has accumulated undistributed passive profits and is taxed at a rate lower than 20% in its country. In such a case, the Israeli resident will be treated as if it had received its proportionate share of the CFC's profits as dividend income (deemed dividend), which will be subject to corporate tax in Israel for controlling company shareholders at a rate of 25% (increased from 24% as from 1 January 2012) and will be subject to income tax of 30% (increased from 25% to 30%) in the hands of Israeli individual controlling shareholders (as from 2012).

A foreign company will be treated as a CFC if the following conditions are satisfied:

- The company is a nonresident;
- The shares or rights of the company are not registered for trading on a stock exchange or less than 30% of the company's shares are offered to the public;
- Most of the company's income in the tax year is passive or most of its profits are derived from passive income;
- The tax rate applicable to the passive income in the foreign country does not exceed 20%; and
- Israeli residents hold, directly or indirectly, more than 50% of one of the means of control, or more than 40% of one or more of the means of control are held by Israeli residents who, together with one or more relatives, hold more than 50% of one or more of its means of control.

The CFC regime does not apply to new immigrants or to veteran returning residents for a period of 10 years from the date those persons become Israeli residents for tax purposes.

Israel does not have a white or black list of countries.

Type of income attributable and when included

Most passive income produced by the CFC in the tax year or most of its profits derived from passive income will be attributable to the Israeli controlling members. The term "passive income" is defined as income from dividends, interest, rent, royalties and consideration for the sale of capital assets, provided the same income is not business income or professional income.

Credit for foreign taxes

If a CFC is liable to tax in its country of residence (this includes an obligation to withhold tax on a dividend distribution), a tax credit will be allowed in an amount equal to the foreign tax that would have been paid had the profits been distributed as a dividend. If the CFC income derives from a company in a chain of companies that is not held directly by the controlling Israel shareholder, additional credit will be granted for the foreign tax that would have been paid in respect of a distribution of dividends by each of the companies in the chain for which a full or partial credit cannot be obtained by any of the companies in the chain. A deemed tax credit for both withholding tax and the underlying corporate tax paid by a foreign company (up to a second tier foreign subsidiary) will be granted only to the extent the Israeli controlling shareholder is an Israeli company that is deemed to hold directly at least 25% control over the foreign subsidiary or, in the case of a second tier foreign subsidiary, if the foreign subsidiary that is at least 25% directly controlled by the Israeli company holds at least 50% control over the second tier subsidiary. The amount of the credit may not exceed the tax to which the Israeli controlling company is subject in Israel on its chargeable income.

Mechanics for ensuring attributed income not taxed again on distribution

If a dividend is actually paid to a shareholder of a CFC out of profits on which the shareholder paid tax (on profits attributed to it under the CFC regime), a credit will be granted for the tax that applies to the actual dividend. The credit will be in the amount of tax paid, but no more than the amount of tax paid by the shareholder on the part of the profits that were distributed as a dividend. The credit will be adjusted according to the rate of the index increase from the end of the tax year in which the profits were attributed up to the date of the actual dividend payment.

Supplementary rules to catch investment in entities not caught by CFC rules

Management and control: Under Israeli tax law, companies incorporated outside of Israel that are

managed and controlled from Israel are considered Israeli resident for tax purposes and are subject to corporate tax (currently 25%) in Israel on their worldwide income (subject to a tiebreaker rule under a tax treaty). However, if a company incorporated outside Israel is managed from Israel by a new immigrant or by a veteran returning resident, the company will be considered a non-Israeli resident company for tax purposes for 10 years.

Foreign occupational company (FOC): According to section 5 of the ITO, an FOC is a foreign resident body of persons of which, *inter alia*, 75% or more of one or more of the means of control are directly or indirectly held by individual Israel residents, and most of the income or profits of the FOC during the tax year, other than equity profits and losses and changes in the value of securities, are derived from a "special occupation." With respect to income and dividends distributed to shareholders of an FOC, the FOC will be treated as if its business were managed and controlled in Israel and the foreign occupational income will be attributed to the Israeli shareholder (pro rata) and subject to Israeli corporate tax at the applicable rate. Any dividend distribution from an FOC to an Israeli individual shareholder will trigger an additional 30% tax (as from 2012).

For the purpose of calculating the minimum holding percentage of Israel residents in an FOC, the holdings of a new immigrant or a senior returning resident will not be taken into account.

Exemptions

Dividends received by a CFC that are distributed out of profits that were subject to tax in the foreign jurisdiction at a rate exceeding 20% will not fall within the scope of the CFC regime. Thus, only upon the actual distribution of the dividend by the CFC to Israeli controlling shareholders will be subject to tax in Israel at a rate of 30% for individual shareholders (or at the corporate tax rate of 25% under the indirect credit mechanism in accordance with section 126c of the ITO in respect of a qualified Israeli company).

Tax treatment on sale of CFC

If a controlling member sells all or some of its means of control in a CFC, it will be exempt from tax that applies to that sale in the amount of tax paid in preceding tax years on unpaid profits in respect of the means of control that are being sold, and which had not been distributed as dividends until the date of the sale. The amount of tax paid in preceding tax years will be adjusted according to the index increase from the end of the tax year in which it was paid until the date of sale of the means of control. The amount of the credit may not exceed the tax that applies to the capital gains after any allowed set off and deduction.

Other features of CFC regime

None

Proposed changes

None

Italy

General

Italy's CFC rules are contained in articles 167 (controlled companies) and 168 (related companies) of the Income Tax Code.

Italy's CFC regime attributes profits of a nonresident entity to an Italian resident where the resident controls, directly or indirectly, the nonresident entity, and the nonresident entity is resident in a listed tax haven. As from 1 January 2010, the same rules apply when the nonresident entity is resident in a country that is not listed as a tax haven if both of the following conditions are satisfied:

- The nonresident entity is subject to an effective tax rate (ETR) lower than 50% of the Italian ETR; and
- More than 50% of the nonresident entity's income is passive income derived from the management, the holding or investment in securities, participations, receivables or other financial investments; the disposition or exploitation of intangibles relating to industrial, artistic or literary rights; or services (including financial services) provided to entities belonging to the same group.

The income of the CFC is attributed to the Italian resident in proportion to its participation in the CFC and the profits of the CFC are taxed in the hands of the Italian resident at its average tax rate.

When applicable

The CFC rules apply when an Italian taxpayer holds more than 50% of an entity that is tax resident in a non-white list country. While the white list has yet to be published by Treasury (the black list was abolished as from 1 January 2008), the list will contain for an initial period of at least five years countries that were not in the old black list. In addition, the CFC rules apply to "related entities," i.e. entities in which the Italian resident holds, directly or indirectly, a profit entitlement exceeding 20% (10% in the case of listed companies).

Type of income attributable and when included

All income of the CFC is attributable in proportion to the Italian resident's participation in the foreign entity. Where an Italian resident directly or indirectly controls a CFC, the income is subject to separate taxation at the Italian resident's average income tax rate (subject to a minimum rate of 27%). The CFC income is determined by applying the Italian tax rules on the statutory result. If the Italian resident holds more than 20% (10% if the company is a listed company),

without controlling the foreign company, the income is the higher of the local foreign country statutory pretax income or the presumptive income based on the following asset categories: 1% of financial instruments and receivables, 4% of real estate and 15% of other fixed assets. IRAP is not levied on foreign income.

The attributed income is included in the taxable income of the Italian taxpayer for the tax year during which the foreign entity's tax year ends.

Credit for foreign taxes

A foreign tax credit is available for income tax paid by the CFC. The credit is limited to the amount of Italian tax corresponding to the foreign income.

Mechanics for ensuring attributed income not taxed again on distribution

Dividends paid by the foreign entity to the Italian taxpayer are tax exempt up to the amount of the income previously attributed. Additionally, a tax credit for the income tax paid in the CFC'S country is deductible from the Italian income tax on the attributed income.

Supplementary rules to catch investment in entities not caught by CFC rules

There are no specific rules, but the Italian CFC rules apply to both corporate and non-corporate entities.

Exemptions

A ruling may be requested from the tax authorities to avoid application of the CFC regime when the resident controlling entity can demonstrate that:

- (1) The CFC effectively carries on actual industrial or commercial activities as its main business activities on the market of the listed jurisdiction in which it is established. This condition is satisfied for banks and other financial and insurance institutions if most of the financial sources, use of funds or income originates in the local market. The business test is not applicable if most of the CFC income (i.e. more than 50%) is passive income derived from: the management, holding or investment in securities, participations, receivables or other financial investments; the disposition or exploitation of intangibles relating to industrial, artistic or literary rights; or services (including financial services) provided to entities belonging to the same group;
- (2) Its participation in the CFC does not result in allocating income to the entity in the listed jurisdiction ("effective tax test").

Furthermore, the rules for entities in non-black listed jurisdictions do not apply if the resident entity obtains a ruling from the Italian tax authorities stating that the CFC does not constitute an artificial structure aimed at obtaining improper tax benefits.

Tax treatment on sale of CFC

Capital gains/losses on the sale of a participation in a CFC are calculated as the difference between the sales price and the tax base of the participation. The tax base of the participation is increased by the CFC attributed income and decreased by dividends received from the CFC. The capital gain/loss is included in the ordinary taxable base of the Italian taxpayer. The participation exemption (i.e. the 95% exemption for capital gains derived by corporations

and a 50.28% exemption for gains of individuals on substantial participations) may apply if all participation exemption requirements are met, but only if the taxpayer has obtained an advance tax ruling that states the CFC rules do not apply based on the "effective tax test."

Other features of CFC regime

The CFC rules in article 167 (controlled companies) also apply where the controlled entity is resident in a white list country to the extent it has a branch in a non-white list country.

Proposed changes

None

Japan

General

The CFC rules are contained in the Special Taxation Measures Law, articles 66-6 through 66-9 (for corporate taxpayers) and articles 40-4 through 40-6 (for individual taxpayers).

The CFC rules limit deferral of taxation of income earned by a CFC. If the CFC has profits in any fiscal year, each Japanese resident individual or Japanese company that (together with its associated persons) owns directly or indirectly 10% or more of the outstanding shares (or voting shares or dividend rights, if any) of the CFC (a “Japanese 10% shareholder”) is required to report its pro rata share of the taxable profits of the CFC.

The Japanese CFC legislation has been amended several times in recent years. The explanation below reflects changes under the 2011 Tax Reform, which apply for purposes of (1) determining whether a non-Japanese company is a CFC; and (2) calculating the pro rata share of a CFC’s taxable profits for a Japanese 10% shareholder’s fiscal periods ending on or after 1 April 2011.

The discussion in the sections below focuses mainly on the CFC rules that are applicable to corporate taxpayers.

When applicable

A non-Japanese corporation is a CFC if both of the following tests are met:

- The non-Japanese company is more than 50% controlled, directly or indirectly, by Japanese shareholders (i.e. Japanese resident individuals and/or Japanese companies). A CFC is considered “controlled” by Japanese shareholders if Japanese shareholders own (directly or indirectly) more than 50% of the outstanding shares, the voting shares or the dividend rights; and
- There are no income taxes in the country in which the CFC is located or the effective tax rate (ETR) of the CFC is 20% or less. The ETR is calculated by making some adjustments to the local tax rate and is computed for each fiscal year.

Japan does not have a white or black list of countries.

Type of income attributable and when included

When a company is classified as a CFC, a Japanese 10% shareholder is generally taxed on all of the taxable profits of the CFC on a pro rata basis corresponding to its shareholding. Taxable profits may

be calculated either using Japanese domestic company computational rules or the local country method of computing taxable profits, with some adjustments.

Dividends received from holdings of 25% or more in qualifying foreign companies, held for at least six months immediately before the date the payment obligation for the dividend is determined, will be excluded from the CFC attributable income calculation.

The taxable profits of the CFC are included in the taxable income of the Japanese 10% shareholder on the last day of the two-month period after the fiscal year end of the CFC.

If the CFC satisfies the exemption rules (see “Exemptions” below), only certain passive income (e.g. dividends, interest, royalties and capital gains) is subject to CFC taxation.

Credit for foreign taxes

A foreign tax credit is available for foreign taxes suffered by the CFC.

Mechanics for ensuring attributed income not taxed again on distribution

Dividends paid by a CFC are not included in the taxable income of a recipient Japanese 10% shareholder to the extent that shareholder already has been subject to tax on such dividends under the CFC rules.

Supplementary rules to catch investment in entities not caught by CFC rules

There are anti-corporate inversion rules in the Special Taxation Measures Law, articles 66-9-2 through 66-9-5 (for corporate taxpayers) and articles 40-7 through 40-9 (for individual taxpayers) designed to prevent a Japanese company from switching to a subsidiary of an offshore company to take advantage of foreign tax benefits.

Exemptions

All of the following four conditions must be satisfied for the exemption to apply:

- *Active business test.* The main business of the company is not the holding of shares or debt securities; the licensing of intellectual property rights, know-how or copyrights; or the leasing of vessels or aircraft (certain regional headquarters companies may be treated as satisfying the active business test even if their main business is the holding of shares);

- *Substance test*: The company has a fixed place of business in the foreign country in which its head office is located;
- *Local management and control test*: The company manages, controls and operates its business in the country where the head office is located; and
- *Unrelated party transaction test or local business test*: Under the unrelated party transaction test, the main business of the company is that of wholesale, banking, trust company, securities, insurance, shipping or air freight, and more than 50% of its business is conducted with unrelated parties (transactions between regional headquarters companies and their subsidiaries are included in transactions with unrelated parties for purposes of this test). If the main business is not of the type listed for the unrelated party transaction test, then,

per the local business test, the company must conduct its business mainly in the country where the headquarters is located.

Tax treatment on sale of CFC

Any gain on the sale of shares in a CFC is fully taxable (as with the sale of shares in a non-CFC foreign company). There is, therefore, a potential risk that undistributed profits of a CFC are taxed twice: once on inclusion in the sale price and once when originally earned.

Other features of CFC regime

None

Proposed changes

None

Korea

General

The CFC rules, found in article 17 of the International Tax Coordination Law (ITCL), require the current taxation of profits of companies located in a low tax jurisdiction.

The distributable retained earnings derived by a foreign corporation resident in a low tax jurisdiction will be deemed to be distributed to a Korean resident shareholder that holds directly or indirectly at least 10% of the foreign corporation.

When applicable

The CFC rules apply when a Korean resident (corporate or individual) owns directly or indirectly 10% or more of a foreign company and the foreign company's average effective income tax rate for the most recent three consecutive years is 15% or less.

Type of income attributable and when included

All income is attributable under the CFC rules. If the rules apply, a Korean parent company will be deemed to have received dividends from the CFC equal to the amount of deemed distributable earnings multiplied by the shareholding ratio. That is, a Korean parent company will be taxed in Korea on the earnings of the CFC, even though there has been no actual distribution from the CFC. The deemed dividend amount is basically the total distributable retained earnings, adjusted by previous deemed dividend amounts taxed to the Korean parent company, mandatory reserves, share valuation gain/loss, etc. The CFC income will be included in the taxable income of the Korean parent company in the tax year to which the 60th day from the CFC's fiscal year end belongs.

Credit for foreign taxes

A tax credit is available to the Korean parent company for foreign tax paid in the country of the CFC. However, the amount of the credit is limited to the lower of the foreign taxes actually paid and the additional tax in Korea resulting from the inclusion of the foreign income. Unused credits may be carried forward for up to five years. The Korean parent company may claim the credit by filing an amended return for the tax year in which the deemed dividend income was previously taxed.

Mechanics for ensuring attributed income not taxed again on distribution

Actual dividend income distributed from a CFC is treated as nontaxable income to the extent of total deemed dividend income previously taxed to the Korean parent company.

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

There are two exceptions to the CFC rules: (1) the "active business operation" exception; and (2) the "same region holding company" exception. The rules are complex and subject to considerable uncertainty due to lack of precedent, rulings or detailed guidance on their scope. Under the active business operation exception, the CFC rules do not apply when the CFC has an office, a store, factory or other fixed facility in the foreign country through which it actually conducts its business operations. (It should be noted that there are more exceptions to this exception.) Under the same region holding company exception, the CFC rules do not apply when the CFC is a qualified holding company that satisfies the following conditions under the Korean CFC rules:

- The CFC holds shares in "qualified subsidiaries" for six months or longer as of the ex-dividend date; and
- Dividends and interest from "qualified subsidiaries" account for 90% of the sum of dividends, interest, royalties and capital gains.

Foreign subsidiaries can be treated as "qualified subsidiaries" if the following conditions are satisfied: (1) the foreign subsidiaries are located in the same region (i.e. the EU for European countries, but otherwise it refers to each country) where the CFC is located; (2) the CFC owns 50% or more of the foreign subsidiaries; and (3) the foreign subsidiaries are not subject to the CFC rules.

Tax treatment on sale of CFC

Capital gains derived by a Korean parent company from the transfer of a CFC would be included in the book income of the Korean parent and reported to the Korean district tax office as part of its corporate income tax return. Such capital gains are not separately taxed; they are subject to the Korean corporate income tax rate at the normal progressive rate maximum, currently 24.2%. In calculating the capital gains, deemed dividend income previously taxed may be allowed to reduce the amount of capital gain.

Other features of CFC regime

The effective tax rate is calculated by (a)/(b) where: (a) is the sum of tax actually paid for the most recent three years (including tax actually paid on income of the CFC in other countries besides the country where the CFC is resident); and (b) is the sum of "income

before tax” for the most recent three years (if the company is in a loss position for any specific year, the “income before tax” for that year will be deemed to be zero for purposes of the effective tax rate calculation).

Proposed changes

Currently, one of the requirements for qualified subsidiaries of a foreign holding company to apply the

same region holding company exception is that the foreign subsidiary is located in the same region as the CFC. According to a proposed revision, the scope of the term same region would be expanded to include China and Hong Kong (currently only the EU is treated as a same region).

Lithuania

General

The CFC provisions are in the Law on Corporate Income Tax (No. IX-675 of 20 December 2001). The white list is confirmed by Order No. 24 of 24 January 2002 and the black list (i.e. the list of tax havens) is confirmed by Order No. 344 of 22 December 2001, both issued by the Minister of Finance.

When applicable

The CFC rules generally apply when a Lithuanian entity/resident individual:

- Holds directly or indirectly more than 50% of the shares (interests, member shares) in the controlled entity or other rights to a portion of distributable profits or pre-emptive rights to the acquisition thereof; or
- Together with related persons holds more than 50% of the shares (interests, member shares) in the controlled entity or other rights to a portion of distributable profits or pre-emptive rights to the acquisition thereof, and the portion controlled by the controlling entity/individual accounts for at least 10% of the shares (interests, member shares) or other rights to a portion of distributable profits or pre-emptive rights to the acquisition thereof; and
- Exercises such control of the foreign entity on the last day of the tax period.

Application of the rules to attribute the income of a controlled foreign entity to the Lithuanian controlling entity/individual is based on a combination of location and form of business. The rules target certain forms of business where the entity is subject to a special favorable tax regime identified by the Ministry of Finance. The rules apply as follows:

- Income will be attributed if the controlled entity is registered or otherwise organized in a country on the white list, but is organized in one of the targeted business forms subject to a special favorable tax regime;
- Income will be attributed if the controlling entity is not registered or otherwise organized in a country on a white list or black list, but is organized in one of the targeted business forms and is subject to corporate income tax (or analogous tax) at a rate less than 75% of the Lithuanian corporate income tax rate;
- Income will be attributed, regardless of the business form, if the controlled entity is registered or otherwise organized in a black list country, i.e. a tax haven.

The white list designates countries that are excluded from the application of the CFC regime if the entity is not organized under one of the targeted business forms. White list countries are: Armenia, Austria, Azerbaijan, Belarus, Belgium, Bulgaria, Canada, China, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Kazakhstan, Korea, Latvia, Luxembourg, Malta, Moldova, Netherlands, Norway, Poland, Portugal, Romania, Russia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, U.K., U.S. and Uzbekistan.

The black list (i.e. tax haven) countries are: Alderney, Andorra, Anguilla, Antigua and Barbuda, Aruba, Azores, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Brunei, Cayman Islands, Cook Islands, Costa Rica, Djibouti, Dominica, Ecuador, Gibraltar, Grenada, Guatemala, Guernsey, Hong Kong, Isle of Man, Jamaica, Jersey, Kenya, Kuwait, Lebanon, Liberia, Liechtenstein, Macao, Madeira, Maldives, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, New Caledonia, Niue, Panama, St. Helena, St. Kitts and Nevis, St. Pierre and Miquelon, St. Vincent and the Grenadines, Samoa, San Marino, Sark, Seychelles, Tahiti, Tonga, Turks & Caicos, United Arab Emirates, Uruguay, U.S. Virgin Islands, Vanuatu and Venezuela.

Type of income attributable and when included

The positive income of a CFC is attributed to a Lithuanian controlling entity/individual on a pro rata basis. Positive income includes income received by a controlled entity to which the CFC rules apply in proportion to the number of shares of the controlled entity held by the Lithuanian entity/individual. Positive income does not include:

- Active income if certain conditions are satisfied;
- Income received by the controlled entity from the controlling Lithuanian entity/individual, which is treated as nondeductible for tax purposes; and
- Calculated distributable dividends that are not paid out to the controlling Lithuanian entity/individual (also subject to certain conditions).

The calculated amount of positive income is converted into Lithuanian Litas and included in the taxable base of the Lithuanian entity/person in proportion to the shareholding.

Income is attributed annually, with the controlling entity's tax period deemed to be the calendar year. If the tax period of a controlled entity is different or is not established, the tax period of a controlled entity will coincide with the controlling entity's tax period.

Credit for foreign taxes

The CFC provisions stipulate that the same income of the controlled foreign entity will be taxable in Lithuania only once. Foreign tax paid on the same income according to the law of the foreign country may be credited against Lithuanian tax up to the Lithuanian tax on the income. The carryforward of excess credits, however, is not allowed.

Mechanics for ensuring attributed income not taxed again on distribution

See under "Credit for foreign taxes."

Supplementary rules to catch investment in entities not caught by CFC rules

The Law on Corporate Income Tax and the Law on Personal Income Tax include a number of provisions regarding payments made to or received from tax haven countries (i.e. countries on the black list).

Exemptions

The CFC provisions do not apply if:

- The foreign entity is registered or otherwise organized in a country on the white list and is not organized in one of the targeted business forms;
- The income of the foreign entity comprises only payments made by the controlled entity/individual that are deemed to be nondeductible for tax purposes; or
- The income of the foreign entity comprises less than 5% of the income of the controlling entity.

Tax treatment on sale of CFC

There is no special treatment for gains derived from the sale of a CFC; such gains are treated as normal income subject to the corporate or personal income tax rate, as applicable.

Other features of CFC regime

None

Proposed changes

None

Mexico

General

The CFC regime is set forth in Title VI of the Mexican Income Tax Law.

Companies, individuals and resident foreigners must pay tax on all earnings from companies or accounts in low tax jurisdictions. Foreign-source income is deemed to come from a low tax jurisdiction if it is not subject to taxation abroad or if it is subject to an income tax that is less than 75% of the income tax computed under Mexican tax legislation.

Passive income (i.e. dividends, interest, royalties, capital gains and commissions) derived directly or indirectly by a Mexican resident through a branch, entity or other legal entity located in a preferential tax regime will be subject to taxation in Mexico in the year in which the income is derived. Specific rules apply that permit the non-taxation of active income in certain cases. Taxpayers earning income from a preferential tax regime must file an annual information return in February, as must taxpayers generating income from a jurisdiction on the black list and those that conduct transactions through fiscally transparent foreign legal vehicles or entities.

When applicable

Income is attributed to Mexican tax residents (including resident foreigners) from “controlled” entities having more than 20% of their income represented by passive income (broadly defined) and taxed locally at a rate less than 75% of Mexico’s statutory rate. Mexico’s current statutory rate is 30%, thus providing for a 22.5% rate threshold. Reporting rules apply when the foreign entity is established in jurisdictions identified on a black list (see below under “Other features of CFC regime”).

Unless demonstrated otherwise, a taxpayer is presumed to control foreign legal vehicles or entities that generate income if such income is subject to preferential tax treatment. Effective control is based on the average daily participation of the taxpayer and its related and “linked” parties, regardless of whether they are domestic or foreign. Relevant to a finding of “effective control” is the ability to control an entity or legal vehicle’s administration to an extent the taxpayer is able to decide when to distribute income, profits or dividends, either directly or through a third party. A link exists between parties if one person holds a position of direction or responsibility in the enterprise of the other, if the parties are legally recognized as business associates or if certain familial relationships are present.

Type of income attributable and when included

All income from a CFC must be attributed, and thus taxable in Mexico to the resident, if the criteria are met, i.e. the rate threshold is exceeded and more than 20% of the CFC’s income is passive (to include dividends, interest, royalties and capital gains).

CFC income must be computed separately in the year in which the income is generated and must be reported along with the Mexican resident’s annual income tax return.

Credit for foreign taxes

A foreign tax credit is available if the taxpayer can demonstrate that the tax was paid abroad by the foreign legal vehicles or entities. The credit is applied according to the taxpayer’s proportionate share in the income of the entities or vehicles. Additionally, should the foreign legal entity or vehicle have Mexican-source income that is subject to withholding by the Mexican payer, the control taxpayer (i.e. resident taxpayer) can credit the withholding against the recognition in Mexico of the foreign legal vehicle or entity’s income. The credit is limited to an amount obtained by applying Mexico’s statutory rate (30%) to the income taxed.

Mechanics for ensuring attributed income not taxed again on distribution

A credit system ensures that attributed income is not taxed again when distributed as profits (e.g. dividends) and a credit is available for income taxes paid in the CFC’s resident country.

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

An exemption applies for royalties paid for the use of, or a license to use, a patent or industrial secrets, provided the following requirements are met:

- The intangibles are created and developed in the country in which the foreign legal entity or vehicle that owns them is located or resident. This requirement does not apply if the intangibles were acquired by the foreign legal vehicle or entity at prices or for amounts that would have been used by independent parties in comparable transactions.

- The royalties paid do not generate a deduction for a Mexican resident.
- The payment of royalties received by the foreign legal vehicle or entity comply with Mexican transfer pricing rules.
- The accounting records of the foreign legal entities or vehicles are available to the tax authorities and an information return is filed within the required deadline.

Tax treatment on sale of CFC

Income from the sale of an interest in a CFC generally is taxable on a net basis at a rate of 30% (i.e. the corporate income tax rate).

Other features of CFC regime

Payments to a CFC are generally subject to a 40% withholding tax. Additionally, while Mexico moved from using a "black list" to employing the rate threshold, the list still applies and taxpayers are required to provide information on investments in entities located in countries on the black list. (Also, most countries on the list are likely to fail the rate test.)

Listed countries are as follows: Albania, American Samoa, Andorra, Angola, Anguilla, Antigua and

Barbuda, Aruba, Ascencion, Azores Islands, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgins Islands, Brunei Darussalam, Campione d'Italia, Canary Islands (and Special Zone), Cape Verde, Cayman Islands, Channel Islands, Christmas Island, Cocos (Keeling) Islands, Cook Islands, Costa Rica, Cyprus, Djibouti, Dominica, Falkland Islands, French Polynesia, Gibraltar, Greenland, Grenada, Guam, Guyana, Honduras, Hong Kong, Isle of Man, Jordan, Kiribati, Kuwait, Labuan, Liberia, Liechtenstein, Macao, Maldives, Madeira, Malta, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Nevis, Niue, Norfolk Island, Oman, Ostrava, Pacific Islands, Panama, Palau, Pitcairn, Puerto Rico, Qatar, Qeshm, St. Helena, St. Kitts, St. Lucia, St. Pierre and Miquelon, St. Vincent and the Grenadines, Salomon Islands, Samoa, San Marino, Seychelles, Sri Lanka, Svalbard, Swaziland, Tokelau, Trieste, Trinidad and Tobago, Tristan da Cunha, Tonga, Tunisia, Turks & Caicos Islands, Tuvalu, United Arab Emirates, U.S. Virgin Islands, Uruguay, Vanuatu and Yemen.

Proposed changes

- None

New Zealand

General

The rules for New Zealand's CFC regime are predominantly contained in subparts CQ, DN and EX of the Income Tax Act 2007 (ITA).

New CFC rules apply for all income years beginning on or after 1 July 2009. The rules encompass an active income exemption, a limited exception for certain Australian CFCs, a foreign dividend exemption and a comprehensive interest allocation regime. Broadly, a New Zealand resident with an income interest of 10% or more in a CFC has attributed CFC income from that CFC where the active business test is not met or the Australian exemption is not available. Only certain types of income (generally passive income) derived by the CFC are attributed.

When applicable

A New Zealand resident person with an income interest of 10% or more in a CFC is subject to the CFC rules.

A foreign company will be a CFC if a group of five or fewer New Zealand residents has a control interest of over 50% in the company or, in certain circumstances, where a single New Zealand resident has a control interest of 40% or more, or where there is a group of five or fewer New Zealand residents who effectively control the company's affairs.

Type of income attributable and when included

Attributable income broadly includes passive income such as dividends (although generally only where deductible or in relation to fixed rate equity or certain portfolio interests), interest (including foreign exchange gains on financial arrangements), rent and royalties, but there are a number of available exemptions. Deductions also are available for expenses incurred in deriving attributable income.

No attribution is required if the CFC passes the active business test, i.e. broadly, if it has passive income that is less than 5% of its total income. These amounts are determined based on prescriptive terms and, subject to certain criteria, are measured using either financial accounting or tax measures of income. An exemption also is available for certain Australian CFCs.

Credit for foreign taxes

A person that has attributed CFC income for an income year generally is allowed a tax credit for income tax and foreign income tax paid in relation to that income by the person or by the CFC. Surplus credits may be carried forward (subject to shareholder continuity requirements) or transferred within the

same wholly owned group (subject in both cases to jurisdictional ring-fencing). Transitional rules provide for the utilization of tax credits carried forward under the old rules.

Mechanics for ensuring attributed income not taxed again on distribution

Most foreign dividends received by New Zealand resident companies are exempt. However, dividends that are tax-deductible for the foreign company and dividends on fixed rate shares are subject to tax.

Dividends received by New Zealand resident individuals are taxable, but a tax credit mechanism operates to eliminate any double taxation.

Supplementary rules to catch investment in entities not caught by CFC rules

Foreign Investment Fund (FIF) rules apply in relation to investments in foreign entities where the control and income interests of the New Zealand resident shareholders are less than the CFC thresholds.

Income is required to be attributed under the FIF rules, but different methods are available. The FIF rules currently require the attribution of active business income from countries outside a select group of "grey list" countries but changes are proposed to extend the active income exemption to FIFs with retroactive effect for the income year beginning on or after 1 July 2011. In addition, New Zealand has comprehensive trust rules that can apply to foreign trusts where there is a New Zealand settlor.

Exemptions

No attribution is required if the CFC passes the active business test, i.e. if it has "attributable income" that is less than 5% of its "total income" (see above).

A further limited exemption applies if the CFC is resident in Australia, is subject to tax in Australia and meets certain other criteria.

Various other exemptions exist for certain types of passive income, including same jurisdiction exemptions that apply in some cases. There are some more restrictive exemptions for certain royalties and rents.

Tax treatment on sale of CFC

As a general rule, the sale of shares in a CFC is not taxed because New Zealand does not have a capital gains tax regime. In certain circumstances (such as where a CFC is acquired for the purposes of disposal), income derived from the sale of the shares

may be taxable and the cost of acquiring the shares will, in this case, be deductible.

Other features of CFC regime

Interest allocation rules have been introduced in conjunction with the changes to the CFC regime and are designed to prevent an excessive amount of debt from being allocated against the New Zealand tax base. The rules encompass safe harbor thresholds below which no limitation applies, i.e. 60% (or 75% for New Zealand controlled outbound entities) New Zealand group debt percentage (ignoring investments in foreign equity) and 110% of the worldwide percentage.

An outbound entity typically would not be subject to the rules unless the New Zealand group assets are less than 90% of the worldwide group and the total

interest deductions of the New Zealand group are more than NZD 250,000. In addition, there is an adjustment mechanism for outbound entities with finance costs of less than NZD 2 million that provides some relief from these rules.

The distribution of CFC income through New Zealand to nonresident shareholders generally will be subject to New Zealand dividend withholding tax unless New Zealand imputation credits are available to attach to dividends paid.

Proposed changes

A bill before Parliament would extend the active income exemption to the rules for non-portfolio FIFs with retroactive effect for income years beginning on or after 1 July 2011. Certain other remedial changes are expected to ensure the rules operate as intended.

Norway

General

CFC legislation is governed by the Norwegian Tax Act, sections 10-60 to 10-68.

If the CFC rules apply, all income of a taxable nature (under Norway's tax law) is included and the income (profits) will be taxed in the hands of the Norwegian shareholders as if a relevant controlled foreign entity were a Norwegian taxable entity.

When applicable

The CFC rules apply if at least 50% of the shares in a foreign corporation (and certain other entities) are held or controlled (directly or indirectly) by Norwegian resident taxpayers and the foreign corporation, in effect, is subject to less than two-thirds of the applicable Norwegian tax that would have applied on the same income had the corporation been Norwegian. The CFC rules also apply to other legal entities that are non-transparent from a Norwegian perspective but Norwegian tax residents still control the entity (e.g. family trusts).

As a rule, the 50% threshold must be met at both the beginning and end of the fiscal year. However, if Norwegian tax residents own or control at least 60% of a corporation at year end, the owners are caught by the CFC rules regardless of their ownership or control at the beginning of the year.

Norway has a black list/white list setting out countries that are considered low tax countries with respect to the CFC rules. The following countries are included on the black list: Andorra, Bahamas, Bahrain (except companies that are taxable on activities in the oil sector), Bermuda, British Virgin Islands, Cayman Island, Channel Islands, Hong Kong, Isle of Man, Liberia, Macao, Marshall Islands, Moldova, Monaco, Montenegro, Nauru, Oman, Panama, Paraguay, St. Kitts and Nevis, United Arab Emirates, U.S. Virgin Islands and Vanuatu. The following countries are included on the white list (i.e. not low tax countries): Australia, Canada, Chile, China, Croatia, India, Japan, New Zealand, Ukraine and U.S. The white list, however, does not provide blanket protection for potential CFCs. If a corporation resident in a white list jurisdiction primarily has income consisting of dividends and capital gains from a low tax jurisdiction and such income is exempt from tax in the white list jurisdiction in question, the corporation may still be

deemed to be resident in a low tax jurisdiction. Further, CFC rules may apply to foreign entities in white list countries but that are subject to tax incentive regimes.

Type of income attributable and when included

All income of a taxable nature (as determined according to Norwegian tax law) is included if the foreign corporation is considered a CFC. The income (profits) will be taxed in the hands of the shareholders as if the foreign entity were a Norwegian taxable entity (i.e. in accordance with the Norwegian Tax Act).

The income (profits) is taxable in the hands of shareholders, or those who directly or indirectly control the entity at year end, regardless of when the Norwegian tax resident became a shareholder during the year. If, for example, a corporation resident in the Bahamas became 70% owned by Norwegian tax residents on 10 December in a given year, 70% of the profits fixed according to Norwegian tax law for the entire year will be taxed in the hands of those Norwegian shareholders if they are still shareholders (with 70%) at year end, even though there were no Norwegian shareholders before 10 December.

Income is included and costs are deducted in the same year that would have applied had the CFC been tax resident in Norway.

Tax losses incurred by the CFC and fixed according to Norwegian tax rules cannot be set off directly against income (taxable profits) earned by the Norwegian shareholders but will be carried forward for setoff against future profits from the CFC.

Credit for foreign taxes

A credit for taxes paid by the CFC is, within certain limits, granted against Norwegian taxes.

Mechanics for ensuring attributed income not taxed again on distribution

Dividend distributions derived from profits assessed according to the CFC rules are tax exempt when paid to a Norwegian corporate shareholder. When received by an individual, 72% of the dividends is taxable (this corresponds to the treatment of dividends distributed from a Norwegian corporation to Norwegian non-corporate shareholders).

Supplementary rules to catch investment in entities not caught by CFC rules

The CFC rules also apply to other legal entities that are not transparent from a Norwegian perspective, but where Norwegian tax residents still control the entity (family trusts, etc.).

There is no general anti-avoidance provision, but a doctrine has developed under which a transaction may be disregarded for tax purposes if the transaction has no, or only minor, consequences other than the reduction of tax, and the result of respecting the transaction would be contrary to the basic policy of the tax provision in question.

Exemptions

A foreign corporation will not be considered a CFC if Norway has entered into a tax treaty with the relevant country and the income is not mainly of a passive nature. With respect to foreign corporations resident within the EEA, an additional exemption exists insofar as the foreign corporation has an "actual establishment" and carries on "real economic activities" in the jurisdiction in which it is resident.

Tax treatment on sale of CFC

A gain on the sale of shares is, as a rule, taxable as the difference between the sales proceeds and the tax base. The tax base for corporate shareholders is the cost adjusted (increased) for income assessed (including as a rule income that is exempt according to Norwegian tax law) and (reduced for) dividends distributed during the shareholder's ownership period. A corporate shareholder is not entitled to a loss deduction on the sale of shares in a corporation resident within the EEA even if a gain is taxable.

The step up for retained tax profits adjustments do not apply to shareholders that are individuals.

Other features of CFC regime

None

Proposed changes

None

Portugal

General

The CFC rules are found in article 66 of the Corporate Income Tax Code.

Under Portugal's CFC regime, corporate profits (whether or not distributed) of a nonresident company that is subject to a more favorable tax regime may be attributed to Portuguese-resident corporate shareholders having a substantial interest in the nonresident. Such shareholders will be taxed on their proportionate share of their holdings in the nonresident company.

The CFC rules also may apply to individual resident shareholders.

When applicable

The CFC rules apply if a Portuguese resident has a substantial interest in a company subject to a more favorable tax regime. The rules are triggered where a Portuguese resident holds directly or indirectly, or through a nominee, 25% or more of the share capital, voting rights or rights to income or assets of a nonresident company; or 10% or more of the share capital, voting rights or rights to income or assets where more than 50% of the company's share capital or relevant rights is owned (directly or indirectly) by Portuguese resident shareholders. For purposes of calculating the interest in a controlled entity, the interest held by related parties also is taken into account.

A nonresident company is considered to be subject to a more favorable tax regime if:

- The company's income is not subject to tax in its country of residence that is similar or analogous to the Portuguese corporate income tax; or
- The tax effectively paid by the company is equal to or less than 60% of what the company would have paid had it been a Portuguese resident (for purposes of the comparison, income derived by a CFC is recalculated in accordance with Portuguese rules); or
- The company is resident in a jurisdiction included on a "black list" issued by the Portuguese Ministry of Finance.

All countries, including tax treaty partners, are potentially covered by the CFC rules (i.e. there is no white list under domestic law), respect to CFCs resident in EU or EEA member states with effect from 1 January 2012 (see under "Exemptions" below).

Black list countries include: American Samoa, Andorra, Anguilla, Antigua and Barbuda, Aruba, Ascension Island, Bahamas, Bahrain, Barbados, Belize, Bermuda, Bolivia, British Virgin Islands, Brunei, Cayman Islands, Channel Islands, Christmas Island, Cocos (Keeling) Islands, Cook Islands, Costa Rica, Djibouti, Dominica, Falkland Islands, Fiji, French Polynesia, Gambia, Gibraltar, Grenada, Guam, Guyana, Honduras, Hong Kong, Isle of Man, Jamaica, Jordan, Kiribati, Kuwait, Labuan, Lebanon, Liberia, Liechtenstein, Maldives, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue Island, Norfolk Island, Northern Mariana Islands, Oman, other Pacific Islands, Palau Islands, Panama, Pitcairn Island, Puerto Rico, Qatar, Qeshm Island, San Marino, Seychelles, Solomon Islands, St. Helena, St. Kitts and Nevis, St. Lucia, St. Pierre and Miquelon, St. Vincent and the Grenadines, Svalbard Islands, Swaziland, Tokelau Island, Tonga, Trinidad and Tobago, Tristan da Cunha, Turks & Caicos Islands, Tuvalu, United Arab Emirates, Uruguay, U.S. Virgin Islands, Vanuatu, Western Samoa and Yemen.

Type of income attributable and when included

All income received from a CFC is subject to corporate income tax at the level of the Portuguese shareholder. The only exception may be capital gains derived on the disposal of a CFC, where, in certain circumstances, the Portuguese shareholder may benefit from an exemption.

The Portuguese resident must include in its taxable income the after-tax profits of a CFC (i.e. profits derived by the CFC after deducting income tax paid by the CFC in its country of residence, if any) in proportion to its interest in the entity. The attributable CFC profits are those reported by the CFC in accordance with the applicable legislation in its country of residence. There is no requirement to compute such profits under Portugal's rules. The attributed profits are subject to tax at the standard income tax rate of 25%. A state surcharge of 3% is levied on taxable profits over EUR 1.5 million up to EUR 10 million, and 5% on the part exceeding EUR 10 million. A municipal surcharge is levied on taxable profits at rates up to 1.5% (depending on the municipality), resulting in a maximum possible aggregate tax rate of 29.5%-31.5%.

The CFC's profits are included in the tax year (of the Portuguese resident shareholder) that covers the end of a given tax period for the CFC company.

Credit for foreign taxes

No credit is granted for underlying income tax paid by the CFC, but only after-tax profits are attributed if income tax was paid by the entity. However, the Portuguese resident shareholder may credit any foreign taxes levied on dividends paid by the CFC up to the amount of its Portuguese income tax liability. The amount of the credit is limited to the lower of the foreign tax paid on the dividends received or Portuguese income tax payable on the dividends. In the latter case, the maximum amount that may be credited is the Portuguese income tax amount computed in the year the profits were attributed.

Any excess credit resulting from an insufficient amount of tax payable in the year of distribution may be not carried forward.

Mechanics for ensuring attributed income not taxed again on distribution

The amount of profits attributed to a Portuguese resident shareholder in a particular tax period may be set off against any effective (i.e. actually paid) dividends subsequently paid out of those profits, up to the amount of dividends received.

Supplementary rules to catch investment in entities not caught by CFC rules

While there are no supplementary rules, the Portuguese CFC rules are targeted at nonresident "companies" which, in addition to companies with limited liability, may include partnerships, limited partnerships and similar types of entities.

Exemptions

There is no attribution of profits if the nonresident company meets the following requirements:

- At least 75% of its profits are derived from farming or manufacturing/industrial activities carried on in its state of residence, or from the undertaking of commercial activities directed mainly to the local market or not involving Portuguese residents; and

- Its main activity is not banking, financing, insurance related to assets or persons situated or resident outside its residence state, holding activities (of shares, other securities, intellectual property, etc.) or the leasing of assets (except for immovable property located in its state of residence).

In addition, the CFC regime is not applicable where the CFC is resident in an EU member state, or EEA member state with whom an agreement for administrative cooperation in tax matters equivalent to that established for the EU has been concluded, provided the taxpayer demonstrates the economic reasons underlying the interest held and that the controlled company carries on agricultural, commercial or industrial activities or renders services.

Tax treatment on sale of CFC

Capital gains on the sale of a CFC are subject to tax under general rules, at the general rates. Portuguese legislation does not provide for any unfavorable tax consequences resulting from the disposal of holdings in a CFC per se. Therefore, such disposals may potentially qualify for the reinvestment relief (where only 50% of the gain is taxed) or exemption in the hands of a Portuguese holding company (SGPS), provided all relevant conditions are satisfied.

Capital losses on the sale of shares (including shares in a CFC) are not deductible or only deductible at 50%, depending on certain conditions (e.g. the legal status of the seller, holding period, the acquirer, etc.).

Other features of CFC regime

When a Portuguese shareholder is subject to a special tax regime, CFC profits are attributed, irrespective of the shareholding criterion, to entities resident in Portugal (if any) that are in the immediate upper tier of the corporate structure and that are subject to the general tax regime.

Proposed changes

None

South Africa

General

The CFC legislation is contained in section 9D of the South African Income Tax Act.

Under the rules, a South African resident must include in income a proportionate amount of the net income (including capital gains) earned by a CFC. The proportionate income of the CFC to the participation rights held by the resident will be included in the South African resident's income where the participation or voting rights of the resident are 10% or more.

When applicable

South African residents must include in income a proportionate amount of the net income (including capital gains) earned by a CFC. A CFC is a foreign company where South African residents hold, directly or indirectly, more than 50% of the total participation rights, or more than 50% of the voting rights, in the foreign company.

With effect from 1 January 2012, a foreign company is, for CFC determination purposes, defined to include a "protected cell company," a cell or segregated account referred to in the definition of a protected cell company and a foreign company.

A protected cell company is, in turn, defined as a foreign incorporated, formed or established entity whose principal trading activities are that of an insurer which, under the laws of that foreign jurisdiction, is allowed to segregate its assets into independent cells or segregated accounts; link specified assets and liabilities to those cells or segregated accounts or separate participation rights in respect of each such cell or segregated account, irrespective of whether the formation of the cell or segregated account creates a separate legal distinct person from that entity.

"Participation rights" are defined as the right to participate in all or part of the benefits of the rights (other than voting rights) attaching to a share, or any interest of a similar nature, in that company. Where no person holds such rights, the right to exercise voting rights in the foreign company will qualify as participation rights.

South Africa does not have a white or black list of countries.

Type of income attributable and when included

All income is attributable under the CFC rules (unless a specific exemption applies). Where the South African resident holds 10% or more of the participation rights in a CFC, the proportionate amount of the net

income of the CFC for the foreign tax year must be included in the South African resident's income in the ratio of the resident's participation rights to the total participation rights. The CFC's taxable income is determined as if the CFC is a South African taxpayer.

Where a CFC's year of assessment ends during the resident's year of assessment, the resident must include the CFC's net income for that financial year of the CFC in its income.

Credit for foreign taxes

Where all or a portion of income derived by a CFC is attributed to a resident of South Africa, a rebate for the foreign taxes paid on the proportionate amount attributed is granted against the South African tax payable.

Mechanics for ensuring attributed income not taxed again on distribution

Dividends paid out of profits of a CFC are exempt if the profits of the CFC have been included in the South African shareholder's income in terms of the CFC provisions.

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

Subject to restrictions and exceptions, an exemption is provided where the net income, including capital gains, of the CFC is attributable to a foreign business establishment (FBE) in a foreign country, provided the FBE effectively operates at arm's length. An FBE includes a place of business with an office, shop, factory, warehouse or other structure, that is used or will continue to be used by the CFC for at least one year, where the business of the CFC is carried on, and such place of business is suitably equipped and staffed with onsite managerial and operational employees of that CFC who render services for purposes of conducting the primary operations of the CFC. A CFC is permitted to take into account structures, employees, equipment and facilities of another company if:

- Those items are located in the same foreign country as the fixed place of business of the CFC;
- The other CFC is subject to tax in the same country; and
- The other CFC is part of the same group of companies (as defined).

In addition to the above, an FBE includes the following outside South Africa:

- Prospecting, exploration or mining operations;
- Construction projects lasting six months or more;
- Agricultural land used for bona fide farming activities; or
- Vessel, vehicle, rolling stock or aircraft used for transportation, fishing, prospecting, exploration for natural resources or mining or production of natural resources.

An exemption also may apply where the CFC has an FBE whose passive income arises from the principal trading activities of banking or financial services, insurance or rental business, provided the CFC is not a "foreign financial instrument holding company," or the amounts are not derived from certain South African residents.

Where a CFC has an FBE, exemptions are available with respect to capital gains/losses arising from the disposal, or deemed disposal, of any intangible asset (other than an intangible asset created, devised or developed in South Africa) that was an integral part of a business conducted by the CFC and was disposed of as part of the disposal of the business as a going concern.

The 75% tax payable exemption provides that, regardless of whether a CFC has an FBE in its country of residence, its income will not be imputed to its South African parent where the aggregate amount of tax payable by the CFC is at least 75% of the amount of normal tax the CFC would have paid on its taxable income had the CFC been a South African resident.

Other exemptions include:

- Where the net income of the CFC forms part of income that is already subject to tax in South Africa;
- Interest, royalties and rental income payable to a CFC by another CFC and exchange differences arising on exchange items entered into between such parties, where the entities are part of the same group of companies (a deduction for this type of inter-CFC expenditure, however, is disallowed under the CFC rules); and
- Capital gains, to the extent the asset disposed of (subject to exclusions) is attributable to a foreign business establishment of another CFC that forms part of the same group of companies as the CFC.

Tax treatment on sale of CFC

Income from the sale of a CFC is calculated according to South African tax principles and, where no exemption exists, is included in the South African parent company's income for South African tax purposes. Where an entity ceases to be a CFC, it will be deemed, for South African capital gains purposes, to have disposed of its assets at market value and immediately to have reacquired them.

Other features of CFC regime

None

Proposed changes

With effect from 1 April 2012, the current diversionary income exceptions to the FBE exemption are to be replaced with new ones.

Spain

General

Spain's CFC rules are principally set out in article 107 of the Corporate Income Tax Law (CITL) and article 91 of the Personal Income Tax Law (PITL).

Under these rules, entities and individuals that are tax resident in Spain are required to include in their corporate or personal income tax base certain types of income obtained by foreign entities classified as CFCs.

When applicable

The CFC rules apply when a Spanish taxpayer has a shareholding in a foreign entity that is classified as a CFC, and the CFC obtains certain types of income. An entity is deemed to be a CFC where:

- It is a nonresident entity (however, the CFC rules are not applicable to EU residents if the taxpayer can show that the CFC has valid economic reasons and engages in active business activities);
- The Spanish taxpayer, alone or with related parties, holds a direct or indirect participation of 50% or more in the capital, equity, results (profits) or voting rights; and
- The foreign tax paid by the nonresident entity on income subject to the Spanish CFC rules is less than 75% of the tax calculated in accordance with Spanish tax rules.

Spain does not have a white or black list of countries.

Type of income attributable and when included

Only specific categories of income are subject to the Spanish CFC rules (in general, passive income):

- Income derived from the ownership of real property, unless such income derives from the performance of activities that qualify as business activities for Spanish tax purposes;
- Dividend income;
- Capital gains derived from real property and shareholdings;
- Income derived from the lending of capital;
- Income derived from the provision of services and from insurance and financial activities; and
- Other (residual).

When the CFC rules apply, the attribution is made on the basis of the percentage of the Spanish resident's participation in the CFC. The income is attributed in the fiscal period of the Spanish taxpayer that includes the day in which the commercial year of the CFC ends. Alternatively, the Spanish taxpayer can make an election to attribute the income obtained by the CFC in the following fiscal period of the taxpayer.

Credit for foreign taxes

Dividends paid out of income that already has been attributed under the CFC rules are not subject to Spanish corporate/personal income tax. The following amounts may be credited for Spanish corporate income tax purposes:

- Foreign income tax effectively paid by the CFC and/or its subsidiaries on income subject to attribution (not available for individuals); and
- Foreign withholding tax deducted on dividends paid out of profits previously subject to attribution.

The credit is limited to the amount of the Spanish corporate income tax liability corresponding to the income subject to attribution. Taxes paid in tax havens may not be credited.

Mechanics for ensuring attributed income not taxed again on distribution

Dividend distributions made by a CFC to a Spanish taxpayer are exempt from corporate/personal income tax to the extent the distributed profits already were taxed at the level of the Spanish taxpayer as a result of the CFC rules.

Supplementary rules to catch investment in entities not caught by CFC rules

General anti-abuse provisions and "piercing the corporate veil" doctrine apply.

Exemptions

CFC income will not be attributed to a Spanish resident shareholder in the following cases:

- Income derived by real property owned by the CFC, dividends and capital gains from shareholdings where: (1) the CFC holds directly or indirectly at least 5% of another nonresident company; and (2) the CFC engages directly in the management and administration of that entity; and (3) at least 85% of the income of the nonresident entity is derived from an active business.

- Income from the provision of services and insurance and financial activities where: (1) both the supplier/lender and the recipient/borrower belong to the same corporate group as defined in article 42 of the Spanish Commercial Code; and (2) at least 85% of the recipient/borrower's income is derived from an active business; and (3) the recipient/borrower is not a Spanish resident company related to the lender in which such income gives rise to tax-deductible expenses.
- Under the de minimis rule, where the total income subject to the CFC rules (other than income from the provision of services and insurance and financial activities) is less than 15% of the profits of the CFC or less than 4% of the income of the CFC.
- Income derived by CFCs that are tax resident in the EU is not subject to attribution provided the taxpayer can demonstrate that the CFC was set up for valid economic reasons and is engaged in business activities.

Tax treatment on sale of CFC

The tax basis of the shareholding in the CFC is increased in an amount equal to that of the income included in the corporate/personal income tax base under the CFC rules, except where such income has already been distributed by the CFC to the corporate/individual taxpayer.

Other features of CFC regime

- Income of the CFC subject to attribution is quantified under the Spanish corporate income tax rules.
- Losses may not be attributed.
- There is a presumption that income is CFC income, that such CFC income is equal to 15% of the acquisition value of the shareholding and that the foreign tax paid on said CFC income is less than 75% of the tax calculated in accordance with Spanish corporate income tax rules where the CFC is resident in a tax haven.

Proposed changes

None

Sweden

General

Sweden's CFC rules are found in chapter 39a of the Swedish Income Tax Act.

A Swedish resident company (or individual) or a nonresident with a PE in Sweden that holds an interest in certain foreign legal entities is subject to taxation on a continuous basis on its proportionate share of the foreign legal entity's profits if the foreign entity is not taxed or if it is subject to taxation at a rate lower than 14.5% (i.e. 55% of the Swedish tax rate of 26.3%). The CFC regime stipulates a participating interest threshold and a white list applies.

As from 1 January 2008, a shareholder (taxpayer) in a foreign legal person within the EEA that is treated as a CFC is exempt from CFC taxation on income derived from the CFC if the taxpayer can demonstrate that the foreign legal person is actually established in its home state and carries on genuine economic activities.

When applicable

Sweden has a white list comprised of five continents (Africa, America, Asia, Europe and Oceania) that includes countries on the relevant continent (although not every country). Shareholders in a CFC established in one of the countries on the list may be exempt from CFC taxation. However, certain types of income may nevertheless be subject to CFC taxation even if a CFC is established in a country on the white list.

Type of income attributable and when included

Under the CFC rules, a shareholder that holds an interest in a CFC is subject to taxation on a continuous basis on its proportionate share of the foreign legal entity's profits. As a main rule, the CFC legislation applies to all income. However, income from "genuine economic activities" within the EEA may be excluded. The rules on Swedish limited liability companies also apply to foreign legal persons with the exception that a foreign legal person is not considered subject to tax in Sweden. Accordingly, income will be deemed to be taxable income during the tax year that should have been applied if the foreign legal person would have been subject to tax in Sweden.

Credit for foreign taxes

There are special rules on foreign tax credits for low taxed income. Foreign tax paid on income covered by the CFC rules may be credited against the Swedish

tax on the same profits, but the credit is limited to the amount of Swedish tax payable on the foreign-source income.

Mechanics for ensuring attributed income not taxed again on distribution

A shareholder subject to tax under the CFC rules is not taxed upon a subsequent dividend distribution by the CFC provided the shareholder already paid tax on such CFC income.

Supplementary rules to catch investment in entities not caught by CFC rules

Under the Tax Avoidance Act, a transaction may be disregarded if it produces a substantial tax benefit, the tax benefit is seen as the predominant reason for the transaction and an assessment based on the transaction would be contrary to the purpose of the legislation.

Exemptions

In addition to the white list, shareholders in a CFC may be exempt from CFC taxation provided the following requirements are met: the foreign legal person is resident within the EEA and the foreign legal person is actually established in its home state and carries on genuine economic activities there.

Tax treatment on sale of CFC

Capital gains income from the sale of a CFC is tax exempt under the Swedish participation exemption provided the relevant conditions are satisfied. If the participation exemption rules do not apply, capital gains derived from the sale of a CFC constitute taxable income.

Other features of CFC regime

None

Proposed changes

In 2010, the Swedish Tax Agency suggested updating the white list exceptions. While the Agency has no legislative power, the suggestions have been submitted to the Ministry of Finance for further consideration. Specifically, the Agency wants low taxed income derived from the granting of patents, licenses, trademarks and other similar rights from certain countries on the list (including Cyprus, Belgium, Estonia, Ireland, Luxembourg, the Netherlands and Switzerland) to be subject to CFC taxation.

The Agency also is targeting white-list exceptions related to financial and insurance businesses in certain countries on intercompany financing and intercompany insurance business if the foreign entity is resident within the EEA. The Agency suggests that the intercompany restriction be abolished. This would

mean that external financing and insurance business carried on by a foreign entity resident within the EEA could be covered by the CFC rules should the foreign entity not actually be established in its home state or carry on genuine economic activities there.

Turkey

General

Turkey's CFC rules are found in article 7 of the Corporate Tax Law.

When applicable

The CFC rules are triggered where a Turkish resident company controls, directly or indirectly, at least 50% of the share capital, dividends or voting power of a foreign entity and:

- 25% or more of the gross income of the CFC is comprised of passive income;
- The CFC is subject to an effective tax rate of lower than 10% in its country of residence; and
- The annual total gross revenue of the CFC exceeds the foreign currency equivalent of TRY 100,000.

If these requirements are met, the profits of the CFC are included in the profits of the Turkish company in proportion to the Turkish company's share in the capital of the CFC, regardless of whether the profits are distributed, and will be taxed currently at the 20% corporation tax rate.

The government intends to issue a black list in connection with the harmful tax competition initiative.

Type of income attributable and when included

Passive income, such as dividends, interest, rents, license fees or gains from the sale of securities that are outside the scope of commercial, agricultural or professional income, is attributed under the CFC regime.

The attributed income must be included in taxable income as of the month of the close of the accounting period of the foreign subsidiary.

Credit for foreign taxes

A tax credit is available for taxes paid on the income in the country of the CFC. A tax credit is not allowed for taxes paid in jurisdictions other than the jurisdiction where the CFC is located.

Mechanics for ensuring attributed income not taxed again on distribution

Income attributed and taxed under the CFC rules will not be further taxed at the time it is distributed to shareholders in Turkey.

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

None

Tax treatment on sale of CFC

Capital gains derived from the sale of foreign participations that have been held for at least two years (730 days) by an international holding company in the form of a Turkish resident joint stock company are exempt from corporate tax. To qualify as an international holding company, the following requirements must be met:

- At least 75% of the total assets (excluding cash items) must comprise foreign participations for a continuous period of at least one year;
- The Turkish company must hold at least 10% of the capital of each foreign participation; and
- The foreign participation must have the characteristics of a corporation or limited liability company.

Alternatively, a corporate tax exemption is granted for 75% of the capital gains derived from the sale of participation shares that have been held for at least two years provided such gains are kept in a special reserve account under "shareholders' equity" and the sales proceeds are collected by the end of the second calendar year following the year of sale.

If the above conditions are not satisfied, capital gains derived from the sale of a CFC will be included in the profits of the Turkish company and taxed currently at the corporate tax rate of 20%.

Other features of CFC regime

None

Proposed changes

None

United Kingdom

General

The main CFC rules are contained in Chapter 4 of Part 17 of the U.K. Income and Corporation Taxes Act 1988 (ICTA), with the legislation having been amended several times in recent years. The most recent changes to the legislation were enacted on 19 July 2011 as part of the Finance Act 2011.

Further, draft legislation was published in December 2011 outlining substantial reform of the CFC rules for inclusion in Finance Bill 2012. These proposed changes are outlined at the end of this section.

Broadly, if an overseas entity controlled from the U.K. meets the definition of a CFC, its profits are apportioned to the U.K. company (or companies) that controls it in proportion to its interest. Where the aggregate amount of the profits apportioned to the U.K. company, and any connected persons, is at least 25% of the total chargeable profits, they are assessed to U.K. corporation tax.

When applicable

The CFC rules broadly apply if the overseas company is:

- Resident outside the U.K.;
- Controlled from the U.K. (a foreign company generally is "controlled" if U.K. shareholders are able to secure that the company's affairs are conducted in accordance with their wishes; there are, however, special joint venture provisions and anti-avoidance legislation designed to prevent the circumvention of the control rules); and
- Subject to a lower level of tax in the country where it is resident (i.e. if the overseas entity has paid tax of less than 75% of the tax that it would have paid had it been U.K. tax resident).

The U.K. has a published list of "excluded countries," which is updated on an ongoing basis.

Type of income attributable and when included

If none of the exemptions are applicable, the CFC rules will apply to the income/profits of the overseas entity, but not to capital gains. The income/profits of the CFC are recomputed under U.K. tax principles as if the entity were U.K. tax resident and the profits are apportioned to the U.K. entity/entities based on their interest in that overseas entity.

The assessment of whether overseas entities controlled from the U.K. are CFCs as defined for U.K. tax purposes must be performed for each accounting

period and any profit apportionment reported on the relevant U.K. entity's corporation tax return.

Credit for foreign taxes

Where no exemption is available and CFC profits are apportioned to the U.K., the U.K. corporation tax due is reduced by any apportioned "creditable tax." The creditable tax is the aggregate of double tax relief that would be available if the CFC's chargeable profits were liable to U.K. corporation tax (e.g. corporate income tax suffered in the CFC's country), U.K. income tax deducted at source from payments (e.g. interest) received by the CFC and any U.K. income or corporation tax actually charged in respect of the chargeable profits of the CFC (e.g. if the CFC has a U.K. branch or agency).

Mechanics for ensuring attributed income not taxed again on distribution

The U.K. introduced an exemption regime for dividends received on or after 1 July 2009. This exemption applies where the dividend falls in one, or more, of five defined classes. It is likely that most dividends received on or after 1 July 2009 from a CFC by a U.K. entity will be exempt from U.K. corporation tax. However, for distributions made before 1 July 2009, or if the dividend participation exemption does not apply, overseas dividends paid from a CFC to the U.K. are subject to U.K. corporation tax with credit available for overseas tax suffered. To the extent overseas profits previously have been apportioned and taxed under the U.K. CFC rules, credit should be available to further mitigate the U.K. tax payable on the distribution. The calculation mechanism is relatively complex, so each case should be reviewed individually.

Supplementary rules to catch investment in entities not caught by CFC rules

To the extent profits are earned in an entity the U.K. considers to be transparent, those profits would be considered to be the profits of the partners/members of that entity and subject to U.K. tax/CFC assessment in the same way as profits earned directly by the partners/members.

Exemptions

Even if an overseas entity satisfies the definition of a CFC, its profits will not be subject to attribution to the U.K. if any of the following exemptions are satisfied:

De minimis profits: The adjusted accounting profits of the CFC for the accounting period do not exceed GBP 200,000 or the chargeable profits do not exceed GBP 50,000. For accounting periods beginning before 1

January 2011, the limit was only by reference to chargeable profits of less than GBP 50,000. These limits are reduced to a proportionately smaller amount if the accounting period is less than 12 months;

- *Exempt activities:* The stated purpose of the exempt activities test is to exclude from the CFC rules companies that, because of the nature of the activities in their territories of residence, can reasonably be assumed not to be used for reducing U.K. tax. The exclusion covers a wide range of trading activities and certain types of holding company. The conditions, however, are strict and include a residence requirement; or
- *Excluded countries:* Subject to meeting certain conditions, if a company is resident in a territory included on a published list of “excluded countries,” a CFC apportionment is not made. A key additional condition needed to satisfy the “excluded countries” test is that the entity must have at least 90% of its income arising from “local sources.” The excluded countries list (as maintained on the HRMC web site) consists of specified territories and specified territories with qualifications (see above).

A number of interim changes were announced effective for periods beginning on or after 1 January 2011. The additional exemptions from that date are:

- *Trading companies with a limited U.K. connection:* An exemption applies where there is little intragroup trading with the U.K. and, therefore, it is unlikely that U.K. profits are being artificially diverted;
- *Companies exploiting IP with limited U.K. connection:* An exemption applies for CFCs whose main business is IP exploitation and the IP and the CFC have minimal connection to the U.K.; and
- *Temporarily exempt:* An exemption applies for up to three years where foreign subsidiaries fall within the scope of the CFC regime for the first time as a result of a change in ownership or reorganization.

Where none of the above exceptions are satisfied, there is a “motive” exception. This applies where it is possible to demonstrate that the transactions taking place in the overseas country do not achieve a reduction in U.K. tax that is more than minimal or the main purpose of the transactions was not to reduce U.K. tax and one of the main reasons for the company’s existence was not to achieve a reduction in U.K. tax by a diversion of profits from the U.K. This is a subjective test, but clearance can be sought from

the U.K. tax authorities. In practice, it is often difficult to obtain a positive clearance that this exemption should apply.

In addition to the above exemptions, where there are individuals carrying out “genuine economic activities” in an overseas EEA jurisdiction, the “net economic value” that is attributable to those activities can be claimed as a reduction against any apportionable profits.

Tax treatment on sale of CFC

The sale of shares in a CFC is a capital gains event in the U.K. Provided certain holding and trading conditions are satisfied, the substantial shareholdings exemption (SSE) may exempt any gain/loss on a disposal of shares in a CFC from U.K. corporation tax. If the SSE does not apply, any gain on disposal of shares by a U.K. company is subject to U.K. corporation tax. In calculating the gain on disposal, a deduction may be available for the appropriate proportion of any tax assessed on the company in respect of the CFC’s apportioned chargeable profits. The calculation mechanism for this deduction is complex, so each case should be reviewed individually.

Other features of CFC regime

None

Proposed changes

Major changes are being made to the current U.K. CFC rules as part of the drive to improve the competitiveness of the overall U.K. tax regime. It is expected that the new rules will have effect for accounting periods beginning on or after the date of Royal Assent to Finance Bill 2012, but this is subject to further consultation.

Overview

The CFC proposals are, for the first time, based on the principle that overseas activities are not taxed in the U.K. unless there is an artificial reduction of the U.K. tax base. Additionally, where a CFC charge applies, it will be proportionate, targeting only profits that have been artificially diverted from the U.K. rather than being “all or nothing.”

The draft legislation includes a “gateway” that will specifically identify circumstances in which there has been an artificial diversion of U.K. profits. Those circumstances will broadly be where there is a significant mismatch between key business activities

undertaken in the U.K. and the profits arising from those activities that are allocated outside the U.K. Groups do not need to consider the gateway, but can go straight to an exemption if that is more straightforward.

There will be a partial exemption available for finance companies that will exempt three-quarters of their finance profits. The possibility of a full exemption for finance companies is still under consultation.

The new CFC regime will apply to both foreign subsidiaries and exempt foreign branches of U.K. companies.

Capital gains will continue to be excluded from the regime and this exclusion will be extended to include property income.

Operation of proposed CFC rules and exemptions

To determine whether a CFC charge applies, the approach set out in the draft legislation can be summarized as follows (but noting that if an entity level exemption is considered to apply then there is no need to complete the determination of chargeable profits):

1. Determine whether an entity level exemption applies to the CFC;
2. Determine the chargeable profits (this will include only certain categories of profits, as set out below);
3. Apportion the chargeable profits, and related creditable tax, amongst those persons who have relevant interests in the CFC.

The approach of only including certain categories of profits is referred to as the gateway. Broadly speaking, the intended effect should be to limit the in-scope profits to:

- Business profits attributable to activities in the U.K. that arise in a CFC through arrangements lacking any substantial non-tax value and that would not have been entered into by independent companies;
- Certain finance profits; and
- Certain captive insurance profits.

The basic concept of establishing the profits that are attributable to activities in the U.K. is relatively easy to understand; however, in many cases the application of the rules could require a detailed functional analysis. In these situations, the application of an entity level exemption could be more straightforward.

There will be a number of entity level exemptions available. Where a CFC satisfies an entity level exemption, no CFC charge will be imposed in relation to any of its profits. The exemptions will be:

- *Low profits exemption:* The adjusted accounting profits of the CFC for the accounting period do not exceed GBP 50,000, or do not exceed GBP 500,000 and the profits representing nontrading income do not exceed GBP 50,000. There is an alternative exemption that applies the same limits to assumed taxable total profits (i.e. on U.K. tax principles);
- *Low profit margin exemption:* This exemption will be available where a CFC's adjusted accounting profits do not exceed 10% of its relevant operating expenditure. Expenditure payable to a related person is excluded, which may limit the usefulness of this exemption;
- *Excluded territories exemption:* CFCs resident in specified territories (broadly intended to be those with a headline tax rate of more than 75% of the main U.K. corporation tax rate) will be exempt provided their income within certain categories does not exceed 10% of the company's adjusted pretax profits.
- *Tax exemption:* A CFC will be exempt if the local tax amount payable in relation to the CFC's profits in a territory of residence for an accounting period is at least 75% of the corresponding U.K. tax that would be payable (note this lower level of tax test used to be included in the definition of a CFC, but has now been moved to a specific exemption);

The draft legislation does not include any continuation of the current temporary period exemption, or an equivalent to the current motive test. However, the government has confirmed its intention to offer some kind of time limited exemption and this is under consideration.

United States

General

The CFC rules (“subpart F”) are contained in sections 951 through 965 (subpart F of part III of subchapter N of chapter 1 of subtitle A) of the U.S. Internal Revenue Code and regulations thereunder.

Subpart F limits deferral on certain types of income (“subpart F income”) earned by CFCs. “U.S. shareholders” of a CFC generally must include in gross income their pro rata shares of the CFC’s subpart F income for the year. Subpart F also cuts off deferral for accumulated profits of a CFC attributable to non-subpart F income to the extent that the CFC holds a “United States property” (e.g. debt obligations of its U.S. shareholder).

When applicable

Subpart F generally applies when a foreign corporation is a “controlled foreign corporation,” that is, where “U.S. shareholders” (U.S. persons each owning directly, indirectly or constructively, at least 10% of the voting stock of the foreign corporation) own more than 50% of the voting power or value of the foreign corporation. (The thresholds are reduced for certain purposes in the case of insurance companies.) The general subpart F rules apply to a CFC organized in any foreign country. Harsher rules apply to a small number of “sanctioned countries,” set apart for foreign policy (rather than tax) reasons. (The rules otherwise do not apply any type of white or black list.)

Type of income attributable and when included

Subject to various exceptions, the following categories of CFC income are currently taxed to U.S. shareholders:

- Certain types of insurance income;
- “Foreign base company income,” which covers certain dividends, interest, rents, royalties, gains and notional principal contract income; income from certain sales involving related parties; income from certain services performed outside the CFC’s country of incorporation, for or on behalf of related parties; and certain oil related income;
- Income connected with certain sanctioned countries;
- Income from operations in which there is cooperation or participation in an international boycott of Israel; and

- Illegal payments made to a foreign government or agent.

Subject to computational limitations and potential recapture provisions, the U.S. shareholder’s income inclusion for subpart F income generally occurs in the year in which the CFC earns the subpart F income.

Credit for foreign taxes

A foreign tax credit may be available to offset the U.S. shareholder’s income inclusion if the inclusion is foreign source income; the credit mechanism closely resembles the indirect credit available when actual dividends are paid.

Mechanics for ensuring attributed income not taxed again on distribution

Subpart F income becomes “previously taxed income.” Subsequent actual distributions of PTI are not taxed to the U.S. shareholder.

Supplementary rules to catch investment in entities not caught by CFC rules

Passive Foreign Investment Company rules impose an interest charge, or eliminate deferral, associated with income or gains from non-CFC foreign corporations with predominately passive assets or passive income.

Exemptions

There are no blanket exceptions from subpart F. The definition of “subpart F income,” however, has several exceptions related to particular classes or amounts of income, including de minimis amounts, certain highly taxed income, income in excess of annual earnings and profits, active rents and royalties, income earned by securities dealers, income earned from related parties in the CFC’s country of organization and income from some manufactured products. Certain income earned in the active conduct of banking, financing, insurance or securities dealing business, and qualifying dividend, interest, rent and royalty income from a related CFC that is non-passive under a look-through rule, are excluded from foreign base company income under a temporary provision applicable to CFC taxable years beginning before 2012.

Tax treatment on sale of CFC

Gain from the sale of CFC stock may be taxed as a dividend to the extent of the CFC’s previously untaxed earnings; the remaining gain will be taxed as gain from the sale of stock.

Other features of CFC regime

In addition to the substantive tax rules, the reporting and recordkeeping required under the CFC rules are extensive and are enforced with substantial penalties for noncompliance. Failure to satisfy CFC filing requirements on the Form 5471 and Form 926, where applicable, may result in the tax year remaining open for future adjustment under section 6501(c)(8).

Proposed changes

Numerous changes have been proposed. Some are taxpayer favorable proposals, e.g., an exemption of future active foreign income or a reduction of U.S. tax for repatriation of prior year's deferred earnings. Other proposals are not favorable, resulting in deferred deductions at the U.S. company level associated with a deferred earnings in CFCs. These proposals are discussed in the context of tax reform or revenue raising proposals.

Venezuela

General

Venezuela's CFC rules are in articles 101, ff of the Income Tax Law (ITL).

The CFC (or fiscal transparency regime) rules require Venezuelan taxpayers to submit a report of all investments carried out or maintained in low tax jurisdictions. In addition, the taxpayer must submit (along with its final income tax return) bank statements and other documents that evidence the investment in the low tax jurisdiction. Venezuelan residents deriving income from such investments will be taxed currently in proportion to their ownership in the low tax jurisdiction entity.

When applicable

The CFC rules apply where a Venezuelan taxpayer:

- Invests directly, indirectly or through an intermediary in branch offices, companies, movable or immovable property, shares, bank accounts or investment accounts; or
- Otherwise participates in an entity with or without legal personality, a trust, an association, an investment fund or other entity incorporated or existing under the laws of a low tax jurisdiction.

A low tax jurisdiction is one in which income is taxed at a rate lower than 20%.

Venezuela has a list of low tax jurisdictions: Albania, American Samoa, Andorra, Angola, Anguilla, Antigua and Barbuda, Aruba, Ascension Island, Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Brunei, Campione d'Italia, Canary Islands special zone, Cape Verde, Cayman Islands, Channel Islands, Christmas Island, Cocos (Keeling) Islands, Cook Islands, Cyprus, Djibouti, Dominica, Dominican Republic, Falkland Islands, French Polynesia, Gabon, Gibraltar, Greenland, Grenada, Guam, Guyana, Honduras, Hong Kong, Isle of Man, Jordan, Kiribati, Kuwait (but a tax treaty is in effect), Labuan (Malaysia) (but a tax treaty is in effect), Lebanon, Liberia, Liechtenstein, Luxembourg, Macao, Malta, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Niue, Norfolk Island, Oman, Ostrava special zone (Czech Republic), Pacific Islands, Panama, Palau, Pitcairn Island, Puerto Rico, Qatar, Qeshm Island, Samoa, San Marino, Seychelles, Solomon Islands, Sri Lanka, St. Helena, St. Pierre and Miquelon, St. Vincent and the Grenadines, Svalbard, Swaziland, Tokelau, Tristan da Cunha, Tunisia, Turks & Caicos Islands, Tuvalu, United Arab Emirates, Uruguay, U.S. Virgin Islands, Vanuatu and Yemen.

Type of income attributable and when included

Income derived from investments in a low tax jurisdiction will be deemed to be gross income or dividends, unless the taxpayer can prove otherwise. Such income must be reported in the tax year in which it is realized, in proportion to the Venezuelan taxpayer's participation in the investment and not previously taxed regardless of whether there has been an actual distribution.

Credit for foreign taxes

An ordinary foreign tax credit is available for tax paid in a low tax jurisdiction. However, the credit may not exceed the amount of tax attributable to the foreign income computed by applying the corporate income tax rate to the foreign net taxable income.

Mechanics for ensuring attributed income not taxed again on distribution

None

Supplementary rules to catch investment in entities not caught by CFC rules

None

Exemptions

The CFC rules will not apply if the Venezuelan taxpayer's income is derived from business income and at least 50% of the total assets are fixed assets used to carry on the business activities in the low tax jurisdiction (i.e. active income). However, the exemption will not apply if more than 20% of the total income derived from the investment in the low tax jurisdiction comes from dividends, interest, royalties or capital gains from the sale of movable or immovable property.

Tax treatment on sale of CFC

When a taxpayer alienates shares in an investment in a low tax jurisdiction, the profit or loss is determined in accordance with the provisions of the Income Tax Law.

When the taxpayer derives income from a liquidation or decrease of capital stock of legal persons, entities, trusts, associations, investment funds or other legal entity created or incorporated under the law of the low tax jurisdiction, the taxpayer is required to determine the foreign-source taxable income in accordance with the Income Tax Law.

Other features of CFC regime

- To determine the net income from an investment in a low tax jurisdiction, the taxpayer may attribute costs and expenses in accordance with its participation, provided the taxpayer keeps the corresponding accounting books and complies with the fiscal transparency reporting requirement.
- A bank account in a low tax jurisdiction is deemed to be a taxpayer's investment if it benefits or is the property of the taxpayer's spouse or a person who lives with the taxpayer, direct ancestors or

descendants, an agent or when any of the above persons act as the agent of the taxpayer or are authorized to sign or order transfers.

- Transfers made or ordered by a taxpayer to deposit, investment, savings or other similar accounts in a bank located in a low tax jurisdiction will be deemed to be a transfer made to accounts of the taxpayer, unless proven otherwise.

Proposed changes

None

Alternate or No CFC Regime

Of the remaining jurisdictions surveyed, four use an alternate method to capture certain offshore income in low tax jurisdictions. The jurisdictions with alternate methods are summarized below, followed by a list of the countries surveyed with no CFC or notable alternate regime.

Austria

Austria does not have CFC (anti-deferral) legislation in its technical meaning, although section 10(4)-(6) of the Corporate Income Tax Act includes a special anti-abuse rule relating to the participation exemption.

Under section 10(4), which applies to qualified dividends (a continuous shareholding of at least 10% held for at least one year), the credit method rather than the participation exemption will apply to income from qualified foreign equity investments if certain criteria are met that point to tax avoidance (“switch over” provision). This would be the case if the foreign corporation primarily generates passive income (i.e. from interest, licensing and capital gains) and the income of the foreign corporation is not subject to a foreign tax comparable to the Austrian corporate income tax with respect to the taxable base and tax rate (the subsidiary must be subject to an average corporate income tax burden of at least 15%).

Under section 10(5), which applies to portfolio dividends from EU and non-EU countries that have concluded a comprehensive administrative assistance agreement with Austria, the switch-over provision will apply to income from foreign equity investments if the income of the foreign corporation is not subject to a foreign tax comparable to the Austrian corporate income tax with respect to the taxable base and tax rate (the subsidiary must be subject to an average corporate income tax burden of at least 15%), if the foreign nominal corporate income tax rate that applies is below 15%, if the foreign corporation is subject to a full personal or corporate tax exemption in the foreign state (although a participation exemption in the foreign state is harmless). In such cases, income from the equity investment is not exempt from Austrian corporate income tax, but the foreign corporate income tax (not withholding tax, unless creditable under a tax treaty) may be credited against the Austrian corporate income tax (upon application (section 10(6))). The foreign corporate income tax must be credited, rather than the foreign withholding tax, which might be creditable under a tax treaty. Foreign corporate income tax that is not creditable in a tax year may be carried forward.

The European Court of Justice ruled on 10 February 2011 in the *Haribo/Salinen* cases that the “switch over” clause is, in principle, in line with the fundamental freedoms in the Treaty on the Functioning of the European Union.

Section 10(4) and 10(5) do not apply to the shifting of income to the base company, but prohibit the tax-free repatriation of the shifted profits. Therefore, the provision cannot prevent taxpayers from retaining profits on a tax-free basis abroad or utilizing the profits for purposes that do not require repatriation. However, certain substance requirements must be met cumulatively (own premises, personnel, infrastructure, business activity); otherwise, the company may be disregarded for tax purposes.

Greece

Greece has “quasi-CFC rules” for transparent entities situated in another EU member state. Under these rules, where an EU-based subsidiary of a Greek entity is considered transparent (i.e. the profits are taxed at the level of the partner or shareholder and not at the level of the entity), the profits of the subsidiary are added to the gross profits of the Greek parent and taxed accordingly. An actual distribution of profits does not need to take place, but the profits of the EU transparent subsidiary are added to the taxable profits of the Greek parent at year end. There are rumors that CFC legislation may be introduced.

Latvia

Although Latvia does not have CFC legislation, payments made by residents to entities or individuals registered or domiciled in low or no tax countries and territories included on the government’s black list are subject to a special withholding tax of 15%. The tax authorities may exempt payments from the tax if certain conditions are satisfied. The applicable rules are found in the Law On Personal Income Tax (article 17.17) and the Law On Corporate Income Tax (article 3.8).

Loan repayments or payments for goods produced in black list countries are exempt from withholding tax. However, to benefit from the exemption, advance permission must be obtained from the tax authorities

The following jurisdictions are on Latvia’s black list: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Brunei Darussalam, Cayman Islands, Cook Islands, Costa Rica, Dominican Republic, Djibouti, Ecuador, Gibraltar, Guernsey,

Grenada, Guam, Guatemala, Hong Kong, Isle of Man, Jamaica, Jersey, Jordan, Kenya, Kuwait, Labuan, Lebanon, Liberia, Liechtenstein, Macao, Maldives, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, New Caledonia, Niue, Olderne, Panama, Qatar, Samoa, San Marino, Santome and Prinsipi, Seyssel, St. Pierre and Miquelon, St. Kitts and Nevis, St. Luis, St. Vincent and Grenadines, St. Helena, Tahiti, Tonga, Turks & Caicos, Tonga, United Arab Emirates, Uruguay, U.S. Virgin Islands, Vanuatu, Venezuela and Zanzibar.

anti-avoidance rules for low taxed portfolio investments. A "low taxed portfolio investment subsidiary" will exist if, cumulatively, (1) the subsidiary is held as a portfolio investment (this is typically only the case if the investment is (predominantly) held with the aim of giving a return that is comparable to genuine portfolio investment activities); (2) the assets of the subsidiary, as well as those of the (in)direct subsidiaries it owns (if any), on aggregate consist of more than 90% of low taxed passive assets; and (3) the direct subsidiary is not subject to a reasonable taxation on its profits (indicative threshold is a rate of 10%).

Netherlands

The Netherlands does not have a CFC regime. However, the participation exemption regime includes

No CFC Regime		
Belgium	Luxembourg	Saudi Arabia
Bulgaria	Malaysia	Singapore
Chile	Malta	Slovakia
Colombia	Mauritius	Slovenia
Cyprus	Nigeria	Switzerland
Czech Republic	Peru	Taiwan
Ecuador	Philippines	Thailand
Gibraltar	Poland	Ukraine
Hong Kong	Romania	Uruguay
India (proposed rules in Direct Tax Code)	Russia	Vietnam
Ireland		

Contacts

If you have any questions, please contact one of the tax professionals at a Deloitte office in your area, or Susan Lyons at slyons@deloitte.com.

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