

# THE INTERACTION BETWEEN CFC RULES AND QDMTT: A DUTCH PERSPECTIVE

*By Tim van Brederode, Institute of Tax Law and Economics, Leiden Law School, Leiden University, the Netherlands.*

## 1. INTRODUCTION

The introduction of anti-tax avoidance policy and the minimum tax in the EU appears to have significantly supported the international initiative of the Organization for Economic Collaboration and Development (OECD) addressing Base Erosion and Profit Shifting (BEPS). In December 2022, the Member States of the European Union adopted the Directive on a minimum level of

taxation for multinational enterprises. Consequently, as of December 31, 2023, most\*\* EU Member States have incorporated these rules into domestic laws, with immediate effect.<sup>1</sup> With the quick pace at which we are seeing implementation of the Directive, there is growing interest about the potential interactions between the new minimum-tax rules and existing corporate income tax provisions.

This paper explores one of those interactions in the context of the Netherlands. Most notably, the scenario in which a controlled foreign company (CFC) rule must be applied for corporate tax purposes in the Netherlands and the subsidiary entity applies a domestic top-up tax for minimum tax purposes that creates potential for economic double taxation. In discussing this interaction, I address the question of whether this economic double taxation is to be considered a tax policy issue.



In brief, a foreign subsidiary qualifies as a CFC for Dutch tax purposes if the entity is resident in a jurisdiction that:

- does not subject the entity to income taxes; or
- subjects the entity to tax at a statutory rate of less than 9%; or
- is listed on the EU tax list of non-cooperative jurisdictions.<sup>2</sup>



With regard to the final condition, being listed on the EU tax list of non-cooperative jurisdictions is a crucial factor for the application of the CFC rule in the subsequent year. As several Caribbean jurisdictions (along with other Small Island Developing States) currently appear on the EU tax list, the blacklisting of these jurisdictions holds significance for multinational enterprises operating locally, as its effects are widespread. The Bahamas serves as an exemplary case:

blacklisted by the EU, it is deemed as a CFC jurisdiction and it has implemented a Qualifying Domestic Minimum Top-up Tax (QDMTT) to be applied as of January 1st, 2024. The EU Code of Conduct Group (COCG), responsible for the listing criteria, is contemplating the inclusion of the global minimum tax implementation as a requirement for jurisdictions to comply with good tax governance. The potential interplay arises from the fact that being listed on the EU tax list not only necessitates the application of CFC rules in EU Member States but, notably, may also exert pressure on jurisdictions to align with EU minimum-tax rules, should such criteria be introduced. This dual impact underscores the intricate relationship between the EU tax list, CFC rules, and the potential future implications of minimum-tax criteria. If the new criteria comes to pass, it is conceivable that, in a few years, all Caribbean jurisdictions will have implemented (at least) QDMTTs.

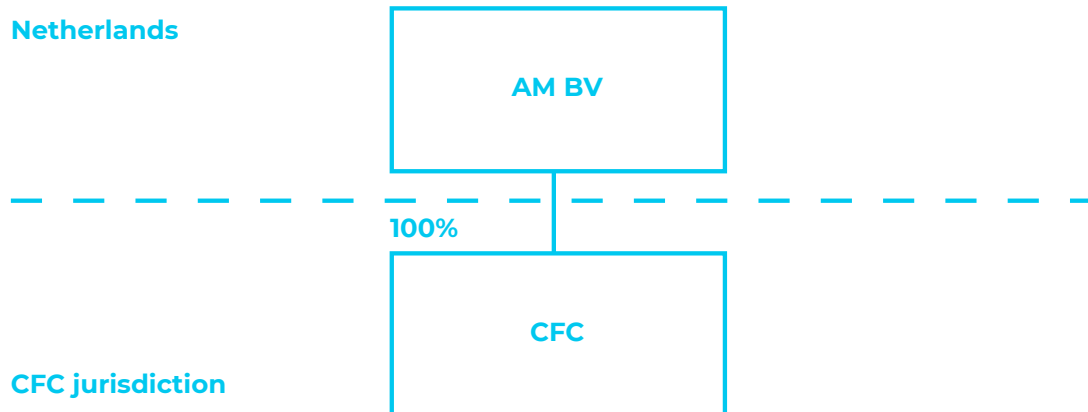
## 2. NAVIGATING COVERED TAXES

While the OECD's Global Minimum Tax was agreed upon in late 2021, the international actor's leading role in the ongoing coordination on the application of the rules is far from over. One particular method to clarify the interpretation of the rules and provide guidance to tax administrations is through Administrative Guidance, as published by the OECD in February 2023 ('Administrative Guidance').<sup>3</sup>

According to this OECD Administrative Guidance, the application of a CFC rule – including the corporate tax imposed on CFC income by the Netherlands – is not considered in calculating the effective tax rate in the CFC jurisdiction for the purpose of a QDMTT. Consequently, the corporate tax levied on the CFC income does not lead to a lower QDMTT in the CFC jurisdiction, resulting in economic double taxation.

The following case exemplifies the issue of double taxation. Company AM B.V. resides in the Netherlands and holds all shares in the CFC subsidiary (located in a jurisdiction without a corporate income tax in place).

According to Dutch CFC rules, CFC income is allocated to AM B.V. The CFC income consists of interest payments that amount to total profits of 100. The Dutch statutory tax rate of 25,8% applies to the CFC income as the latter is included in the corporate income tax base of AM B.V. in the Netherlands. Regarding the application of the QDMTT by the CFC jurisdiction, the amount of qualifying income for the purpose of the minimum tax is similar to the amount of the CFC income, as it follows the interest payments of 100 that are recorded in the financial accounts. Based on the Administrative Guidance explained earlier in this section, the taxes on the CFC income levied by the Netherlands cannot be taken into account as covered taxes in the CFC jurisdiction for the purpose of calculating the effective tax rate in the CFC jurisdiction. The absence of a corporate income tax system indicates the CFC is not subject to any tax. This would mean that the top-up tax percentage for the QDMTT is 15%. When combined with the tax on the CFC income in the Netherlands, the effective tax burden on the income of the CFC subsidiary amounts to 40,8%  $((25,8+15)/100)$ .





### 3. MATERIAL SCOPE: MINIMUM-TAX RULES VERSUS CFC RULES

As emphasized in the EU Directive aiming to establish a minimum level of taxation, the objective of these rules is to eliminate a significant portion of the benefits derived from shifting profits to jurisdictions with little or no taxation, and to allow jurisdictions to better protect their tax bases. Such profits are often situated in jurisdictions with either (A) no corporate income taxes or (B) very low effective rates. The minimum effective tax rate of 15% is envisioned to evolve into an international standard for corporate tax revenues, and this standard is founded on the OECD Model Rules and the Commentary accompanying them.<sup>4</sup>

Tax scholars have begun to point out that the characteristics of the Income Inclusion Rule (IIR) resemble those of the CFC rule but with a broader scope.<sup>5</sup> For anti-tax avoidance purposes, OECD-drafted CFC rules were imported into EU law through the Anti-Tax Avoidance Directive (ATAD).<sup>6</sup>

The ATAD mandated EU Member States to domestically tax CFC income as an inclusion in the corporate tax base.<sup>7</sup> The CFC income is taxed with the statutory rate, which is often higher than the effective tax rate. While the minimum-tax rules target low-taxed profits in a broad sense, the CFC rules specifically address the case of taxpayers with a controlling interest in a low-taxed foreign subsidiary. Without anti-abuse rules, the subsidiary could be used as the destination of shifted (passive) income to defer taxation.

The intentional nature of these similarities has allowed the OECD to ensure, through public consultations and academic input, that CFC rules and minimum-tax rules do not clash, preventing de facto double taxation.<sup>8</sup> In contrast to the application of the QDMTT, the taxes paid on CFC income by the parent entity should be allocated to the covered taxes of the entity deemed a CFC for the calculation of the IIR, thereby



increasing the effective tax rate. This ensures that the parent entity has already paid corporate tax on the CFC income, preventing the IIR from being applicable to the same income. In other words, although the operation of the IIR and CFC rules is similar, they can coexist because they have different policy objectives. However, the same safeguard does not apply to the QDMTT. The allocation of taxes paid is by exception to the principal rule not taken into account for the calculation of the effective tax rate. The mechanism of charging a QDMTT appeared in the OECD Model Rules at a late stage, effectively allowing

the primacy of a jurisdiction to tax its own taxpayers. The conditions of the QDMTT are akin to the IIR – i.e., the entity is not taxed at an effective tax rate of at least 15%.<sup>9</sup> Although much alike, the QDMTT exhibits different characteristics in the imposition of a minimum tax on low-taxed profits. The Administrative Guidance provided the first interpretation on the design and operation of a QDMTT, instead of the Model Rules. The amount of QDMTT charged depends on various domestic factors, inter alia, a jurisdiction's corporate tax system and the implementation choices of the global minimum tax.<sup>10</sup>

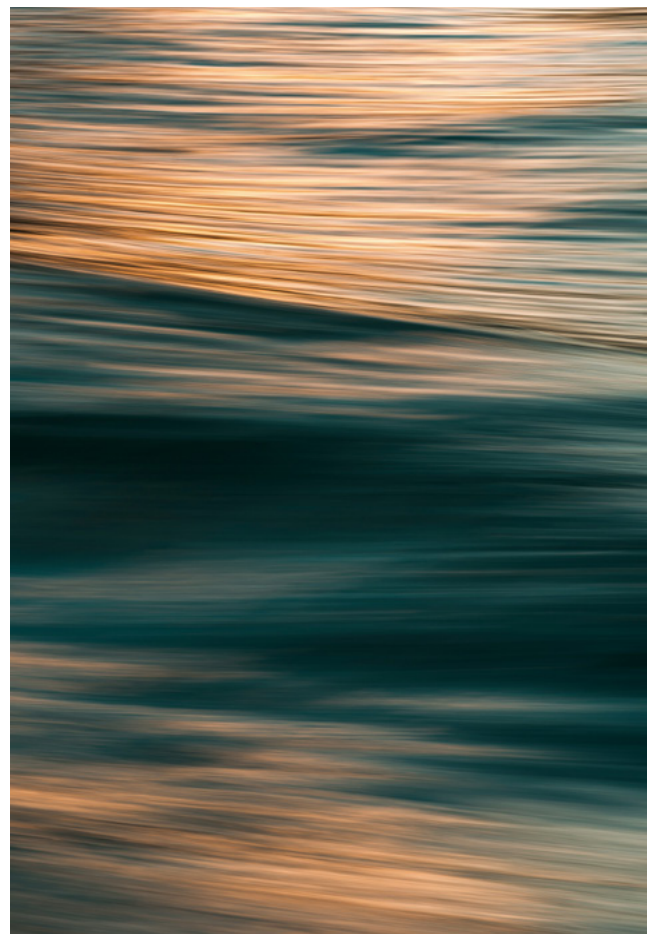
Jurisdictions have the freedom to incorporate the global minimum tax rules into their domestic laws. Some, like the United Arab Emirates, have indicated a preference for initially implementing only a QDMTT over the IIR. In other instances, jurisdictions are expected to initially adopt a QDMTT before making a final decision on implementing the other mechanisms of the global minimum tax into domestic law. Notably, a third option is not only possible, but plausible. The Netherlands anticipates that Curaçao is embracing a legal transplanted version of the Dutch Minimum Tax Act 2024 into its domestic tax legislation, aligning its tax policies with the new international standard, showcasing a commitment to a more comprehensive incorporation of minimum taxation beyond a QDMTT. This move is interesting, considering that Curaçao only opts for a legal transplant from certain measures of the Netherlands.<sup>11</sup>

#### 4. SOLUTION ON THE PREVENTION OF ECONOMIC DOUBLE TAXATION

In the Netherlands, the implementation of the minimum tax involved a specific amendment to the CFC rule outlined in art. 13ab of the Corporate Income Tax Act (CITA). This amendment, drawing inspiration from the Administrative Guidance published by the OECD in February 2023 allows the offset of QDMTT charged by a foreign jurisdiction. The offset takes place via a tax credit in the CITA.

The tax credit, providing a reduced overall burden, alleviates the corporate income tax pressure on the allocated CFC income in the Netherlands. The QDMTT charged in a foreign jurisdiction is offset against the CFC measure, resulting in an effective tax burden on the CFC income of 25.8% (similar to the Dutch statutory tax rate). The European Commission has confirmed that the offset of the QDMTT does not interfere with the Netherlands' obligation to implement ATAD. To prevent economic double taxation, the European Commission considers it both possible and desirable to offer a credit in corporate taxation for the QDMTT paid in a CFC jurisdiction. Based on this experience, it is anticipated that other EU Member States may implement similar offset mechanisms in their CFC rules.

Despite variations in recognizing income within the corporate tax base under the Dutch CFC measure and the criteria for applying the QDMTT as per the Model Rules (wherein a comparable income is used in the previous example to illustrate the issue), the Netherlands finds it necessary to mitigate the risk of economic double taxation in such scenarios.<sup>12</sup> In situations where the QDMTT takes into account a lower income than that included as CFC income for Dutch corporate tax purposes, the QDMTT on the overlapping income will be considered creditable.



## 5. CONCLUSION

Preventing economic double taxation is a desirable tax policy choice. The OECD Inclusive Framework monitors the interaction between the QDMTT and CFC rules to ensure this interaction results in the intended outcomes under the GloBE Rules. It could be contended that, since the objective of the CFC rule is broadly addressed by the minimum tax, it is no longer necessary to strictly enforce both rules. However, it is unlikely that the EU ATAD will be changed anytime soon to prevent economic double taxation. The Netherlands has paved the way with a practical solution: a tax credit for the amount of foreign QDMTT that lowers the Dutch corporate tax on CFC income. The European Commission recognizes the issue and supports the credit.

Given the overlap in the allocation of CFC income and the QDMTT levied, it is a reasonable outcome for the EU Member States to provide a foreign QDMTT credit to ease the burden on taxpayers that are faced with the interaction of the CFC and minimum-tax rules.



**Tim van Brederode**

\*\* The EU Member States that incorporated minimum-tax rules into domestic law are: Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Romania, Slovenia, and Sweden. While Estonia, Latvia, Lithuania, Malta and Slovakia notified the European Commission of their decision of a delayed implementation for countries with fewer than 12 companies in scope of the tax. The following EU countries have missed the transposition deadline: Republic of Cyprus, Greece, Poland, Portugal and Spain.

<sup>1</sup>The Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union. (OJ L 328/3, 22.12.2022, p. 5).

<sup>2</sup>J.J.A.M. Korving & C. Wisman, ATAD implementation in the Netherlands, 49(11) *Intertax*, p. 917-937.

<sup>3</sup>OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD/G20 Inclusive Framework on BEPS, (OECD, february 2023).

<sup>4</sup>OECD (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD, Paris; and OECD (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD, Paris.

<sup>5</sup>See J. Becker & J. Englisch, *Implementing an international effective minimum tax in the EU*, (June 23, 2021). Available at <http://dx.doi.org/10.2139/ssrn.3892160>; A. Dourado, *Pillar Two Model Rules: Inequalities Raised by the GloBE Rules, The Scope, and Carve-Outs*, 50(4) *Intertax*.

<sup>6</sup>J. Mosquera Valderrama, *The EU Standard of Good Tax Governance in Tax Matters for Third (Non-EU) Countries*, 47(5) *Intertax*, p. 454-467; Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, (OJ L 193/1, 19.07.2016, p. 1).

<sup>7</sup>The two options include: (i) Model A – the income approach that results in an annual inclusion of certain types of passive income derived by a CFC; or (ii) Model B – the substance approach that results in an annual inclusion of income that cannot be attributed to the CFC under application of the arm's-length principle, but is attributable to the EU Member State based on its functionality.

<sup>8</sup>See article 24(3) of the Minimum Tax Directive (or article 4.3.2. of the OECD Model Rules).

<sup>9</sup>For more background on the mechanisms of the global minimum tax, see T. Melendez, *Global Minimum Tax*, *Caribbean Tax Law Journal*, 2022 (1), p. 23-27.

<sup>10</sup>For a comprehensive analysis of the QDMTT, see R.A. (Jr.) Galendi, *The Single Top-Up Tax Principle: Justification, Content and Functions upon the Design of QDMTTs*, 15 *World Tax J.* 4 (2023), para. 4.3.1. (accessed 11 Jan. 2024).

<sup>11</sup>Ministry of Finance, *Policy Note of 19 October 2023*, p. 2

<sup>12</sup>NL: *Parliamentary Papers II, 2023/24, 36 418, nr. 36, p. 8-9.*