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Should Countries Declutter Their CFC Legislation Once They Adopt the Global Minimum Tax?

Takato Masuda (Nishimura & Asahi (Tokyo)) · Friday, July 28th, 2023

Some OECD officials have reportedly noted that countries should consider changing or eliminating potentially duplicative anti-avoidance measures, such as CFC legislation when they implement the 15% global minimum tax rules (or the so-called GloBE rules proposed by the OECD).[1] This blog will overview the German approach, which seems in line with this view, and the Japanese approach, which is probably on the other side of the spectrum.

The Ministry of Finance of Germany recently released a draft bill[2] to partially repeal its CFC regime upon introducing the GloBE rules into German domestic tax laws. For example, Article 5.2 of the bill proposes to amend the definition of “low taxation” (which may trigger the additional taxation under the German CFC regime) from “under 25%” to “under 15%.”[3] This would mean that if the tax rate of the relevant income of the CFC (within the meaning of the German CFC legislation) is 15% or more, no additional tax will be imposed any longer, even when the tax rate is less than 25%. According to the explanation attached to this draft bill, this amendment is intended to ensure tax rate consistency between the German CFC regime and the global minimum tax.[4]

However, there is a different view: some say that the CFC regime and the global minimum tax regime have little functional overlap and, thus, there is no good reason to declutter the CFC regime. The Ministry of Finance of Japan seems to take this position. At a Japanese tax conference in September 2022, an official of the ministry revealed that they would not consider abandoning or narrowing down the CFC regime upon adopting the GloBE rules since the global minimum tax regime and the Japanese CFC regime should serve different objectives.[5] In the ministry’s view, the Japanese CFC regime is to address the abuse of foreign subsidiaries without actual business activity and other similar ways to avoid Japanese taxation. The global minimum tax, on the other hand, is to ensure a level playing field by setting a globally accepted limit on the race to the bottom regarding corporate tax rates.[6]

Apparently, the prevailing view in Japan is that the CFC regime cannot be a “duplicative” anti-tax avoidance measure even after the global minimum tax implementation. This June, the Tax Commission (a tax policy advisory body established by the Japanese government) emphasized the same argument in its report.[7]

Indeed, compared to the CFC regime, the global minimum tax arguably lacks some key design features to address income shifting from Japan to lower-tax jurisdictions. For example, the Japanese CFC regime applies to persons of all sizes, including SMEs and individuals; however, the

global minimum tax only covers large MNE groups with more than EUR 750 million in revenues. The Japanese CFC regime ensures that covered CFC income is subject to the Japanese corporate tax rate of about 30% (including local taxes); by contrast, the global minimum tax would, at best, ensure the 15% minimum effective tax rate. Accordingly, the Japanese CFC regime will remain meaningful, as taxpayers may keep their interest in shifting income out of Japan in search of tax rates below 30%, even after the 15% minimum tax globally comes into effect.[8]

It should also be noted that the “effective tax rate” within the meaning of the global minimum taxation relies primarily on financial accounting income and does not precisely reflect income as a tax base for Japanese tax purposes. Furthermore, the “effective tax rate” is calculated country by country, so the passive income of one entity can be offset by the active losses of another entity in the same jurisdiction for global minimum tax purposes. This would undermine its capacity to address the shift of passive income. Moreover, the global minimum tax would be applied indiscriminately, regardless of the type or activeness of the business carried on by the relevant foreign subsidiaries. In contrast, the Japanese CFC regime will apply more selectively; the type and activeness of the CFC’s business have been taken into account to exclude income shifting arising from legitimate business activities from the scope of the CFC regime to some extent (the so-called economic activity tests).

It would be fair to say that the global minimum tax structure is unlikely designed to capture income shifting by examining it through the lens of Japanese tax law. If that is the case, the global minimum tax would not replace the Japanese CFC regime that much, nor would it provide a theoretically plausible excuse for decluttering the Japanese CFC legislation.

Having said that, the Japanese Ministry of Finance seems to be aware of the need to address the high compliance costs of the global minimum tax.[9] In response, Japanese business groups argue that commonizing the information required for the CFC regime and the global minimum tax would reduce administrative burdens. This opinion was featured in a study group report posted on the website of the Ministry of Economy, Trade, and Industry (METI) of Japan.[10]

However, it would not be that simple. Another research report was posted on the METI website in March this year,[11] indicating that the information used in the global minimum tax mechanism and the one used in the Japanese CFC regime may be too different to be coordinated. Again, the global minimum tax requires country-by-country income data based on accounting information. In contrast, the Japanese CFC regime requires entity-by-entity income data based on tax reporting information.[12]

In conclusion, countries may or may not find the CFC regime duplicative of the global minimum tax. Accordingly, despite some OECD officials’ remarks, not all countries may be willing to declutter their CFC regime, especially when they are concerned about potential conflicts with the tax policy behind them. Instead, another possible amendment to the CFC regime might be to communize the information required for it and the global minimum tax to reduce compliance costs. However, as far as Japan is concerned, the feasibility of this alternative idea is still under discussion.

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other entity.

[1] See e.g., Stephanie Soong, *Time to Declutter Tax Systems Amid Pillar 2 Adoption*, *Pross Says*, 110 Tax Notes Int'l 1660, 1660-61 (2023); Stephanie Soong, *Germany to Start Legislating For OECD Global Minimum Tax*, *OECD Official Says*, 111 Tax Notes Int'l 72, 73 (2023); Elodie Lamer, *Time to Declutter the Corporate Tax System*, *OECD Official Says*, 111 Tax Notes Int'l 204, 204-05 (2023).

[2] Referentenentwurf eines Gesetzes für die Umsetzung der Richtlinie zur Gewährleistung einer globalen Mindestbesteuerung für multinationale Unternehmensgruppen und große inländische Gruppen in der Union und die Umsetzung weiterer Begleitmaßnahmen (Mindestbesteuerungsrichtlinie-Umsetzungsgesetz – MinBestRL-UmsG)

[3] *Id.* at 90.

[4] *Id.* at 96, 284.

[5] Japan Tax Association, *Shakai Keizai no Henka to Zeisei*, OECD/G20 “BEPS Houkatsuteki Wakugumi” “Futatsu no Hashira” no Goui 167 (2022).

[6] *Id.* at 166.

[7] The Tax Commission, *Wagakuni Zeisei no Genjo to Kadai – Reiwa Jidai no Kozo Henka to Zeisei no Arikata* 232 (2023).

[8] This analysis may also cast doubt on the plausibility of the German tax reform. Some say that the German CFC legislation is supposed to “eliminate cross-border tax advantages and equate them with domestic situations.” (Jochen Gerbracht, *Controlled Foreign Company Legislation in Germany* 293, 293-94 (Georg Kofler et al., eds., 2020).) Given that the German corporate tax rate is about 30% (including local taxes), reducing the threshold from 25% to 15% could undermine this policy objective of the German CFC regime, even taking into account the 15% global minimum tax.

[9] Japan Tax Association, *supra* note 6, at 167; The Tax Commission, *supra* note 8 at 232.

[10] Study Group on the GloBE Rules and Controlled Foreign Company Taxation, *Saiteizeiritsu Kazei Seido oyobi Gaikokukogaisha Gassan Zeisei no Arikata nitsuite*, 15 (2022). The study group comprises 13 members, including four academics, two tax professionals, and seven companies, such as Toyota and SONY. Its secretariat is the METI which may negotiate tax policy with the Ministry of Finance of Japan from the economic and industrial policy perspectives.

[11] KPMG Tax Corporation, *Reiwa 4 Nendo Naigai Ittai no Keizaiseityousenryaku Kouchiku ni kakaru Kokusaikeizai Chousajigyo*, 277 (2023). This report is the product of a research project conducted by KPMG Japan based on the research contract with the METI.

[12] The same logic could be applied to the reformed German CFC regime. The amendment does not appear to eliminate the redundant tax rate calculations (one for the global minimum tax and one for the German CFC regime).

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