Feedback on the Proposal for a Directive laying down rules to prevent the misuse of shell entities for tax purposes (UNSHELL)

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Introduction

On 22 December 2021, the European Commission presented a proposal for a Directive laying down rules to prevent the misuse of shell entities for tax purposes (UNSHELL) and amending Directive 2011/16/EU.

The proposal seeks to create a new minimum economic substance test, organized in several steps, to help Member States identify undertakings that do not perform any actual economic activity and that can be misused for tax avoidance or evasion purposes.

Representing the voice at EU level of 215 000 regulated tax advisers, the European Tax Adviser Federation (ETAF) would like to express its firm support to this European initiative.

As parts of the new reporting process foreseen in the Directive will have to be carried out by the tax profession, ETAF carefully scrutinized the proposal and is pleased to present to the European Commission and Member States its comments aiming at:

- **Finding the right scope**
- **Addressing the complexity and unnecessary burden**
- **Finding a good balance in the burden of proof**
- **Ensuring proportionality in consequences and penalties**

I. Finding the right scope

The proposed rules would apply to all legal persons and legal arrangements that are resident for tax purposes in an EU Member State (article 2).

In line with the Regulatory Scrutiny Board opinion on the draft Impact Assessment of the proposal, we believe that the broad scope chosen has not been justified enough. At this stage, we have high concerns about the administrative burden that this could generate.

We notably call on the European Commission and the Council of the EU to thoroughly rethink if the exact same requirements should apply to SMEs and to large companies.

Moreover, provided that all the legal requirements, including in terms of taxes and money laundering, are complied with, it is fundamental for ETAF that the freedom of establishment (article 49 TFEU) is being preserved.

We do recognize that, in addition to tax reasons, there may be other business reasons (e.g., better control of shareholding, flexibility of investment and disinvestment, etc.) for setting up a company that would be classified as a shell company under the draft Directive. Those well-intentioned companies set up for fair tax purposes should not be penalised.

II. Addressing the complexity and unnecessary burden

The proposed Directive does not contain a definition of a shell company and relies instead on a two-tier system, composed of a so-called *"gateway"* (article 6) and indicators of minimum substance (article 7), which could, in our view, create complexity and legal uncertainty.

For the sake of simplicity and to reduce the administrative and compliance costs, we believe that a single set of indicators would have been preferable and more efficient.

The gateway

The draft text proposes to first differentiate between risky and non-risky entities by relying on self-assessment by the undertakings as regards whether or not they meet the so-called *"gateway"*, in the form of a set of three cumulative criteria. We expect a significant number of companies to cross the gateway and thus to fall under the reporting requirements.

From our perspective, the criteria are too far-reaching. One good example is the criterion aiming at verifying if the undertaking outsourced the decision-making on significant functions in the preceding two tax years. *"Significant functions"* is too vague to figure in a text of law and should absolutely be specified. As it stands, we expect this criterion to be problematic to verify.

Minimum substance indicators

Those undertakings considered at risk at the first step would be asked, in a second step, to declare in their annual tax return, for each year, whether they meet a set of indicators of minimum substance looking at premises and staff.

ETAF members generally believe that these indicators well reflect the economic minimum substance of a company. However, we find that a definition of economic activities in the sense of an asset/liability catalogue would be desirable.

In an ever-digitalized world and with a strong tendency towards home office, it is questionable if the requirement of having premises for its exclusive use (article 7, paragraph 1, a) is still up to date. This can also pose an issue for smaller companies which registered their seats at the owner's home.

Moreover, it is of outmost importance to specify that all the documents required during this process can be sent online.

III. Finding a good balance in the burden of proof

Proof of economic substance

As required by article 7, proving the minimum economic substance every year will generate a considerable effort for taxpayers and their tax advisers. This burden of proof should be reconsidered: the presumption of economic substance should be valid until there is a substantial change which may affect the ability of the undertaking to meet the economic minimum substance indicators.

Moreover, the validity for only one year of the presumption of minimum substance for tax purposes (article 8) is not coherent with the validity of the rebuttal for five years.

Rebuttal mechanism

For ETAF, it is fundamental that the rebuttal mechanism (article 9) - allowing the undertaking which is presumed to be a shell to prove that it has substance or is not misused for tax purposes - is maintained in the final text of the Directive.

In this regard, we fear that, as it stands, the workload linked to the evidence to produce and the expected length of the entire process could discourage taxpayers to invoke it. Without clear guidance on its use, we might also face abusive interpretation from fiscal authorities.

Besides documents allowing to ascertain the commercial rationale behind the establishment of the undertaking, we think that it might be relevant for taxpayers to provide documents ascertaining the undertakings' purpose or the activities in the Member State including marketing or sales activities.

Moreover, taking into account the EU data protection rules, we disagree with the requirement to provide information about the employee profiles by the undertaking.

Exemption for lack of tax motives

Similarly, we consider the exemption for lack of tax motives (article 10) to be necessary. We see it positively that companies can be exempt from their obligations arising from the Directive if they can produce elements proving that the tax liability of the beneficial owners or the group is not reduced.

However, according to the draft Directive, the non-differentiated tax burden must be determined at the level of the country of residence. There, we want to point out that the data required for the assessment are not usually available, so we would recommend that the determination could at best be made at the level of the group's top management or at the level of the beneficial owner.

We also recommend to the European Commission to come with examples and guidance about the application of this exemption as well as with its interaction with the rebuttal mechanism.

IV. Ensuring proportionality in consequences and penalties

Tax consequences

ETAF believes that the tax consequences attached to the certification as a "shell" (e.g. the relevant agreements, conventions and EU directives granting tax benefits to this undertaking should be disregarded and the tax advantages thus disallowed) (articles 11 and 12) are relevant and have the potential to discourage the misuse of shell companies in the future.

The denial of the tax residence certificate by concerned Member States is a measure fairly easy to implement and with expected benefits. We however believe that more clarity should be provided on how the income flows to and from the undertaking, as well as any assets owned by the concerned undertaking, should actually be taxed.

Financial penalties

From our point of view, the proposed administrative pecuniary sanction of at least 5% of the undertaking's turnover in the relevant tax year (article 14) is not entirely coherent. ETAF opposes the application of the same penalty rate for a false declaration in the tax return – situation where there is a clear intention of fraud – and for non-compliance on time.

We would recommend to leave it to Member States to lay down *"effective, proportionate and dissuasive"* penalties applicable against the violation of the reporting obligations, as the proposal already foresees.

Timeline

Finally, ETAF believes that the timeline for application of the new rules as of 1 January 2024 is reasonable. However, we would like to point out that the implementation of the Pillar II of the OECD tax deal in the EU, probably by 31 December 2023[1], is tying up resources and increasing the workload not only for the multinational enterprises in-scope and their tax advisers, but also for tax administrations.

[1] The latest compromise proposal tabled by the French Presidency of the EU Council, discussed by EU Finance Ministers on 5 April 2022, delays the application of the rules on Pillar II from 1 January 2023 to 31 December 2023.

Conclusion

As a concluding remark, ETAF would like to point out the multiplication of anti-abuse regulations at EU level in recent years. As justified as their objective may be, it must also be taken into account that they form an increasingly confusing patchwork for taxpayers and tax advisers.

As demonstrated in a recent study[2], the Anti-Tax Avoidance Directive (ATAD) and the latest update to the Directive on Administrative Cooperation (DAC) are already effective tools to combat tax avoidance and abuse.

It is therefore crucial for ETAF members that this new Directive can be used to effectively prevent the misuse of shell companies, while at the same time contributing to the simplification of tax law and reducing the administrative burden.

To achieve this goal, a uniform and sufficiently concrete concept of minimum economic substance to which all Member States align their anti-abuse standards is an indispensable contribution to ensuring the legal certainty.

Generally speaking, the burden of proof must be reconsidered throughout the whole text. This is particularly true when it comes to the rebuttal mechanism and the exemption for lack of tax motives, which are two core safeguards of the Directive.

ETAF thanks the Commission for this opportunity to give a feedback and will continue to follow and engage in the discussions on this important initiative.

Notes
For enquiries, please contact: Marion Fontana, EU Policy Officer, marion.fontana@etaf.tax, Phone: +32 2 2350 105 | Mobile: +32 471 78 90 64

About ETAF
The European Tax Adviser Federation is a European umbrella organisation for tax professionals whose activities are regulated by law. It is set as an international not-for-profit organisation (AISBL) governed by Belgian law, based in Brussels and was launched on 15th December 2015. ETAF represents more than 215,000 tax professionals from France, Germany, Belgium, Romania, Hungary and Austria.

[2] Werner HASLEHNER and Katerina PANTAZATOU, Assessment of recent anti-tax avoidance and evasion measures (ATAD & DAC 6), Study requested by the FISC Subcommittee of the European Parliament (March 2022)