

ATAD 3 and shell companies

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With thanks to Paul Kraan of Van Campen Liem for permission to use an amended version of the slides we used at an earlier joint presentation

EU Objectives

- Fight against misuse of shell entities for improper tax purposes
- According to EU shell companies are often used for aggressive tax planning or tax evasion
- “continuous scandals”
- Amounts at stake unknown to commission, EP estimates EUR 23 billion per annum

Why does the EU think it is necessary?

- Current rules fragmented
- Ex post
- Not targeted
- Not identical

Scope of the proposed directive?

It covers:

- All EU tax resident entities
- Not just companies and other legal entities
- Also trusts and partnerships if considered a tax resident

If in scope

- Self-assess whether one meets each of three gateways

The three “gateways”

- Predominantly passive income or ownership of certain assets
- Considerable cross border element
- Corporate management and administration outsourced to other associated entities

Measured over last two years

- “Predominantly” means $>75\%$
- “Considerable” means $>60\%$
- “Associated” means $> 25\%$ votes, capital or profits
- For assets based on book value

Passive income/assets

- Interest
- Royalties, IP income
- Financial leasing
- Immovable property
- Movable property with book value over EUR 1 million

Carve-out

- Despite perceived need for targeted rules certain entities are excluded because
- They are highly regulated in other areas (i.e. not targeted!); or
- They are considered low risk

Carve-out 2

- Stock exchange listed companies
- Regulated financial undertakings
- Entities with a clear nexus in relevant member state: UBOs and business of subsidiaries
- Entities with at least five full-time employees carrying out activities that generate relevant income
- Not subsidiaries

Substance requirements if meet all three gateways

Entities 'at-risk' must report on their yearly tax return whether they have:

1. Individual premises in a Member State
2. An active bank account within the EU
3. At least:
 - a) a local director exclusive to undertaking, or
 - b) full-time local employees

Also, gross revenue, expenses, details of directors and employees and outsourced activities

Documentary evidence is required

Rebuttal

- If entity does not meet substance requirements it is presumed to be a shell
- Presumption can be rebutted or there can be an exemption

Rebuttal

Need to produce and present additional evidence showing:

- commercial reason
- employee profiles
- directors' meetings in member state
- Control over and borne risks of business

If granted can be extended for 5 years if no change

Exemption

- Need to produce and present additional evidence showing tax liability of structure with and without the entity
- If granted can be extended for 5 years if no change

Consequences of being a shell company

Aim to neutralize tax impact:

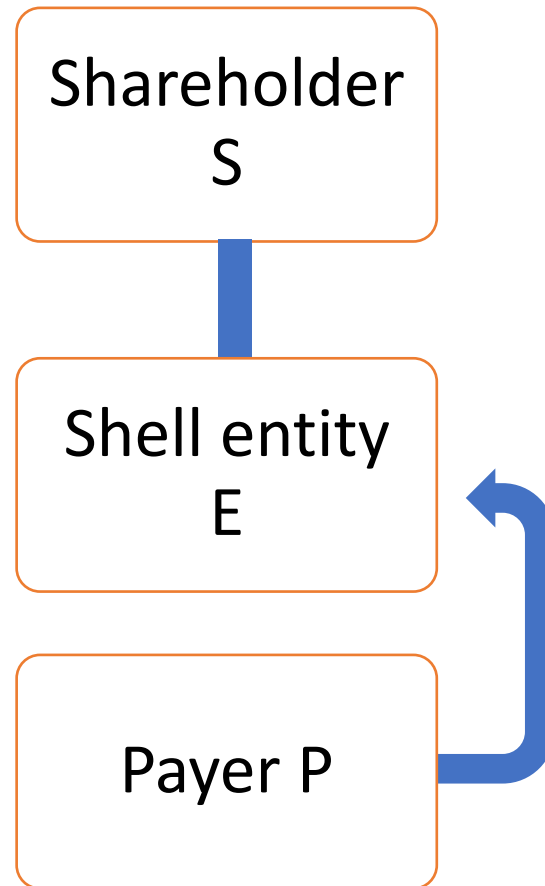
- No access to tax treaty network of member state or to PSD and IRD
- No residence certificate or one with warning
- Payments not treated as passing through shell entity for payer and shareholder
- Still considered a domestic taxpayer
- Shareholder in MS pays tax on shell income, with credit

Assets owned by shell

- Immovable property
 - Taxed where situated
 - Treated as owned directly by shareholder
- Movable
 - Treated as owned directly by shareholder and taxed in that state

Tax treaties still apply

Examples



Non-EU to EU to EU

Non EU-payer /EU shareholder

- Country P outside scope
- Country E applies domestic law
- Country S treats shell entity as transparent and includes its income unless treaty with P determines otherwise. Possible relief for tax withheld in P or paid by shell in E.

EU to EU to EU

- Treaty between P and E does not apply: domestic WHT
- No entitlement to PST or IRD
- Country E taxes entity normally
- Country S treats shell as transparent and includes its income in tax base, deducting tax paid by shell or payer

What rate of WHT can shell deduct from its tax?

EU to EU to Non-EU

- Country P applies domestic tax provisions unless treaty with S provides otherwise
- Country E applies domestic law
- Country S outside scope. May provide relief for tax withheld by P

Non-EU to EU to Non-EU

- Country P applies domestic tax provisions or treaty **with E** unless it introduces a look through
- Country E applies domestic law
- Country S outside scope. May provide relief for tax withheld by P

Information and audit

- A member state can request another member state to carry out a tax audit to determine if entity is shell
- Obligation to carry out audit and notify outcome
- Information exchange among all member states

Penalties

At least 5% of undertaking's annual turnover if fraudulent reporting or no reporting (EP suggests 2½%)

Proportional?

Proposed timeline

- Adoption by Council expected 'early 2022'
- Directive to be implemented by Member States before 30 June 2023
- Legislation effective as from 1 January 2024 (may be 2025)
 - Substance test entails look-back period of preceding 2 tax years
 - In fact, retroactive effect to 1 January 2022
 - Any actions should be initiated already now to avoid future issues
- Proposed timeline is quite ambitious:
 1. EC's legislative agenda for 2022 is already packed
 2. International tax reforms proposed by OECD Inclusive Framework require time (see next presentation – lots of things to consider)

More coming!

- In course of 2022 rules covering non-EU entities expected to be announced

Comments

Is it needed?

We already have:

- GAAR
- MLI/PPT
- Anti-abuse provisions in PST and IRD
- DAC 6
- CbC
- CFC

How many more letter combinations do we need?

The modern economy

- Employees?
- Fixed and exclusive office space
- Work within a reasonable distance of the business?

Compliant with EU law?

- Does not include domestic situations, unlike pillar 2
- Tests too rigid and catch too many companies
- Proportional?

Exclusions also probably not compatible:

- Same state exemption: freedom of establishment and free movement of capital?
- Carve-outs do not apply to subsidiaries
(this is being looked at and may be extended to 85% to 95% subsidiaries)
- Minimum employee numbers not proportional to business
- Exclusivity re office and staff too strict
- Does not take account of modern economy

EU Freedoms

- Directors must not be further from business than is compatible with proper performance of their duties, but this does not apply if they live in the member state concerned. Freedom of establishment?
- Requirement for active bank account in EU. Freedom of movement of capital?

More (or less?) EU Freedoms

- No clear idea on what will happen if different tax authorities take different views. Single market?
- Penalties can vary substantially. Single market?

Issues

- Cascade situations can result in excessive tax and difficult compliance
- Dual residence of shell not covered
- Denial of residence certificate can result in non-applicability of treaty for other activities
- How is payer to know that a company is a shell company? Especially if an audit is in progress

More issues

- What happens when income actually remitted to shareholder? Is it taxed again?
- Terms often vague
- Terms not always the same as in other rules
- Revenue for ATAD3 is not IRFS revenue
- What about groups or parties filing a consolidated return?
- Backdated effect
- Compliance costs

- Right to rebuttal entails even more additional administrative burden - both for taxpayers and tax authorities
- Why no exclusion for large groups within scope of OECD's Pillar Two Model Rules?
- Larger companies can better 'afford' to create additional substance
- Why not rely on existing case law (such as the Danish cases) and anti-abuse rules (notably LOB, GAAR and/or PPT)?

Alternative

- Why not look at the TP situation? Where are risks run and where is income earned?