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NOTE

From: Presidency
To: Delegations

Subject: Draft Directive on shell entities
- Presidency steering note

Delegations will find attached a note on the above subject for the meeting of the Working Party on Tax Questions (High Level) on 4 October 2023.



Presidency steering note

Working Party on Tax Questions (High Level)

4 OCTOBER 2023

Draft Council Directive laying down rules to prevent the misuse of shell entities
for tax purposes and amending Directive 2011/16/EU





I. Introduction

On 22 December 2021, the Commission submitted a proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (the “Unshell” proposal).

The objective of the proposal is to ensure fair and effective taxation in the internal market and to prevent tax avoidance and evasion through actions taken by entities not fulfilling the indicators of minimal substance provided by the Directive. The proposal aims to fight against the misuse of shell entities for improper tax purposes and to ensure that shell companies in the EU that have no or minimal economic activity are unable to benefit from tax advantages.

The European Economic and Social Committee adopted its opinion on 23 March 2022¹. The European Parliament adopted its opinion on 17 January 2023².

II. State of play

On 6 January 2022, at the Working Party on Tax Questions (High Level) (HLWP), the proposal was presented to delegations and the French Presidency announced its intention to launch the discussions in the Council on this file. The technical analysis of the proposal was carried out in the Working Party on Tax Questions (Direct taxation) (WPTQ) on 11 March, 1 April, 6 May, 23 May and 9 June 2022. The first round of article-by-article analysis of the proposal was completed in these sessions.

Under the Czech Presidency, the technical analysis in the WPTQ continued on 11 July, 27 September and 22 November 2022. Progress was made on exploring the way forward as regards tax consequences and compromise texts were submitted on parts of the proposal. In principle, most delegations supported the

¹ ST 8007/22.

² https://www.europarl.europa.eu/doceo/document/TA-9-2023-0004_EN.html



objectives of the proposal, but were of the view that further important technical work would be necessary.

The Swedish Presidency conducted three WPTQ meetings, on 22 January, 21 February and 22 March 2023. In these meetings, delegations expressed concerns about some issues and a strong support for others. Based on the outcomes of the first and the second meeting the Swedish Presidency prepared a compromise text which was discussed in the WPTQ on 22 March 2023.

This compromise text was presented and analysed in the HLWP on 25 April 2023³. The outcome of this meeting was that delegates supported the objectives of the Directive but requested further technical work on some areas before an agreement could be feasible (i.e. in particular, more technical work was requested for clarification on issues related to compatibility of antiabuse measures, for making the rebuttal process workable and for designing a feasible system for the certificate of residence). There were also diverging views between two approaches regarding tax consequences linked to tax treaties where a compromise was needed. Conflicting positions were also expressed on the substance criteria or exclusions, where some delegations wanted to be stricter and others less so; and there was a request to restrict the scope with the aim to ease the administrative burden while maintaining the effectiveness of the Directive.

Following the guidance received from the HLWP and building on the progress made under the previous Presidencies, the Spanish Presidency carried out intensive work on the Unshell proposal and has been working with different delegations in all these areas in order to agree on a balanced compromise text. The Presidency has considered it to be of utmost importance to find a compromise text that could be acceptable for all delegations.

³ WK 4310/2023.



In this regard, the Spanish Presidency organised two WPTQ meetings, on 4 July 2023 and on 5 September 2023. In the first meeting, the Spanish Presidency mapped the main outstanding issues which needed further discussion in the WPTQ and suggested a possible way forward on those issues, including in the form of partial compromise texts. Following this discussion, in the WPTQ on 5 September, the Spanish Presidency presented a comprehensive compromise text⁴, building also on the previous one presented by the Swedish Presidency. Additionally, other background notes on several aspects of the draft Directive were presented⁵. The compromise text was discussed in the WPTQ on 5 September.

The Presidency addressed a wide variety of issues raised by delegations, provided explanations to delegations, tried to converge views and to find compromise solutions that would be acceptable for all delegations.

A. Issues on which technical work is exhausted

The Presidency considers that great progress has been made on most of the issues and that most of technical work is finished on the following issues:

- Subject matter and Scope (Articles 1 and 2): During the HLWP meeting on 25 April 2023, most of the delegations indicated that it was necessary to clarify the interaction between the national antiabuse rules and the Directive in different situations that may arise and to make the text clearer regarding the possibility for Member States to maintain or adopt national measures. In this regard, the compromise text presented by the Presidency includes some changes in Article 1 and in the recitals in order to clarify that the Directive only covers manifest cases of misuse of shell entities in order to avoid administrative burden. In addition, the interaction of national law and EU law for the different situations has been clarified,

⁴ WK 10232/2023.

⁵ WK 10876/2023 and WK 10877/2023.



setting out that when an entity is not considered to be a shell under this Directive, nothing prevents a Member State from considering that such entity lacks sufficient economic substance under the applicable national or agreement-based provisions. The Presidency considers that the text is clear enough in relation to this interaction and almost all of the delegations agreed on this text and the proposed way forward.

- Rebuttal of the presumption (Article 9): At the HLWP meeting on 25 April, most delegations acknowledged the need to provide a possibility to rebut the presumption of being a shell entity, although the views among delegations diverged with regards to its application. Various delegations expressed doubts about the rebuttal, in particular regarding the administrative burden that this process entails for the tax administration of the entity's Member State of residence. In order to address the concerns, the compromise text presented by the Presidency simplifies the approach for the rebuttal, as follows: an entity should prove that it is genuine and that it has been put in place and operates for valid commercial reasons. Additionally, in order to allow Member States time to adapt, the compromise text also includes the possibility to extend the six-month period to one year during the first tax period of application of the Directive. Other improvements to the process have been also added to reduce the administrative burden. All these changes were to a large extent acceptable for delegations. However, the compromise text also stipulates that if within six months from the request for a rebuttal (or one year) the competent authority of the Member State of the entity has not issued a notice, the request for rebuttal of the presumption shall be deemed to have been rejected. The effects of this administrative silence have generated further doubts among delegations. The Presidency issued a note⁶ explaining the substance of the process, trying to solve those doubts.

⁶ WK 10876/2023.



Although some minor amendments could still be made, the process of rebuttal as drafted is supported by almost all delegations except as regards the effects of administrative silence. It should be taken into account that the Administration of the Member State has the obligation to issue a notice within the timeframe agreed so the cases of administrative silence should be very rare. Furthermore, in case the notice is issued afterwards, the effects of the administrative silence may revert. The Presidency is of the view that the provision on administrative silence is proportionate and in conformity with EU law, but it also recognises that a large number of Member States is not comfortable with this measure. Therefore, the Presidency considers that there may be a need to avoid such discomfort in order to reach an agreement.

- Tax residency certificate (Article 12): At the April 25 HLWP, several delegations expressed doubts about the relevance of the tax residency certificate indicating that the entity is presumed to be a shell, while others considered that the tax residency certificate would be useful. Taking into account the suggestions of some delegations, the Presidency's compromise text provides that, once an entity is presumed to be a shell entity, tax residency certificates issued afterwards will include a notice, which would alert the withholding agents of Member States. When this situation reverses and the entity ceases to be presumed a shell entity in subsequent periods, tax residency certificates issued afterwards will not include such a notice and withholding agents will have to apply the Directives (and the treaties, if applicable). In similar terms, the different scenarios are also described. The Presidency's view is that this reduces the administrative burden and achieves the deterrent effect proving the usefulness of the certificate of residence. In general terms, this Article is accepted by almost all the delegations.



- Tax consequences (Article 11): At the HLWP of 25 April, almost half of the delegations expressed concerns and doubts when it comes to regulating tax consequences regarding the Double Tax Agreements (DTAs) concluded between Member States. In light of this, at the WPTQ of 4 July, the Presidency proposed to delete the reference to the DTAs concluded between Member State from the Article and to include language in the recital of the Directive. During this meeting the Commission explained that national provisions cannot contradict the EU law whatever option of drafting chosen. Thus, tax consequences provided for in this Directive should not be undermined by the application of similar exemptions or reductions of tax enshrined in other provisions, in particular in agreements and conventions that provide for the elimination of double taxation of income, and where applicable, capital, concluded between Member States or other national law provisions. In order to accommodate delegations' requests and taking into account the Commission's explanations, the Presidency's compromise text, presented at the WPTQ of 5 September, incorporates this general idea and provides more legal certainty stating that the Directive disallows any exemption or reduction of tax that follows from (a) the Parent-Subsidiary Directive (PSD) and the Interest-Royalty Directive (IRD) and (b) any other provision which contradicts the purposes of the provisions under point (a) concerning the same income streams. Additionally, the Article now clarifies the functioning of the withholding procedure, further explained in the new recitals (10a and 10b). Whereas some wording changes have been requested by delegations and could be made in the Article in order to increase legal certainty, the Presidency believes that this Article is now balanced, taking into account the two different approaches regarding tax consequences related to tax treaties.



- Exchange of information (Article 13): Delegations have expressed support for automatic exchange of information to be a part of the Unshell Directive, The Presidency's compromise text includes only some technical changes from the previous compromise text, without changes in the substance.
- Other issues (i.e. Confidentiality of information - Article 16a; Transposition - Article 18): The Presidency's compromise text foresees other changes in some articles in order to address the concerns expressed by some delegates. In this regard, changes in Article 16a "Confidentiality of information" have been made in order to clarify that the Commission is not a Union authority but a Union institution. Additionally, the compromise text postpones the transposition of the Directive to 31 December 2025.

B. Outstanding issues of principle

However, there are two issues where fundamental disagreement still remains:

- Excluded entities and Definitions (Article 2a and Article 3): During last HLWP on 25 April most delegations supported the idea that entities that are outside the scope of the Unshell Directive should not report according to the Directive (for instance, regulated financial entities). Some delegations argued for adding more excluded entities in order to limit the administrative burden for both taxpayers and tax administrations. However, other delegations considered that no more exclusions should be added. The compromise text presented in September includes a new exclusion (i.e. the governmental entities, according to the definition of DAC 2) and increases the gateway/threshold criteria. In the Presidency's view, through this inclusion and the increase of the threshold, Member States would be able to reach a better balance between the need to tackle shell



entities and the reduction of administrative burden for both tax administrations and taxpayers.

However, a few delegations have strongly argued for the inclusion of special purpose vehicles (i.e. entities owned at least 95% by AIFs or UCITS, in line with the approach taken in Pillar 2) in the definition of regulated financial entities. As requested by some delegations, the Commission presented a note⁷ explaining the rationale of the excluded entities trying to alleviate the concerns of those delegations not willing to extend the exclusions within the Directive. This is an issue where strong concerns are still present and political guidance would be needed.

- Minimum substance criteria (Article 6): During the HLWP of 25 April, several delegations expressed the desire to make the criteria stronger, while others requested for changes to alleviate some of the criteria. The Presidency's view regarding the compromise text was that it was a well balanced approach taking into account the different views of the Member States on this issue, so no changes were proposed.

However, during the meeting of 5 September, one delegation raised concerns about the robustness of these criteria and their possible spillover effects, i.e. the likelihood of these criteria becoming a "safe harbor", so that any other antiabuse rule would not be applicable if an entity fulfils those criteria, as the entity would be presumed to have substance for all purposes. This concern prevented them from agreeing on the Directive in the current structure. These concerns were shared by several delegations.

III. Two-stage approach

During the meeting of 5 September, regarding the minimum substance criteria, one delegation suggested that, taking into consideration the difficulties to achieve

⁷ WK 10877/2023.



a unanimous agreement at this stage, a way forward could be a two-stage approach.

At the first stage, the Directive would include the automatic exchange of information regarding the hallmarks agreed. This would allow domestic or internationally-agreed antiabuse rules to be applied using that information exchanged.

At a second stage, best practices among the Member States could be exchanged about the use of that information to apply tax consequences through domestic, EU or internationally-agreed antiabuse rules with a view to develop a dynamic process about following steps to be taken, such as the modification of this Directive to include harmonised tax consequences, if appropriate.

Regarding tax consequences, in the WPTQ meeting of 27 September 2022, the Czech Presidency asked delegates about three options⁸: (1) not including tax consequences in the Directive, just automatic exchange of information, (2) having automatic exchange of information and limiting consequences to the shell entities and (3) maintaining the Commission's initial proposal with consequences to both the shell entities and their shareholders as well as automatic exchange of information. The views were diverging, but a majority of delegates favoured option 2, which has been the basis of the work done afterwards.

However, during the WPTQ meeting of 5 September 2023 and in the comments received, given the current situation where an agreement on the latest compromise text of the Directive turned out to be unlikely, a significant number of delegations have shown openness to reach an agreement through a two-stage approach as described above.

The arguments provided by delegations explain that the Directive would be useful although it may not mention explicit consequences neither to the respective

⁸ WK 12150/2022.



entities nor to their shareholders. However, there may be a reference to the application of the tax consequences included in the domestic, EU or internationally agreed antiabuse rules. In fact, it has been argued that the problem is not the lack of instruments to tackle the abuse, but the lack of the application of these instruments.

In addition, the Member State of the respective entity would alert other Member States through the automatic exchange of information channels without the delay and without the complexity of undergoing a rebuttal process. It would also leave any Member State applying its internal legislation the possibility to design its own processes to ensure that taxpayers and other stakeholders are aware in a timely manner of their obligations to act.

Once the information starts to flow to the Member States, the dissuasive incentive may also be created. After an evaluation of the situation once this Directive starts applying, Member States may be in a better position to decide about the way that the procedures and tax consequences work and the need for the following steps to further harmonise those processes.

On the one hand, taking into account the different positions of delegations described above, the Presidency is of the view that the **current compromise text** is well balanced. Minor drafting changes for refinement may be made to solve most of the pending issues. However, finding a solution to the critical pending issues would require a fundamental change which may prevent certain delegations from agreeing on the revised text.

On the other hand, the arguments provided show that there may be merit in the **two-stage approach** as described above and it may be a reasonable landing point considering the diverging views of the delegations. In addition, this approach may solve the concerns raised regarding the exclusions since tax consequences would not be directly linked to the scope of the Directive.



IV. Questions for discussion

The Unshell Directive has been discussed at a technical level during 20 months, in 13 WPTQ and 3 HLWP meetings. In the view of the Presidency, most of the technical work has been concluded and further guidance is needed in order to decide on the way forward.

In the light of the above, the Presidency has prepared questions to guide the discussion. The aim of the discussion is to get concrete and operational guidance on the way forward on the draft Unshell Directive. Taking into account the amount of work, time and resources that have already been invested in analysing this Directive, the Presidency requests the delegations to reflect carefully about the best approach to take. Delegations are invited to address during their interventions the following questions:

- 1) Taking into account the diverging views of the delegations on some critical aspects of the proposal, do you think that more technical work should be done on the current compromise text in order to try to reach a unanimous agreement?
- 2) Would your delegation be in a position to support a two-stage approach as described above as a compromise?

The Presidency would appreciate getting clear messages from the delegations in order to decide about the best way forward to conclude the work on this Directive and to reach an agreement.