



Council of the European Union
General Secretariat

Brussels, 16 September 2022

**Interinstitutional files:
2021/0434 (CNS)**

WK 12148/2022 INIT

LIMITE

**FISC
ECOFIN**

This is a paper intended for a specific community of recipients. Handling and further distribution are under the sole responsibility of community members.

NOTE

From:	General Secretariat of the Council
To:	Working Party on Tax Questions (Direct Taxation)
Subject:	Proposal for a COUNCIL DIRECTIVE laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU - Presidency compromise proposal on Chapter II

In view of the meeting of the Working Party on Tax Questions on 27 September 2022, delegations will find attached the Presidency compromise proposal on Chapter II.

CHAPTER II

IDENTIFICATION OF UNDERTAKINGS THAT DO NOT MEET INDICATORS OF HAVE MINIMUM SUBSTANCE FOR TAX PURPOSES

Article X

Minimum substance

1. Member States shall require undertakings to declare to the competent authorities, each tax year, whether they meet at least one of the following criteria during the tax year that immediately precedes the reporting year:
 - (a) total revenues of the undertaking do not exceed EUR 100 000 or the equivalent amount in another currency;
 - (b) no more than 75% of the revenues accruing to the undertaking is relevant income;
 - (c) no more than 60% of the undertaking's relevant income is earned via cross-border transactions, and no more than 60% of the undertaking's payments having a nature of relevant income are paid out via cross-border transactions;
 - (d) the undertaking has at least five full-time equivalent employees that are residents for tax purposes in the Member State of the undertaking, or at no greater distance from that Member State than what would be compatible with the proper performance of their duties, and such employees are qualified to carry out the activities and perform such activities that generate relevant income for the undertaking;
 - (e) at least one of the managing persons that have the power to bind the undertaking towards third persons is a natural person that :
 - (1) is resident for tax purposes in the Member State of the undertaking, or at no greater distance from that Member State than what would be compatible with the proper performance of his/her duties;
 - (2) is qualified and authorised to take decisions in relation to the activities that generate relevant income for the undertaking;
 - (3) actively and independently uses the authorisation referred to in point (2) on a regular basis; and
 - (4) the person does not perform the above mentioned functions in more than four other undertakings.

[For the purposes of this paragraph, 'reporting year' means the tax year during which the undertaking is reporting for the purposes of this Directive.]

2. Undertakings shall ensure that documentary evidence in support of their declaration under paragraph 1 is available for inspection at the request of the tax authorities of the Member State of the undertaking. The documentary evidence must relate to the criteria that the undertaking declared to have met and provide proof for that declaration.
3. An undertaking which does not declare that it meets at least one of the criteria set out in paragraph 1 or that does not maintain available satisfactory supporting documentary evidence in accordance with paragraph 2 shall be presumed not to have minimum substance for the relevant tax year for the purposes of this Directive.

Presidency note:

Based on the previous discussions at the WPTQ meetings, the Presidency is of the opinion that the best way to find a compromise that will have the chance to be unanimously agreed in the Council lies in a significant simplification of the proposal. Chapter II represents one of the crucial elements.

The Presidency proposes to merge Art. 6 to 8 of the original Commission proposal in a new Article X and to partially redraft these three Articles, while fully maintaining the underlying principles and goal of the original provisions, i.e. to identify undertakings posing high-risk of being misused for the purposes of obtaining unintended tax benefits. The new wording is presented to the Member States in a clean text since highlighting the changes in marking in bold, underline, strikethrough compared to the Commission proposal would have been very confusing (Articles 6 to 8 were merged and redrafted).

New Art. X reflects a clear preference for a simplified approach to reporting by undertakings in the scope of the Directive. The proposed changes enable the tick-the-box approach as discussed and supported by many Member States (especially during the WPTQ on 9 June 2022). Instead of having carve-outs, gateway criteria and substance indicators, the proposed wording contains only one set of five criteria. Once an undertaking meets at least one of the criteria, it is assumed not to be high-risk and therefore can not be labeled as lacking minimum substance for the purposes of this Directive.

The compromise text shows how the text could be simplified if the directive would focus on income only (basically passive income). In such a scenario, no reference to property is needed, which again brings the required simplification.

The Presidency believes that it is not necessary to apply any carve-outs given the overall simplification of the mechanics of the rules. The absence of any carve-outs will further simplify the application and minimize the complexity of the rules. The criteria were designed to be as simple and easy to assess as possible, and therefore it should not pose any problem to ascertain the fulfilment of at least one of them for any undertaking. Moreover, if none of the criteria is met, such an entity poses a certain amount of risk even if it would fall under certain “exempt” categories (as originally proposed).

The Presidency is proposing to replace the original two tax years averaging by a simple reference to one tax year. This would again simplify the rules and increase the chance that newly established entities will be tackled as well (without drafting special rules for newly established entities).

Each of the five criteria (Art. X(1)) should be sufficient to eliminate entities that pose none or very limited risk in terms of the aim of the Directive. The general intention was to define criteria that provide for appropriate identification of high-risk entities (lacking substance), and are clear and understandable. Most of the criteria are based on the original Commission proposal, the wording has been changed in order to reflect the discussions and to avoid misunderstandings.

Some explanation about every single criterion:

- (a) The aim is to filter out entities being in (income) situation that does not represent a serious problem in terms of possible amount of tax that could be avoided/evaded. The amount is for discussion.*
- (b) The criterion is based on the original proposal.*
- (c) The criterion is based on the original proposal, clarification changes proposed.*

(d) The criterion is based on the original proposal. It represents an adjusted combination of the original Art. 6(2)(e) and Art. 7(1)(c)(ii).

(e) The criterion is based on the original proposal. The proposed wording aims at minimizing the problems with unclear definition of the terms, such as “director”. It covers only individuals. The limit “more than four other undertakings” is for discussion. The Presidency will be happy to discuss whether to limit this condition to “non-associated enterprises” only.

Some of the indicators used in the original proposal were abandoned, namely “own premises in the Member State, or premises for its exclusive use”, “own and active bank account in the Union” and the issue of outsourcing of “the administration of day-to-day operations and the decision-making on significant functions”.

The (non)existence of a bank account or the above mentioned premises do not seem to sufficiently ensure the substance in today’s digitalized world. Once an entity fails all the five proposed criteria, it means that a significant part of its income represents “relevant income” as defined in Art. 4 of the proposal. It is hard to imagine that such an income is realized in cash. Additionally, it is nowadays extremely easy and basically cost free to set up an account anywhere.

It should be noted that the reference to the premises criterion can be found e.g. in para 67 of the Cadbury Schweppes (Case C-196/04) or in Art. 7 of the ATAD. However, the world is changing very fast and the digitalization of the economy brings new standards. It is possible (and is becoming usual for certain sectors) to do business purely remotely without owning or renting any premises simply because there is no need for that.

The issue of outsourcing has been thoroughly discussed at the WPTQ meetings. The debates have clearly shown that it is very complicated to define which kind of activities are covered and which not. Even if alternative wordings of the “outsourcing” issue were discussed, it still remains very unclear where the limits are (which activities exactly are covered and which not, definition of day-to-day operations, whether to limit the outsourcing to certain enterprises only – associated vs. non-associated, geographical location, etc.) and certain level of investigation seems to be necessary to decide whether such a condition (gateway) is met. Many disputes may arise. The Presidency is of the opinion that the criteria proposed in the Presidency text are sufficient for filtering out entities lacking substance. Moreover, the criteria (d) and (e) implicitly touch and tackle the issue of excessive outsourcing.

Paragraph 2 reflects the wish to replace the requirement for undertakings to submit supporting documentation to the authorities annually by a requirement to ensure the availability of the relevant documents. The text does not prescribe concrete evidence that should be kept. It reflects the proposed changes of paragraph 1, i.e. undertakings are obliged to keep the evidence (without any further specification, general rules apply). The documentary evidence must relate to the criteria that the undertaking declared to have met and provide proof for that declaration.

- 1) Do Member States agree with the proposed simplified structure of the provision for the sake of compromise?*
- 2) Do you support the underlying logic, i.e. one layer of criteria when only undertakings not meeting at least one of the criteria are considered not to have minimum substance?*

- 3) Which criteria are missing/unnecessary in your opinion?
- 4) Could Member States agree with the proposed parameters used in the criteria in Art. X(1)?

Article 9

Rebuttal of the presumption

1. Member States shall take the appropriate measures to allow undertakings that are presumed not to have minimum substance under Article 8(2)~~X~~ to rebut this presumption by providing any ~~additional supporting~~ evidence of the business activities which they perform to generate relevant income **within two months from the date of reporting in accordance with Article X.**
2. For the purposes of paragraph 1, undertakings shall provide **all** the following ~~additional~~ evidence:
 - (a) **any evidence** ~~a document~~ allowing to ascertain the commercial rationale behind the establishment **and existence** of the undertaking; **and**
 - (b) information about the employee profiles, including the level of their experience **and qualification**, ~~their decision-making power in the overall organisation, role and position in the organisation chart, the type~~ **and duration** of their employment contract, ~~their qualifications and duration of employment;~~
 - (c) ~~concrete evidence that decision making concerning the activity generating the relevant income is taking place in the Member State of the undertaking.~~
3. A Member State shall treat an undertaking as having rebutted the presumption if the evidence that the undertaking has provided under paragraph 2 proves that the undertaking has performed and continuously had control over, and borne the risks of, the business activities that generated the relevant income ~~or, in the absence of income, the undertaking's assets.~~ **Members States shall ensure that the decision on whether an undertaking has rebutted the presumption is taken within three months from the submission of evidence in accordance with paragraph 2.**
4. **Without prejudice to the reporting obligation set out in Article X,** ~~a~~After the end of the tax year for which the undertaking rebutted the presumption successfully, in accordance with paragraph 3, a Member State may consider for a period of ~~five~~**three** years that the undertaking has rebutted the presumption on the condition that the factual and legal circumstances of the undertaking remain unchanged during this period.

Presidency note:

Based on the previous discussions at the WPTQ meetings the Presidency is of the view that Art. 9 ("Rebuttal of the presumption") has its place in the logic of the whole proposal. It is suggested making a few changes.

The main goal of this Article should be to provide taxpayers with a chance to prove (using any credible evidence) that the concrete arrangement pursues valid (non-tax) commercial reasons. For the purposes of certainty and in order make the rules more unified, certain time limits have been added.

- ***Do Member States agree with the proposed wording of Article 9?***

Article 10

Exemption

- ~~1. A Member State shall take the appropriate measures to allow an undertaking that meets the criteria laid down in Article 6(1) to request an exemption from its obligations under this Directive if the existence of the undertaking does not reduce the tax liability of its beneficial owner(s) or of the group, as a whole, of which the undertaking is a member.~~
- ~~2. A Member State may grant that exemption for one tax year if the undertaking provides sufficient and objective evidence that its interposition does not lead to a tax benefit for its beneficial owner(s) or the group as a whole, as the case may be. That evidence shall include information about the structure of the group and its activities. That evidence shall allow to compare the amount of overall tax due by the beneficial owner(s) or the group as a whole, as the case may be, having regard to the interposition of the undertaking, with the amount that would be due under the same circumstances in the absence of the undertaking.~~
- ~~3. After the end of the tax year for which an exemption was granted in accordance with paragraph 2, a Member State may extend the validity of the exemption for five years on the condition that the factual and legal circumstances of the undertaking, including of the beneficial owner(s) and the group, as the case may be, remain unchanged in the relevant period.~~

Presidency note:

During previous WPTQ meetings, several Member States spoke in favour of removing Art. 10 “Exemption” or at least in favour of merging it partially with Art. 9 (“Rebuttal of the presumption”).

Leaving aside the practical application of the proposed rules, the Presidency supports the view that the non-tax benefit exemption under Art. 10 loses significance if the non-tax reasons are seen as the main conceptual basis for the rebuttal under Art. 9 (“Rebuttal of the presumption”). It is obvious that a rational business would not maintain a purposeless step in an arrangement. Of course demonstrating the lack of tax benefit can serve as evidence of a lack of tax motive and, therefore, the existence of a different commercial rationale. In other words, Art. 9 (“Rebuttal of the presumption”) seems to provide a sufficient basis. Therefore, it is suggested removing Art. 10 “Exemption” in its entirety from the proposal.

- ***Do Member States agree with the above mentioned reasoning and with the deletion of Art. 10?***