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NOTE

From:	Presidency
To:	Delegations
Subject:	Draft Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU - Presidency steering note

Delegations will find attached a steering note from the Presidency for the meeting of the Working Party on Tax Questions (High Level) on 25 April 2023.

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Presidency Steering Note for the Working Party on Tax Questions (High Level) on 25 April 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

1. 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).

2. Ensuring fair and effective taxation in the internal market and tackling tax avoidance and evasion remain high political priorities in the Union. The objective of the proposal is to strengthen Member States' resilience against practices of tax avoidance and evasion by ensuring that entities lacking minimal substance are not used as instruments of such practices. This proposal complements the progress achieved in corporate transparency through requirements concerning beneficial ownership information introduced by the anti-money laundering framework, which address situations where entities are created to conceal true ownership, whether of the entities themselves or of the assets they manage and own, such as real estate or property of high value.

II. State of play

3. On 6 January 2022, at the 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 on 23 May 2022.

4. 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, such as the identification of entities not having minimum substance as well as on exchange of information. In principle, most delegations supported the objectives of the proposal, but were of the view that further important technical work would be necessary before an agreement could be feasible.

5. Building on the progress made under the previous Presidencies, the Swedish Presidency carried out intensive work on the Unshell proposal. The objective of the Presidency was to make as much progress on this file as possible, focusing *inter alia* on finding accurate substance criteria and tax consequences. The WPTQ met on 22 January, 21 February and 22 March 2023.

6. The Presidency prepared partial compromise texts (WK 528/2023 and WK 1907/2023) and background notes on several aspects of the draft Directive, including a timeline on reporting deadlines (WK 3716/2023). The compromise text covering the whole Directive was discussed in the

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WPTQ on 22 March (WK 3554/2023). A clean version of this compromise text can be found in document WK 4310/2023. The Presidency addressed a wide variety of issues raised by delegations, provided explanations to delegations, managed to converge views and to find compromise solutions that were acceptable for many delegations. However, further technical work will be needed.

7. Some of the most discussed topics during the Swedish Presidency, where also major progress was made, were the following:

(a) scope (Article 2). Delegations asked questions about the hierarchy between legal acts and requested clarity to what extent the Unshell Directive would limit the application of domestic anti abuse measures or other EU law (e.g. the provisions on controlled foreign companies and the GAAR in ATAD). During the discussions it was clarified that following the adoption of the Unshell Directive, which would mean that the Union had exercised its competence in an area of shared competence, Member States would not be able to introduce different or derogatory rules as regards those elements that are governed by the Unshell Directive (cf. Article 2(2) TFEU). However, Member States would remain free to adopt or maintain national measures in respect of aspects that are not governed by the Directive. In the latest compromise proposal, it was suggested to clarify that the Directive does not preclude Member States from applying domestic or agreement-based provisions required for the prevention of tax avoidance, tax evasion, tax fraud or abuse, provided that such provisions are compatible with Union law, including the Unshell Directive. Several Member States have however requested that the Directive should be further clarified in the sense that stricter national rules can still be applied. A possible way forward could be to clarify in the Directive that the measures are

intended to ensure only a minimum level of protection necessary for the internal market, enabling the application of stricter national rules. Also, it could be clarified that the Directive establishes a test of minimum substance for the identification of manifest cases of shell entities misused for tax purposes in the internal market. For entities that do not have sufficient substance according to this test, i.e. that are presumed to be shell entities according to the Directive and do not successfully rebut this presumption, the Member State of the entity would be obliged to apply the consequences set out in the Directive (i.e. exchange of information and notice in tax residency certificates). Likewise, source states would be obliged to apply the tax consequences set out in Article 11 on relevant income distributed to entities found to be shell entities in the Member State of the entity. According to this line of reasoning, the test in this Directive would not be an exclusive test. It would not preclude source states from continuing to apply other domestic or agreement-based provisions (including provisions corresponding to the anti-tax avoidance rule in the PSD or the IRD) on entities that are found to have substance according to the Directive, or that have successfully rebutted the presumption of being a shell entity. The arguments against such clarification in the text are mainly focused on legal certainty, since this means that the substance of an entity could be assessed by the home state and the source state with a diverging outcome. This could occur when the source state applies stricter substance criteria than those in the Directive and uses a different interpretation of "valid commercial reasons which reflect economic reality" which is used in the Unshell Directive, as well as in PSD and ATAD. Although this could be acceptable from an EU-law perspective, which allows for harmonisation to be introduced gradually or in stages, the administrative burden of the Directive must be considered;

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(b) excluded entities (Article 2a). Most delegations supported the idea that entities that are outside the scope of the Unshell Directive should not report according to the Directive, in order to limit the administrative burden for both taxpayers and tax administrations. This question was presented in the steering note on reporting obligations and threshold amounts (WK 2144/2023). In the compromise text presented in March excluded entities, such as regulated financial entities and entities that do not cross the gateway/threshold criteria, are exempt from reporting obligations according to Article 2a;

(c) minimum substance criteria (Article 6). These criteria have been discussed on several occasions. The main question is how to ensure that the criteria are robust and at the same time easy to report and control. The Presidency compromise text presented in March sets out that substance should be in the Member State of the entity and that criterion (a) regarding manging persons should be a mandatory criterion for entities to fulfil in order to have substance. Furthermore, three out of the four criteria ((b) premises, (c) bank account, (d) employees and (e) board meetings) should be met in order to have substance according to the Directive. Whilst views among delegations still diverge, the compromise gained broad support;

(d) rebuttal of the presumption (Article 9). Whereas most delegations acknowledge the need for providing a possibility to rebut the presumption of being a shell entity, the views among delegations have been diverging on the relevant criteria, timing aspects etc. Some further technical work will be needed at the WPTQ level;

(e) tax consequences (Article 11). In order to accommodate delegations' requests, the Presidency compromise text foresees that when an entity is considered a shell entity, other Member States shall deny the shell entity exemptions or reductions of tax that follow from a) the

Parent-Subsidiary Directive (PSD) and the Interest-Royalty Directive (IRD), and b) double taxation agreements within the EU (DTAs). Almost half of the delegations that expressed a view at the WPTQ meeting in February raised concerns and doubts when it comes to the reference to bilateral double taxation agreements concluded between Member States, *inter alia* for policy reasons. However, it is the view of the Presidency that the majority of the delegations are of the opinion that DTAs within the EU must be included. The reason for this is that the DTAs often mirror the benefits laid down in the PSD and IRD. If a shell entity is not entitled to benefits according to the PSD and the IRD but is entitled to the same benefits according to a tax treaty, it can be argued that the proposal would not accomplish a robust effect in preventing the misuse of shell entities for tax purposes. Consequently, it is proposed that the DTAs should be included in Article 11. The compromise text presented by the Presidency in March reflects that tax consequences will apply for the relevant income and the tax period when the entity has been found to be a shell entity;

(f) tax residency certificate (Article 12). At the request of several delegations, the Presidency compromise text now sets out that when an entity is presumed to be a shell entity and does not successfully rebut this presumption, any tax residency certificate granted by the Member State of the entity shall contain a notice that the entity is presumed to be a shell entity for the relevant tax period. Some delegations are of the view that rules on the tax residency certificate would not be useful within the Unshell Directive, mainly because of timing aspects, and instead would prefer to rely only on exchange of information;

(g) exchange of information (Article 13). Delegations have expressed support for automatic exchange of information to be a part of the

Unshell Directive, i.e. that amendments in the Directive on Administrative Cooperation (DAC) are necessary. Some delegations have suggested that exchange of information would be a sufficient consequence and that no other tax consequences are necessary. Delegations have discussed what information should be requested from shell entities and exchanged, so that this information is useful for tax authorities of Member States, other than the ones where the shell entity is resident. This is important in order to ensure that the appropriate actions can be taken, for example regarding taxation of relevant assets. For these purposes, the Presidency has suggested a new Article 10, clarifying what information should be collected from the shell entities. As regards timing, delegations share the view that Automatic Exchange of Information (AEOI) should only take place after the shell entity status has been concluded, i.e. when an entity is presumed to be a shell entity and does not successfully rebut this presumption.

7. The complexity of the proposal will require further technical discussions in the WPTQ: delegations will need to work on possible compromise solutions on some issues, while keeping in mind the interlinkages between different parts of the Directive. Choosing one option in one part of the Directive may influence the solution in another part. The Presidency notes that delegations are committed to continue the work on the file. The Presidency is of the view that some guidance is needed on some of the above-mentioned issues, in particular on the scope and tax consequences.

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8. The European Economic and Social Committee adopted its opinion on 23 March 2022.[1] The European Parliament adopted its opinion on 17 January 2023.[2]

III. Questions for discussion

In the light of the above, the Presidency has prepared questions to guide the discussion at the meeting of the Working Party on Tax Questions (High Level) on 25 April 2023. The aim of the discussion is to get guidance on the way forward on the draft Unshell Directive. Delegations are invited to address during their interventions the following questions:

1) Are you of the view that it should be clarified that the Directive is intended to ensure only a *minimum level of protection* necessary for the internal market?

2) Regarding the criteria of minimum substance in Article 6, do you agree that the criteria in the compromise proposal presented by the Presidency is a balanced compromise, i.e. that they fulfil the purpose of being robust and at the same time easy to report and control?

3) Do you share the view that since tax treaties often mirror the benefits laid down in the PSD and IRD, keeping the reference to double taxation agreements in Article 11 is necessary in order for the proposal to be robust? If not, would it make sense to also delete the reference to the PSD and IRD?

[1] St 8007/22.

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

4) Do you support the idea that a notice in a tax residency certificate that an entity has been found to be a shell entity in a previous year, could serve as a useful "warning flag" for other Member States?

5) What are the key elements for your delegation that need to be solved before an agreement on the Unshell file could be reached in the Council? What could be the solutions to these outstanding issues in your view?

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