Opinion of the European Economic and Social Committee on the Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU

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Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	3.3.2022
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Outcome of vote	
(for/against/abstentions)	206/1/6

1. **Conclusions and recommendations**

1.1. The EESC fully supports the Commission proposal on the misuse of shell companies for tax purposes and its objectives. Ensuring an effective, fair taxation across the single market is crucial to favour a real recovery after the COVID-19 pandemic.

1.2. The EESC appreciates the wide public consultation launched by the Commission that will be open to all stakeholders, as well as the more targeted consultation of national experts, which were involved based on their specific expertise. These consultations have given stakeholders the opportunity to deliver a meaningful contribution, and they should continue to be included in future discussions.

1.3. The EESC supports the choice of a Directive aimed at ensuring a common legal framework among Member States. The nature of the subject matter to be regulated and the objectives pursued means that they cannot, indeed, be handled through single initiatives by Member States in their respective legal systems.

1.4. The EESC considers the proposal to be in line with the proportionality principle, since it does not go beyond ensuring the necessary level of protection for the single market, with an apparently reasonable impact on companies.

1.5. The EESC considers that, in order to correctly manage the necessary checks and to share the resulting information related to the proposal, the Commission and national tax authorities should have adequate capacity to do so in terms of skills and resources.

1.6. The EESC hopes that, once the investigations into shell companies have been undertaken and completed, the outcome will be made transparent to the public, making known the results of the Directive's implementation.

1.7. The EESC believes that adequate checks should be carried out with regard not only to corporate income but also to assets, given that taxes can be levied even if such assets do not generate any income, as for example in the case of wealth taxes.

1.8. The EESC underlines the need to establish common and clear rules on the specific content of the declarations required from undertakings. Overreporting going beyond the Directive objectives, and the resulting compliance costs, should be avoided.

1.9. The EESC recommends that targeted rules to prevent the activity of 'professional enablers' be laid down in a different legislation, thus following the OECD approach to the subject matter. The EESC believes that the cooperation of professional supervisory bodies in combatting malpractice and possible criminal activities carried out by 'professional enablers' would be of great value.

1.10. The EESC reiterates the need to have a complete and wide-ranging EU list of non-cooperative tax jurisdictions located outside the EU, *inter alia* so that EU companies can see whether the funds and assets they manage may be connected to shell entities located outside the EU.

1.11. The EESC suggests that the Commission issue appropriate guidelines regarding the substance test set forth by the Directive, with particular regard to the meaning of specific terms such as 'residence', 'resident director' and 'premises'.

1.12. The EESC observes that shell companies can also be established and utilised to facilitate undeclared work, as well as to avoid social security contributions. The EESC therefore suggests that the Commission consider the possibility of addressing such issues in European legislation in addition to the proposal at hand, which is purely a tax directive.

2. **European Commission background**

2.1. The European Commission Communication on Business Taxation for the 21st century, adopted on 18 May 2021, lays down both long-term and short-term objectives to support the recovery from the COVID-19 outbreak and to ensure adequate public revenues in the future.

2.2. The proposed Commission Directive on shell entities is one of the short-term specific initiatives announced by the Communication to improve the current tax system, with a particular focus on ensuring fair and effective taxation.

2.3. Legal entities with no minimal substance and economic activity could be used for improper tax purposes, such as tax evasion and tax avoidance or even for money laundering. It is therefore necessary to tackle situations where those expected to pay tax evade or avoid their tax obligations by means of undertakings not performing any actual economic activity. Shell companies could favour an environment of unfair tax burden distribution, as well as unfair fiscal competition among jurisdictions.

2.4. The proposal put forward by the Commission applies to all undertakings that are considered tax resident and are eligible to receive a tax residency certificate in an EU Member State. Once adopted as a directive, the new rules should be transposed into Member States' various national legal systems by the 30 June 2023, coming into full effect on 1 January 2024.

2.5. There is a wealth of European legislation on money laundering, a crime which is often favoured by certain shell companies, that could provide useful context to the Commission proposal. In particular, reference should be made to the Commission's proposed legislative package of July 2021, which consists of three regulations and a directive ([1]).

3. **European Commission proposals**

3.1. The Directive refers to schemes used for the purposes of tax avoidance or tax evasion. The scheme targeted by the proposal involves the setting up of undertakings in the EU that are supposedly performing genuine economic activities, but that do not actually conduct such activities. The real reason why some of these types of companies are established is, indeed, enabling certain tax advantages to flow to their beneficial owner or to the group they belong to.

3.2. In order to tackle these schemes, the proposed Directive lays down a test aimed at helping Member States identify undertakings supposedly engaged in a legitimate activity, but that do not have a minimal economic substance and are therefore possibly being misused in order to obtain undue tax advantages. This test is defined as a 'substance test'.

([1]) See EESC opinion on the Anti-money laundering legislative package (OJ C 152, 6.4.2022, p. 89).

3.3. The first step of the test divides the various types of undertakings between those ‘at risk’ of lacking substance and being misused for tax purposes on the one hand, and those ‘at low risk’ on the other hand. Risk cases are characterised by a number of features usually simultaneously identified in undertakings that lack substance (‘gateway criteria’). By contrast, low-risk cases present none or only some of these criteria and do not pass the gateway.

3.4. The relevant criteria consider as ‘at risk’ those undertakings, not specifically exempted by the Directive, engaged with cross-border activities, that are geographically mobile and that, in addition, rely on other undertakings for their own administration (in particular professional third-party service providers). Low-risk cases that do not cross the gateway are irrelevant for the purposes of the Directive.

3.5. The companies first have to self assess themselves and, if they qualify as ‘at risk’, are asked to report on their substance within their tax return. Reporting on substance implies providing specific information to facilitate the assessment of the activity performed by the undertaking.

3.6. As for the second step, three elements determine the outcome of the substance test:

i) premises available for the exclusive use of the undertaking;

ii) at least one own and active bank account in the EU;

iii) at least one director resident close to the undertaking and dedicated to its activities or, alternatively, a sufficient number of the undertaking’s employees who reside close to the undertaking and are engaged with its core ‘income generating activities’.

3.7. The third step of the test prescribes the appropriate assessment of the information reported by the undertaking in the second step with regard to substance. An undertaking that is a risk case — since it has crossed the gateway — and whose reporting also leads to the finding that it lacks at least one of the relevant elements on substance, should be presumed to be a ‘shell’ under the new Directive and therefore lacking substance and presumably being misused for tax purposes.

3.8. An undertaking that is a ‘risk case’, but whose reporting reveals that it has all relevant elements of substance, should instead be presumed not to be a ‘shell’ for the purposes of the Directive. However, this presumption does not exclude the possibility of a tax administration finding that such undertaking is a shell on grounds outside the scope of the Directive.

3.9. The fourth step involves the right of the undertaking presumed to be a ‘shell’ and being misused for tax avoidance purposes under the Directive to prove otherwise by demonstrating its own substance using concrete evidence (‘rebuttal’). The undertakings in question will therefore have an effective right to make the claim that they are not a ‘shell’ under the Directive.

3.10. Once an undertaking is considered to be a ‘shell’ for the purposes of the Directive and does not rebut this presumption, tax consequences should be triggered accordingly. These consequences should disallow any tax advantages that have been or could be obtained.

3.11. Since in order to be entitled to the benefits of a tax treaty an undertaking normally needs to provide a certificate of residence for tax purposes, the Member State of tax residence of the ‘shell’ will either not issue the tax residence certificate at all, or will issue a certificate with a warning statement, meaning the inclusion of an explicit statement to prevent its use for the purposes of obtaining the above advantages.

3.12. In the case that tax advantages accorded to the undertaking are disallowed, it should be determined how income flows to and from the undertaking, as well as any assets owned by the undertaking, should actually be taxed. The allocation of taxing rights should take into account all jurisdictions that may be affected by transactions involving the ‘shell’.

3.13. The rules of the Directive necessarily affect only Member States, as third countries are outside the remit of EU law. In these cases, agreements for the avoidance of double taxation between a Member State and a third country should be duly respected as regards the allocation of taxing rights. In the absence of such agreements, the Member State involved will apply its national law.

3.14. All Member States will have access to reporting entities under the Directive, at any time and without the need to specifically file a request for information. To this effect, information will be exchanged among Member States from the first step, when an undertaking is classified as being 'at risk' under the Directive. For this purpose, a register or database will be introduced.

3.15. The proposed legislation leaves it to the Member States to lay down the penalties applicable for violating the reporting obligations enshrined in the Directive, as transposed into the various national legal systems. The penalties shall be effective, proportionate and dissuasive.

3.16. A minimum level of coordination amongst Member States is expected through the setting of a minimum monetary penalty as per existing provisions in the financial sector. Penalties should include an administrative pecuniary sanction of at least 5 % of the undertaking's turnover.

4. **EESC general comments**

4.1. The EESC fully supports the Commission proposal and its overall objectives. Ensuring effective and fair taxation across the single market is crucial in order to favour a real recovery after the COVID-19 pandemic. Sufficient tax revenues to Member States are indeed a key factor in facilitating public investments aimed at achieving a greener and more digitalised single market. The EESC is slightly concerned that the substance requirements do not recognise the digital side and only emphasise the importance of tangible assets. This could create problems in the future.

4.2. The Commission proposal is therefore fully in line with the Communication on Business Taxation for the 21st century, resulting in concrete and consistent action aimed at combatting tax evasion and tax avoidance, thereby ensuring a fair taxation environment across Europe.

4.3. The EESC notes that the Commission proposal is consistent with previous legislative initiatives undertaken by the EU institutions, such as the Anti-Tax Avoidance Directive (ATAD) and the Directive on Administrative Cooperation (DAC) between tax authorities. It is of paramount importance to pursue consistency among different tax rules between which constant interplay is expected, in order to avoid unintended outcomes.

4.4. The Commission proposal is complementary to the recent proposal regarding the global minimum level of taxation for multinational groups in the EU (known as 'pillar 2'), notwithstanding the different scopes of application of the two Directives, given that pillar 2 will be applied to companies exceeding a turnover threshold of EUR 750 million, while the Directive on shell companies is not subject to such limitations.

4.5. The EESC appreciates the public consultation launched by the Commission before publishing its proposal. This consultation contained 32 questions aimed, among other things, at delineating the problem and its causes, and identifying the appropriate form of EU action. Stakeholders have therefore been given a significant opportunity to participate in voicing their observations and concerns before the development of the new rules. The EESC regrets that only a few stakeholders (50) have used that opportunity.

4.6. The EESC also supports the additional public consultation of national experts, which have been involved in a targeted way, based on their specific expertise. The combination of a wide consultation addressed to stakeholders and a more detailed one addressed to qualified experts strikes a good balance between ensuring both a participatory and technically advanced legislative process.

4.7. The very same nature of the subject matter to be regulated through the Directive and the objectives set out — tackling cross-border tax avoidance and evasion — require a common framework to be implemented by Member States.

4.8. Indeed, an appropriate and effective common framework could not be achieved through single measures implemented by each Member State with regard to their respective legal systems. In that case, the existing fragmentation would indeed be replicated and possibly even worsened by multiple, uncoordinated actions carried out at the national level.

4.9. Shell companies that have been set up in Member States need to be brought into line with the Directive, and the collaboration of the Member States' administrations is more imperative than ever to avoid eroding the fiscal capacity of the EU as a whole. In order to correctly manage the checks and to share the information, the Commission should have the adequate capacity and sufficient resources to do so.

4.10. The EESC also deems the proposal to be in line with the proportionality principle, since it does not go beyond ensuring the minimum necessary level of protection for the single market, with an apparently reasonable impact on companies. Indeed, the Directive aims at achieving a minimum protection for Member States' tax systems, ensuring the essential degree of coordination within the EU for the purpose of achieving its objectives.

4.11. On the other hand, the impact on companies also seems to be proportionate, striking an appropriate balance among the various objectives and values, including:

i) effectiveness in reducing the misuse of shell entities;

ii) tax gains for public finances;

iii) compliance costs for businesses and tax administrations;

iv) indirect effects on the single market and on competition among firms.

4.12. The EESC agrees with the Commission's approach that an effective and transparent exchange of information between tax authorities is essential in order to combat the inappropriate use of shell companies and, more generally, to ensure a fair and more efficient taxation environment. This point has to be followed very carefully so that there is cooperation between Member States in which a shell company has transactions that involve two Member States. Once the investigation processes into shell companies are completed, the outcome should be made transparent to the public. European and national authorities should make known the results of the Directive's implementation.

4.13. Shell companies that fall under this Directive can be used both for tax evasion and tax avoidance and in particular cases even for committing crimes, such as money laundering, with which they are often connected. Therefore, legislative coordination and coordination of the various supervisors responsible for combatting these crimes, both at national and European level, are essential. With UNSHELL tax authorities will have access to further information, which will allow them to cross-check this new array of information with the information provided by Anti-Money Laundering (AML) authorities. The national and European authorities must ensure that the application of this Directive does not cause any problems for any type of company that carries out its activity in accordance with the law.

4.14. Knowledge of the beneficial owners of shell companies and their assets and of the real owners of the transactions they carry out is essential in order to unravel the real nature of their activities and to understand the extent of tax evasion or money laundering committed. The hiding of beneficial ownership through chains of shell companies, managed by 'professional enablers', is inherent to their criminal purposes. The tools for knowing the beneficial owners are in the anti-money laundering legislation. However, there is no reference to the issue in the proposed Directive under discussion. The EESC considers that this as well as other loopholes in the linking of the two pieces of legislation should be resolved, either by explaining how to do so in this Directive or by urgently promoting a European framework law to address it.

4.15. Outside the scope of this Directive, some shell companies are also created and used to facilitate undeclared work and avoid social security contributions. The EESC proposes that the Commission analyse the possibility of addressing this issue in European legislation.

5. **Specific comments**

5.1. The EESC considers the ‘gateway criterion’ implemented by the Commission proposal in the form of cumulative indicators as reasonable and appropriate. In this respect, the EESC observes that entities holding assets for private use, such as real estate, yachts, jets, artwork or equity alone may have no income for long periods of time, but still give rise to significant tax benefits for their controlling entities.

5.2. The Committee therefore believes that checks should be not solely on income, but also on assets, as taxes can be levied even if they do not generate any income, such as wealth taxes wherever applicable. The EESC believes that, in order to correctly manage these checks and to share the information, the Commission should have the adequate capacity and enough resources to do so.

5.3. The EESC suggests that the Commission issue appropriate guidelines regarding the substance test set forth by the Directive, with particular regard to the meaning of specific terms such as ‘residence’, ‘resident director’ and ‘premises’. Following this approach, national discrepancies and divergent interpretations potentially harmful for the internal market could be reduced or better addressed. In particular, the EESC requires the Commission to duly consider the new digital models of business in this respect.

5.4. The EESC considers that companies’ engagement in cross-border activities should be carefully evaluated with regard to the actual nature of the transactions carried out by such companies on the one hand, and with reference to their properties and assets on the other hand. Companies presenting an adequate level of transparency and not posing a real risk of lacking economic substance for the purpose of tax evasion or tax avoidance should not be covered by the Directive.

5.5. The UNSHELL Directive draws on the existing EU and international standard. The EESC recommends that the Commission ensure compatibility with the relevant international and common EU standard already in place, in particular the concept of ‘substantial economic activity’ developed in the context of preferential tax regimes and extensively discussed within the forum on harmful tax practices. Another important issue to address concerns the establishment of common and clear rules concerning the specific contents of the declarations required of undertakings. Overreporting going beyond the Directive objectives and the resulting compliance costs should be avoided.

5.6. The EESC urges that specific attention should be paid to the role of so-called ‘professional enablers’, an issue not mentioned in the proposal for a Directive. The EESC recommends that the rules regulating the activity of ‘professional enablers’ be laid down in a different legislation, in line with the criteria set out on the subject by the OECD, who often also play a relevant role in the specific area of shell companies ([2]).

5.7. The OECD, which describes the professional categories, some of whose practitioners manage or collaborate with chains of shell companies, considers it essential to focus on ‘professional enablers’ in order to combat the criminal activity of companies established for unlawful purposes, including tax evasion. Law abiding professionals should indeed be duly distinguished from a small set of practitioners using their skills in the field of tax law and corporate accounting to actively favour practices relating to tax evasion, tax avoidance and money laundering.

5.8. The EESC therefore highlights the need to target professional enablers who actively supply opportunities to exploit unlawful practices favouring fiscal and financial crimes. By doing so, it would be possible to disrupt a crucial factor relating to tax abuses. Reducing the opportunities to develop unfair fiscal practices is indeed a fundamental step towards achieving the very same objectives pursued by the Commission proposal.

5.9. The EESC believes that the cooperation of professional regulatory or supervisory bodies in combatting malpractice and possible criminal activities of ‘professional enablers’ would be of great value. This would be an interesting line of development of the European social and political pact against fiscal and economic crimes, money laundering and corruption, which the Committee has advocated in various opinions.

([2]) *Ending the Shell Game: Cracking down on the Professionals who enable Tax and White Collar Crimes*, OECD, Paris, 2021.

5.10. The EESC also suggests coordinating the Commission Directive proposal with the existing rules regarding transfer pricing, since the use of shell companies aimed at tax evasion might interplay with such a practice across the EU and should therefore be specifically considered in this respect. Here again, the EESC considers that the possibility of establishing a transfer pricing directive should also be considered.

5.11. The Committee believes that the list of companies not subject to reporting (Article 6(2)) must be properly justified and assessed in order to ensure that they do not benefit from an inappropriate tax advantage and that they are not used to circumvent the law.

5.12. The EESC also considers that more action should be put in place when a company or entity outside the EU does business with an EU-listed company or entity. One has to understand what action could be made available to EU-listed companies or entities in order to see that the funds or assets being managed are not coming from outside the EU 'shell' entity.

5.13. In order to be able to take effective action against companies that do business with companies based in non-cooperative jurisdictions for tax purposes, the Committee reiterates the need for the EU list of non-cooperative tax jurisdictions to be as effective and comprehensive as possible.

Brussels, 23 March 2022.

The President
of the European Economic and Social Committee
Christa SCHWENG