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PROPOSAL

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	SWD(2021) 579 final
Subject:	COMMISSION STAFF WORKING DOCUMENT EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT Accompanying the document Proposal for a COUNCIL DIRECTIVE laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU

Delegations will find attached document SWD(2021) 579 final.

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COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT

Accompanying the document

Proposal for a COUNCIL DIRECTIVE

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

{COM(2021) 565 final} - {SEC(2021) 565 final} - {SWD(2021) 577 final} - {SWD(2021) 578 final}

Executive Summary Sheet
Impact assessment for an initiative to fight the use of shell entities and arrangements for tax purposes – "Unshell"
A. Need for action
What is the problem and why is it a problem at EU level?
The main problems addressed by the impact assessment are tax avoidance and tax evasion caused by the use of shell entities for tax purposes by companies and individuals. Shell entities can be defined as companies and other entities which do not have substance (they do not have offices, employees, equipment etc.) and do not perform any genuine economic activity, only fulfilling the essentials of registration and organisation. Shell entities can take different forms depending on the intended use. Overall, tax losses due to tax avoidance by companies are in the order of tens of billion of euro per year.[1] It is particularly challenging to estimate tax losses due to the use of shell entities. A first approximation of the phenomenon hint at a tax loss that could be estimated at around EUR 23 billion per year. There is moreover robust anecdotal evidence that shell entities continue to be employed to reduce tax liability in legal and sometimes illegal fashion by a variety of economic actors, including large multinationals. The three main drivers of the problem are: a) lack of EU rules defining common minimum substance requirements for tax purposes in the EU; b) lack of information that tax administrations would need to effectively apply existing rules against tax avoidance and evasion; c) promotion of shell entities by certain intermediaries.
What should be achieved?
The general objective of the initiative is to tackle tax avoidance and evasion via shell entities and in doing so contribute to proper functioning of the internal market. More specifically, the initiative aims to achieve the following three objectives: first, it aims at introducing, within the EU, common rules to be able to identify shell entities at risk of being used for tax avoidance or evasion. Second, Member States need to know about the existence of shell entities being identified as such in another Member State. Third, the initiative aims to disincentive the use of tax and company service providers from creating shell entities in the EU.
What is the value added of action at the EU level (subsidiarity)?
The problem of tax avoidance or tax evasion through the use of shell entities is typically a cross-border problem. It has the same drivers and underlying causes no matter in which Member State it appears. Within the Union, national approaches risk distorting the internal market and could make some Member States vulnerable to regulatory and tax arbitrage, especially if national action translates in some Member

[1] Within the EU, tax avoidance is estimated at between EUR 35 billion and EUR 70 billion of tax revenues lost per year. Source: Dover, R., Ferrett, B., Gravino, D., Jones, E., & Merler, S. (2015) Bringing transparency, coordination and convergence to corporate tax policies in the European Union, European Parliamentary Research Service, PE 558.773.

States not imposing substance requirements for shell entities or imposing requirements more lenient than elsewhere. Importantly, as shell entities are commonly used to erode the tax base of a Member State other than the one where the shell entity is located, some Member States might not have sufficient incentive to introduce robust, national rules.

Only a common EU framework can help to achieve the objective of tackling tax avoidance and evasion via shell entities while preserving both the integrity of the internal market and ensuring a level playing field among economic operators across the Union.

B. Solutions

What are the various options to achieve the objectives? Is there a preferred option or not? If not, why?

The baseline (option 0) represents the status quo: lack of minimum substance requirements for shell entities and implementation of existing rules at EU, national and global level to tackle tax avoidance and tax evasion. This includes action by the EU Code of Conduct Group for business taxation (COCG) to address the issue of substance but only for preferential tax regimes.

Option 1 is a soft-law option. It would introduce minimum substance requirements for shell entities however, such requirements would not be binding nor enforceable. Option 1 could take the form of a Commission recommendation or of an expansion of the mandate of the COCG to check that substance requirements are applied as a general feature of Member States' tax systems.

Option 2 is the basic regulatory option, on top of which Option 3 and Option 4 are built. Option 2 would introduce common substance requirements across the EU, obliging (certain) legal entities and legal arrangements – those that would not be carved-out from the start and that would pass certain gateways – to demonstrate to the tax administration that they have substantial economic activity in their Member States of tax residence. Lack of substance requirements would lead to tax consequences (namely, stop to tax advantages for shell entities under relevant EU directives and/or tax treaties).

On top of Option 2, Option 3 would include the establishment of a mechanism for administrative cooperation and exchange of information concerning shell entities. Option 4 would be composed of the same elements of Option 3, with the addition of a common definition of sanctions in case of non-compliance by shell entities.

Option 4 is the preferred option. It includes all elements of Option 2, exchange of information between tax administrations as per Option 3 and complements this with a common sanction framework. Option 4 is expected to best meet the objectives of the initiative, with the highest deterrent effect on taxpayers, while not imposing a disproportionate cost for businesses nor for tax authorities.

What are different stakeholders' views? Who supports which option?

Overall, the respondents to the public consultation acknowledge the ongoing challenge of tax avoidance and evasion, including through the misuse of shell entities. However, suggestions on the way forward differ. While some respondents support action to tackle tax avoidance and tax evasion via shell entities, others take the view that an EU legislative initiative in this direction may be premature. Member States overall have expressed constructive openness and in some cases explicit support for an EU legal initiative to tackle the use of shell entities used for tax avoidance or tax evasion.

C. Impacts of the preferred option

What are the benefits of the preferred option (if any, otherwise of main ones)?
Option 4 provides for a common minimal substance definition, which was lacking in the current anti-tax abuse framework of the EU. Thanks to its exchange of information between tax authorities, it complements current exchange of information already in place at EU level. It would ensure that Member States, whose tax bases are being eroded by the use of shell entities, registered in other Member States, are made fully aware of this. Through common sanctions, it ensures the highest level of compliance by entities and equal treatment for all entities in the EU, independently of their place of registration. Thus, the potential positive effect on the sustainability of public finances is the highest amongst all options and the EU intervention is seen as contributing to the better functioning of the internal market by avoiding its fragmentation via the various possible choices of sanctions. Even if the intervention reduced tax avoidance and tax evasion by a very small amount, it is expected that benefits would nonetheless outweigh the costs (mainly compliance and administrative costs) associated with this initiative.
What are the costs of the preferred option (if any, otherwise of main ones)?
Compliance costs for entities are expected to be limited as this would be information readily available to the entity, for the entities that will have to self-assesse and to report. Costs for the tax administration are limited to the implementation of a platform for the exchange of information, the evaluation of reported data and the administration of sanctions. The evaluation of the reported data, to conclude whether an entity is shell or not, is made by the tax administration, based on the self-assessment made by the entity against specific criteria. The size of the costs of sanction administration would depend on the form the sanction would take. For a financial penalty, the costs are expected to be limited to the administrative costs generated by issuing a fine and monitoring its payment. Enforcement costs should not be fundamentally different for the national administration between option 2, 3 and 4, because, if no common framework of sanctions was planned, the national administration would still have to apply certain sanctions to ensure compliance.
What are the impacts on SMEs and competitiveness?
The initiative aims at covering those entities that do not have substance and are set up to avoid or evade taxation[2], not businesses with employment and genuine economic activity. The criteria that trigger reporting obligations to the tax authority are strictly limited to companies with a risk of practising tax avoidance or tax evasion, which is expected to cover only a very small proportion of the SME-defined population. The gateway criteria are expected to exclude the vast majority of SMEs (e.g. to fall in scope, a SME should have most of its revenues from passive income, be owned mainly by foreign owners and

[2] The OpenLux investigation revealed that more than 1 000 companies with no employees were registered at the same address.

would not have the resources required to conduct a genuine economic activity).

On competitiveness, the initiative would only impact financial flows that are not associated with employment nor with genuine economic activity. In the longer term, limiting the use of entities with no substance could have positive second-round (indirect) effects, stimulating productive investments.

Will there be significant impacts on national budgets and administrations?

The main impact for national budgets would be a tax gain, difficult to estimate. Within the EU tax avoidance is estimated at between EUR 35 billion and EUR 70 billion of tax revenues lost per year.

Tax revenue forgone can be considered a resource shortfall that could otherwise be used for public investment and the provision of public goods. Such a shortfall is especially unwelcomed at a time when resources are needed to boost the recovery after the COVID-19 pandemic.

Will there be other significant impacts?

No

Proportionality?

Action would not go beyond setting minimum substance criteria. Mechanisms such as carve-outs and exemptions from the reporting requirements under the initiative will mean that low tax abuse risk entities and arrangements will not be subject to the initiative. Furthermore, according to Commission analysis, only a minimal amount of entities and arrangements in the EU will need to self-assess under the initiative.

D. Follow up

When will the policy be reviewed?

If the preferred option was chosen, the policy would be monitored through in two main ways. Fist, Member States will report data on the implementation of the policy and enforcement actions. At least in part, this data should be made public, for the purpose of transparency and to enable public scrutiny in Member States. Second, the Commission will assess implementation and enforcement of the initiative in the various Member States and report about it. Such assessment will be conducted mainly on the basis of data from Member States.

Five years after the implementation of the instrument begins, the Commission will evaluate the results of the policy, with respect to its objectives and the overall impacts on tax revenues, businesses and the internal market.