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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) 579 final}

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Term or acronym	Meaning or definition
AEOI	Automatic exchange of information
AML	Anti-money laundering
AMLD	Anti-money laundering directive
ATAD	Anti-Tax Avoidance Directive, Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
ATP	Aggressive Tax Planning. Defined in the Commission Recommendation of 6 December 2012 on Aggressive Tax Planning as: "(...) taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. Its consequences include double deductions (e.g. the same loss is deducted both in the State of source and residence) and double non-taxation (e.g. income which is not taxed in the source State is exempted in the State of residence)."
BEPS	Base Erosion and Profit Shifting
BO	Beneficial ownership
CD	Central Directory for automatic exchange of information
CFT	Counter-terrorism financing
CIGA	Core income-generating activities
CRS	Common reporting standard
DAC	Directive on administrative cooperation, Council Directive (EU) of 15 February 2011 on administrative cooperation in the field of taxation, as amended.
DTT	Double tax treaties
EOIR	Exchange of information on request
FATF	Financial Action Task Force
FHTP	OECD Forum on Harmful Tax Practices
IFCs	International Financial Centres
IBFD	International Bureau of Fiscal Documentation
IMF	International Monetary Fund
Legal	The term is used to refer to trusts and partnerships and any other similar

arrangement	legal arrangements.
Legal entity	The term is used to refer to any body corporate that has legal personality.
NACE	The Statistical Classification of Economic Activities in the European Community (NACE) is the industry standard classification system used in the European Union.
MEP	Member of the European Parliament
MNEs	Multinational enterprises
OECD	Organisation for Economic Co-operation and Development
ORBIS	A database on private companies compiled by Bureau van Dijk
PPT	Principal purpose test
SEOI	Spontaneous exchange of information
TCSPs	Trust or company service providers

1. INTRODUCTION: POLITICAL AND LEGAL CONTEXT

The EU tax policy agenda aims at enabling fair and sustainable growth. EU tax policy priorities are guided by the principles of fairness, efficiency and simplicity. To contribute to achieving fair and effective taxation, in May 2021[1] the Commission committed to stepping up the fight against the abusive use of shell entities for tax purposes through a new legislative initiative. Targeting this type of abuse has become all the more important after massive media revelations regarding abusive shell entities in the beginning of 2021.

The initiative would focus on entities established in EU Member States that have no or minimal substantial economic presence, for example in terms of employment, and that may be used for tax avoidance or evasion. The overall objective of the initiative whose impact is assessed in this document is therefore to counter the misuse of shell entities for tax purposes only, and in so doing contribute to fair and effective taxation.

Shell entities serve a variety of purposes. The use of a shell entity is not *per se* an indication of tax avoidance or evasion. Nevertheless, what are generically called shell entities are sometimes used for illegal purposes such as money laundering. Moreover, they can be used for evading and avoiding taxes. Examples of their persistent misuse were revealed by the OpenLux investigation. Based on publicly available information, OpenLux journalists found significant amounts of assets located in Luxembourg held by non-resident taxpayers in holding companies, some of which neither maintain their own premises, nor have employees nor carry out economic activity in Luxembourg.[2] The investigation found that this enabled, for instance, some French investors to significantly lower their tax bill.[3] Such tax savings may be indicative of evasion and avoidance and warrant further investigations.[4] More recently, the Pandora Papers,[5] a massive data leak concerning offshore accounts of several high-net-worth individuals, have revealed that shell entities continue to be used in complex offshore structures, also with the aim of avoiding if not evading taxation.

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[1] European Commission, 2021, Communication on Business Taxation for the 21st Century.

[2] OpenLux shows failures of beneficial ownership registers | International Tax Review

[3] Following the publication of the investigation, it was quoted in the French press that, ibid. quote : « S'il devait être rapatrié demain en France et soumis à la « flat tax » de 30 % sur les revenus du capital, ce « trésor de guerre » pourrait faire rentrer près de 5 milliards d'euros dans les caisses de l'Etat ».

[4] Note that, following the OpenLux press releases, the Luxembourgish authorities stated, among others, that: "Luxembourg is fully compliant with and has implemented all applicable EU and international rules and standards with regards to tax transparency, the fight against tax abuse as well as AML – and even gone beyond these requirements – Luxembourg rejects the claims made in these articles as well as the entirely unjustified portrayal of the country and its economy". Source: https://gouvernement.lu/en/actualites/toutes_actualites/communiques/2021/02-fevrier/08-declaration-openlux.html

[5] The Pandora Papers are the result of an investigation by the International Consortium of Investigative Journalists, more information can be found at: https://www.icij.org/investigations/pandora-papers/

The European Parliament has at several occasions stressed the importance of tackling tax evasion and avoidance via shell entities. It has called for EU intervention on the matter, inviting the Commission to exercise its right of initiative and act to counter the misuse of shell entities for tax purposes. In its resolution of 26 March 2019 on financial crimes, tax evasion and tax avoidance[6], the European Parliament put forward several actions to address the tax challenges posed by companies registered in a jurisdiction mainly for tax avoidance or tax evasion purposes and without any significant economic presence.[7] Some of the actions requested include establishing a common definition of shell companies and economic activity requirements tests. More recently, in March 2021, the European Parliament discussed in plenary, the findings of the OpenLux investigation.[8]

The initiative assessed here fits within a larger set of Commission initiatives for fair and effective taxation. Among others, key recent initiatives include the Anti-Tax Avoidance Directives ('ATAD')[9] and expanding on several occasions the scope of the Directive on Administrative Cooperation ('DAC')[10]. Moreover, related work has been done and is ongoing by the Code of Conduct Group on business taxation not only on the EU Member States but also with regard to non-EU countries through the EU list of non-cooperative tax jurisdictions[11]. Since 2018, the EU has been reviewing the robustness of non-EU countries' tax systems against tax avoidance or tax evasion, in part conducted via the misuse of shell entities. Technically, this process proposes the introduction of substance requirements to some non-EU countries to counter the use of shell companies to avoid or evade tax.

This initiative also relates to other EU interventions currently under preparation to ensure fair and effective business taxation. In its recent Communication on Business Taxation for the 21st century[12], the Commission argued in favour of a fair sharing of tax burden across businesses. As outlined in the Communication, the Commission remains committed to building a Union framework for business taxation in the EU: the "Business in Europe Framework for Income Taxation" (or BEFIT). Alongside BEFIT, the

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[6] More information on OpenLux is provided in the Annex

[7] https://www.europarl.europa.eu/doceo/document/TA-8-2019-0240_EN.html. Among others, recommendations for actions, whose scope may be broader than tax policy, included: establishing a single definition of shell or letterbox companies, repealing anonymity for owners of these companies and establishing coordinated, binding, enforceable and substantial economic activity requirements as well as expenditure tests for these companies.

[8] "OpenLux" tax investigation discussed in plenary | 08-03-2021 | News | European Parliament (europa.eu) During the debate, MEP Mr Paul Tang, chair of the FISC committee at the European Parliament, explicitly called for action to tackle tax avoidance and evasion through the use of shell entities.

[9] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market

[10] Council Directive (EU) of 15 February 2011 on administrative cooperation in the field of taxation

[11] https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/

[12] COM (2021) 251

Commission will propose new initiatives with the aim of: (i) addressing the debt-equity bias in corporate taxation; (ii) enhancing tax transparency of large multinational companies; and (iii) proposing the initiative subject of this impact assessment. The Commission will also launch a broader reflection on the EU tax mix, the proportion of total tax revenues derived from various tax sources (corporate income tax, personal income tax, VAT, etc.).

The initiative assessed here also aligns with the objective of fair taxation shared by the international community[13] and fits with related international actions to tackle cross-border tax avoidance. In the late 2010s, the OECD Base Erosion and Profit Shifting (BEPS) project introduced substance criteria for tax purposes. In particular, BEPS Action 5 aims to ensure that participants in the so-called Inclusive Framework on BEPS have significant economic activities linked to preferential tax regimes and their incentives. The same action introduced substantial activity requirements for no or only nominal tax jurisdictions and provided guidance on the application of the requirements. BEPS Action 6 on Treaty Shopping aims to prevent the abuse of double tax treaties by interposed shell entities.[14] In addition, the Commission and Member States are also actively promoting fair taxation in international fora to fight harmful tax practices at worldwide level, e.g. the OECD Forum on Harmful Tax Practices (FHTP).

Mandated by the G20, the OECD Inclusive Framework is currently working on the implementation of a global, consensual solution to reform the international corporate tax framework. The reform is based on two main work streams: Pillar 1 (re-allocation of taxing rights) and Pillar 2 (minimum effective taxation). The two pillars aim to address different but related issues linked to the increasing globalisation and digitalisation of the economy. Pillar 2 is expected to put an end to the race to the bottom in tax competition among jurisdictions and to tackle corporate tax avoidance. Pillar 1 aims to better link taxing rights to place of economic activity. Note that Pillar 1's scope will be limited to a relatively low number of the large and most profitable multinationals only,[15] while Pillar 2 will apply to multinational companies that meet the EUR 750 million threshold, thus leaving all companies below this threshold out of the scope. As such, this process will not provide a comprehensive solution to tackle the use of shell entities for tax avoidance or evasion.

In addition, it is important to stress that shell entities are by no means only associated with large, multinational enterprises. Smaller companies and individuals, often high-net worth individuals, make use of them as well. As revealed by the OpenLux investigation,

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[13] https://www.g7uk.org/g7-finance-ministers-and-central-bank-governors-communique/

[14] Namely, through a limitation-on-benefits rules or principle purposes test (PPT).

[15] The scope will cover multinational enterprises with global turnover above EUR 20 billion and a pre-tax profit margin above 10%.

thousands of foreign nationals make use of Luxembourg-based holding companies, including about 15 000 French individuals.[16]

Addressing the abusive use of shell entities is important as, despite broader efforts to counter tax avoidance and evasion loopholes in the EU and globally, the estimated tax revenue losses of the affected jurisdictions remain high. Globally, corporate tax avoidance is estimated[17] at between USD 90 billion and USD 240 billion per year. Within the EU tax avoidance is estimated at between EUR 35 billion and EUR 70 billion of tax revenues lost per year.[18]

To conclude, the current political context points to the need for additional and specific policy actions to tackle the abusive use of shell entities for tax purposes. More generally, the ongoing economic and health crisis also adds to the urgency of putting in place a fair and effective tax framework for sustainable public spending that can help fund and sustain the recovery. Countering the misuse of shell entities for tax avoidance and evasion purposes can contribute to that aim.

2. PROBLEM DEFINITION

2.1 What is/are the problems?

2.1.1 Indicators of the use of shell entities to escape tax

Anecdotal and investigative evidence suggests that high net-worth individuals and companies sometimes make use of shell entities to minimise their tax bill. For instance, the media reported that, in 2020, without any employee other than directors, an Irish subsidiary of Microsoft made a "tax-free" profit of USD 315 billion[19]. According to research by an Australian based tax research institute CICTAR, Uber shifted almost EUR 6 billion through about 50 shell companies in the Netherlands in 2019, after creating a massive tax shelter[20]. According to a US fair tax think-tank, between 2011 and 2015, Walmart transferred ownership of more than USD 45 billion in assets to a network of shell companies in Luxembourg, where Walmart does not have stores[21]. In 2017, when

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[16] LeMonde, 9 February 2021 : OpenLux : l'insatiable appétit des Français pour les sociétés luxembourgeoises

[17] Recent meta-analysis on tax avoidance from Professor Lejour showing global (conservative) estimates of tax revenue losses ranging from tax avoidance.

[18] 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

[19] https://www.theguardian.com/world/2021/jun/03/microsoft-irish-subsidiary-paid-zero-corporate-tax-on-220bn-profit-last-year

[20] https://cictar.org/ministers-urged-to-act-on-ubers-50-company-dutch-tax-she

[21] Americans for Tax Fairness, "The Walmart Web" June 2015, accessed from: https://americansfortaxfairness.org/files/TheWalmartWeb-June-2015-FINAL1.pdf

investigating illegal tax benefits to Amazon in Luxembourg, the Commission found that considerable income (royalties) was generated by a holding company that was an empty shell with no employees, no offices and no business activity[22], and paid only minimal taxation.

The initiative intends to address both tax avoidance and tax evasion. Both tax avoidance and tax evasion undermine the fairness and integrity of tax systems. Businesses that avoid or evade tax gain a competitive advantage over enterprises that pay their fair share. Taxpayers with similar incomes or assets may end up paying different amounts of tax. Ultimately, both tax avoidance and tax evasion in practice mean less resources (tax revenues) to finance public services including, among others, "(…) infrastructure, social security and education systems".[23]

For the sake of clarity, it is worth stressing that the problem to be addressed is not the existence of shell entities *per se*. Indeed, the latter can serve several valid and fully legitimate commercial and business purposes. Just to provide some examples obtained via the public consultation on this initiative,[24] shell entities can be used to: ensure limitation of liability; protect investors and maintain the value of the portfolio; meet the requirements of third party lenders to ring-fence assets and liabilities; facilitate joint ventures between funds and other investors; streamline decision making by giving authority to the directors of holding entities; provide a convenient vehicle for sale or partial sale. As said, shell entities as such are not the problem. Therefore, it would not be appropriate to distinguish between legitimate and problematic shell entities: rather, the issue is about distinguishing between the legitimate and problematic uses of shell entities. As other technologies or forms of innovation and organisation, shell entities can be exploited or rather serve broader economic and social goals.

Specials purpose entities (SPEs) are also used for legitimate business purposes and have characteristics in common with shell entities. For example although they are formally registered with a national authority and subject to their fiscal and legal obligations, they can lack substance activities like having few non-financial assets and employees.[25] Legitimate uses of SPE's include spreading financial risk and facilitating complex financing and project operations. The aim of the current initiative is not to curtail these

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[22] Statement by Commissioner Vestager on illegal tax benefits to Amazon in Luxembourg and referring Ireland to Court for failure to recover illegal tax benefits from Apple 4 October 2017, https://ec.europa.eu/commission/presscorner/detail/fr/STATEMENT_17_3714

[23] Examples of public services funded via general taxation, mentioned by Commission President von der Leyen in her 2021 State of the Union address, 15 September 2021.

[24] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by the European Fund and Asset Management Association (EFAMA)

[25] For more information about SPEs please consult: https://ec.europa.eu/eurostat/statistics-explained/index.php/Glossary:Special-purpose_entity_(SPE)

operations but instead to prevent such vehicles from being used for tax avoidance or tax evasion.

Shell entities have also been set up to avoid double taxation, for example when the resident jurisdiction of a company does not have a double taxation treaty with another jurisdiction with which it is doing business. However, Member States have decided both at national level and international level through the OECD BEPS project that their resident companies are required to have substance in order to benefit from their double taxation treaties. The problem, as the evidence above suggests, is the misuse of such entities for tax abuse purposes only.

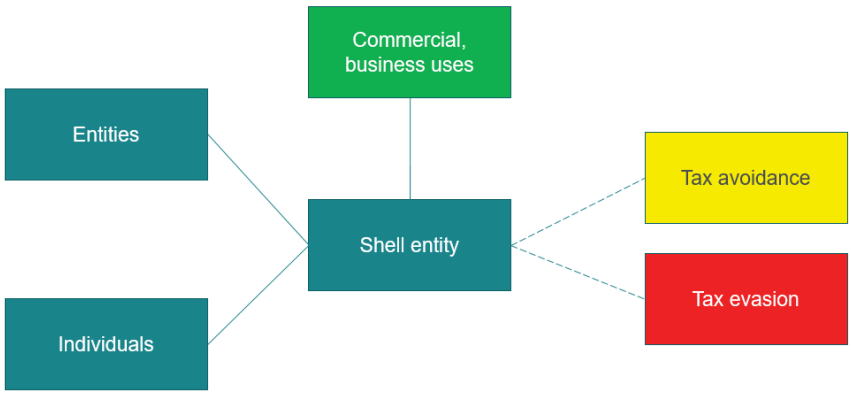

Figure 1 A high-level illustration of the problem to be addressed: the use of shell entities for tax avoidance or tax evasion.

On the geographical scope of the problem

The use of shell entities for tax avoidance or evasion is not an "EU problem" only. Shell entities are spread across the globe, especially in zero or very low tax jurisdictions. Data from tax leaks[26] by the International Consortium of Investigative Journalism (ICIJ) can suggest an answer to the geographical scope and magnitude of the problem.

For instance, the recent Pandora Papers revelations point to shell entities in many third countries: British Virgin Islands, Seychelles, Hong Kong, and the United Arab Emirates to cite only some. On the other hand, in the Pandora Papers there is also mention of entities in some EU Member States, namely Cyprus, Ireland and Luxembourg. Most of the entities involved in the Panama Papers were from the British Virgin Islands, followed by Panama and The Bahamas. The Panama Papers also mentioned several entities in Cyprus and Malta.

[26] https://offshoreleaks.icij.org/

On the question of the geographical scope of the problem, it may also be relevant to consider the work of some civil society organisations, in particular the NGO Tax Justice Network. The latter has developed a combined indicator ranking jurisdictions according to how much they facilitate tax avoidance by multinational corporations. The indicator is called the Corporate Tax Haven Index (CTHI).[27] According to the latest edition of the CTHI, the countries ranking at the top 10 of the index are mainly third countries, however also the Netherlands and Luxembourg score high.[28]

2.1.2 Why the existing EU legislation and the international tax frameworks are not sufficient to address the problem

The BEPS project has been a major step forward in addressing the problem of shell companies being used for tax purposes. However, the implementation of BEPS measures in practice proves challenging for tax authorities, as it emerged also from the public and targeted consultation conducted for preparing this initiative. For instance, one respondent to the public consultation pointed out that current rules are challenging to implement.[29] As part of the targeted consultation for this initiative, some Member States pointed out the difficulty of using existing measures.

The main challenge lies in the fact that BEPS relies primarily on general anti abuse rules to tackle shell entities, namely via the General Anti Abuse Rule (GAAR). The latter was introduced within the EU through the Anti-Tax Avoidance Directive (ATAD), the main existing anti-tax avoidance tool at the EU level. "General" in practice means that tax administrations address the use of shell entities in tax schemes on a case-by-case basis. As put by one Member State in the targeted consultation: "The current rules in ATAD with respect to General Anti Avoidance Rule and Controlled Foreign Company Rule apply the notion of non-genuine economic activity, valid commercial reasons and the substantive economic activity test, however, the interpretation is facts and circumstances dependent." Challenges with tackling shell entities are reported by other Member States. For instance, a Member State stressed how difficult it is for Member States to come up with "defensive measures" addressing the problem. Member States at present have limited scope to implement effective measures to fight harmful tax practices. Operationally, tax administrations need significant time and resources to implement existing measures to counter the use of shell entities for tax purposes. Moreover, tax administrations often lack the information necessary to detect such use.

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[27] https://cthi.taxjustice.net/en/cthi/data-downloads

[28] https://cthi.taxjustice.net/en/cthi/cthi-2021-results

[29] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by the Spanish Tax Agency.

As the problems of tax avoidance and tax evasion persist, it is important that shell entities are addressed in a targeted, specific manner, providing tax administrations with the information they need to prevent (preferably, rather than to react ex post) tax avoidance and tax evasion. It is also important, to ensure a level playing field and to avoid distortions between Member States, that specific provisions to tackle tax avoidance and tax evasion via shell entities are introduced at the EU level, via common provisions so that, to put it simply, a shell entity is identified and recognised as such, on the basis of the same objective criteria. To avoid distortions, moreover, the same tax consequences should be applied no matter where the problem emerges within the EU.

2.1.3 The challenge of defining shell entities

There is currently no standard and comprehensive definition of shell entities[30], which in itself may partly explain our limited ability to measure and understand the extent of tax avoidance or tax evasion by shell entities. Nevertheless, there are a number of definitions available both at EU and at international level that can help us identify shell entities. The International Bureau of Fiscal Documentation (IBFD) refers to a letterbox company that 'lacks any further business substance'[31]. The Guidance paper on transparency of beneficial ownership prepared by the Financial Action Task Force (FATF) lists several definitions of letterbox companies (shell, front or shelf companies) and defines shell companies as those companies that have 'no independent operations, significant assets, ongoing business activities, or employees'.[32] The OECD describes a letter box company in the following manner: 'A paper company, shell company or money box company, i.e. a company which has complied only with the bare essentials for organization and registration in a particular country. The actual commercial activities are carried out in another country'[33].

2.1.3.1 Common features of risky shell entities

Despite the lack of a universal definition, available international definitions such as those above, definitions at national level[34] and a literature review on shell entities, indicates that there are a number of characteristics common to shell entity definitions:

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[30] ICF Consulting Services Ltd (2021), Commission Study on Letterbox Companies

[31] IBFD, International Tax Glossary, available at: https://www.ibfd.org/IBFD-Products/IBFD-International-Tax-Glossary-7th-Edition

[32] FATF, Concealment of beneficial ownership, 2018, available at: https://www.fatf-gafi.org/media/fatf/documents/reports/FATF-Egmont-Concealment-beneficial-ownership.pdf

[33] https://www.oecd.org/fr/ctp/glossaryoftaxterms.htm#L

[34] The US Securities and Exchange Commission (SEC) defines a shell entity as company, other than an asset-backed issuer, with no or nominal operations and either: no or nominal assets, assets consisting solely of cash or equivalents or assets consistent of cash or equivalent and nominal assets, source: US Securities Act, part 203, rule 405.

i) Lack of substance or economic activity – there are no or minimal non-financial assets, employees, production or operations;
ii) No physical presence beyond a 'brass plate', sometimes with multiple entities using the same postal address;
iii) Anonymity – the identity of the real owner behind a shell entity ('the beneficial ownership') is often concealed;
iv) Cross-border element – use of complex group structures typically using multiple jurisdictions which can conceal beneficial ownership;
v) Use of intermediaries - for example, trust and company service providers (TCSPs) are required to set up shell entities given their complexity and the knowledge needed to set them up.

These elements, often combined, point to a risk of shell entities being used for tax evasion or avoidance. While most of these risk characteristics are common to both tax evasion and tax avoidance, existing literature points to essential differences depending on whether entities are used for tax avoidance or tax evasion. For example, tax evaders may more often make use of anonymous shell entities[35] not to pay tax.[36]

Given the difficulties in establishing a general definition of shell entities, this initiative aims to define a common set of objective criteria which, if met, would imply that there is sufficient substance in an entity not to be at risk to be misused for tax purpose.

2.1.3.2 Shells of different form

Shell entities come in many different legal forms. Both legal entities like private limited liability companies and foundations can be used as shell entities for tax avoidance or tax evasion, as can legal arrangements like express trusts or partnerships and similar arrangements[37]. The problem to be addressed is tax avoidance and tax evasion though shell entities, irrespective of which tax (corporate income tax, personal income tax, and other taxes) is avoided or evaded.

Different legal forms may lead to different tax consequences. From a tax perspective, legal entities, such as companies, established in a jurisdiction will be considered as resident for taxation purposes, subject to corporate income tax, and will normally be entitled to tax treaty benefits. This is different from a situation where there is a legal arrangement, a partnership, which, under the applicable national law, might not be considered as a tax resident. Instead, it might be transparent for tax purposes implying

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[35] Anonymous shell companies are not allowed in the EU. Under company and anti-money laundering rules, basic and beneficial ownership information should be disclosed.

[36] Panama Papers and the Abuse of Shell Entities, Carl Pacini , Nicole Forbes Stowell, Corporate Fraud Exposed, Publication date: 9 October 2020 retrieved online from: https://www.emerald.com/insight/content/doi/10.1108/978-1-78973-417-120201023/full/html

[37] COM (2020) 560 Report from the Commission to the European Parliament and the Council assessing whether Member States have duly identified and made subject to the obligations of Directive (EU) 2015/849 all trusts and similar legal arrangements governed under their laws

that the relevant beneficiaries should be taxable for the income of the partnership at their residence jurisdiction.

2.1.3.3 How many shells?

The number of shell entities within the EU is unknown. This is in particular because within the EU, there is no common definition of what shell entities are and consequently nor statistics about them.[38]

Some studies estimate the number of shell entities using proxies. For instance, a 2018 study by the European Parliament uses the number of foreign-owned companies as a proxy.[39] In this impact assessment, the estimation of shell entities is conducted in three steps: first, the sectors of activity often associated with the existence of shell entities are identified.[40] Second, the number of companies active in those sectors is estimated. Third, using firm-level data, a rather conservative estimation for the number of shell companies in the EU could be some 29 000 entities. An upper-bound estimate, based on Irish data, arrives at a number of max 75 000 shell companies in the EU.[41] This is also the closest estimation possible to the overall number of entities (including companies) that would be targeted by the regulatory options considered in this impact assessment. The estimate suggests that shell companies are relatively few. Put in perspective, the upper bound estimate of 75 000 companies amounts to only circa 0.5 per cent of the overall number of corporate income taxpayers[42] and about 0.3 per cent of the overall number of active enterprises within the EU.[43]

2.1.4 Tax avoidance and tax evasion via the use of shell entities

Shell entities can be used for both tax avoidance and tax evasion purposes. This is why the intervention intends to tackle both tax avoidance and tax evasion through the use of shell entities. An example of tax avoidance via shell entities would be the use by a large

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[38] Even where definitions exist, as in the US, no official statistics are available on shell entities. The US Securities and Exchange Commission defines shell company as a registrant with no or nominal operations and either no or nominal assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amount of cash and cash equivalents and nominal other assets. Source: SEC website.

[39] In 2016, circa 200 000 companies within EU-27 were foreign-owned. Source: European Parliament, 2018, "An overview of shell companies in the European Union", p. 15.

[40] On the basis of the Statistical Classification of Economic Activities in the European Community (NACE).

[41] Please refer to Annex 4(B) "Methods for estimates - Estimation of companies in scope of the initiative" for more details. Only shell companies and trusts are considered here, not other forms of potential shell entities, for example partnerships.

[42] OECD Tax Administrations 2021 report, table A.20.

[43] In 2018, the EU's business economy was made up of almost 25.3 million active enterprises, source: Eurostat, business demography statistics.
https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Business_demography_statistics

multinational of a holding company to transfer money within its corporate group through payments which are not in line with economic reality. As a result, the company ends up paying substantially less tax than other companies. Several examples could be made of tax evasion via shell entities. For instance, it could be the case of a wealthy individual evading wealth tax by concealing the ownership of a yacht by interposing a shell entity. A concrete example: an Italian businessman using a Maltese shell company to evade direct taxes on his employees.[44]

Distinguishing between legal and illegal aspects as well as what is fair and unfair is not always straightforward. Generally, tax evasion is always illegal, while tax avoidance is generally legal but in some cases it may not be so. The European Commission has however on several occasions explicitly pointed out that both tax evasion and tax avoidance are unfair. Recently, for instance, Commission President von der Leyen stated:[45] "(…) social fairness is (…) also a question of fair taxation. In our social market economy, it is good for companies to make profits. And they make profits thanks to the quality of our infrastructure, social security and education systems. So the very least we can expect is that they pay their fair share. This is why we will continue to crack down on tax avoidance and evasion." This statement seems to suggest that the European Commission considers both tax avoidance and tax evasion unfair.

The challenge of defining tax avoidance

The conceptual (as well as legal and administrative) boundary between illegal tax evasion and legal tax avoidance, or tax planning, is robust and well known. However, the divide within the concept of avoidance between what amounts to 'aggressive' or 'unacceptable' avoidance and what can still be considered acceptable 'planning' is a source of on-going disputes between governments and taxpayers. Ongoing and past law cases provide clear evidence of the challenges of distinguishing different forms of tax avoidance. For instance, in the case concerning the selective tax advantage in favour of a Luxembourg subsidiary of the Amazon group, the European Commission's view differs from that of the other parties. In May 2021, the General Court of the European Union concluded that no selective advantage was given.[46] However, the European Commission is considering possible next steps and the case does not seem settled yet.[47]

[44] This case is reported in this press release of 24 March 2021 by the Italian tax administration (Guardia di Finanza): https://www.gdf.gov.it/stampa/ultime-notizie/anno-2021/marzo/maxi-frode-fiscale-internazionale-4-arresti-e-sequestri-per-10-milioni-di-euro

[45] Commission President von der Leyen 2021 State of the Union address, 15 September 2021.

[46] General Court of the European Union PRESS RELEASE No 79/21 Luxembourg, 12 May 2021 https://curia.europa.eu/jcms/upload/docs/application/pdf/2021-05/cp210079en.pdf

[47] Statement by Executive Vice-President Margrethe Vestager following today's Court judgments on the Amazon and Engie tax State aid cases in Luxembourg, 12 May 2021: https://ec.europa.eu/commission/presscorner/detail/en/statement_21_2468

Part of the difficulty is inherent in the challenge of defining tax avoidance to begin with. The term is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability in such a way that, although the arrangement could be strictly legal, it is usually in contradiction with the intent of the law it purports to follow.[48]

Furthermore, the definition of tax avoidance is dynamic. The understanding of what amounts to unacceptable tax avoidance evolves over time. A major development in that respect has been the OECD Base Erosion and Profit Shifting (BEPS) project, probably the most fundamental international tax reform of the 2010s. The project has been referred to as "International collaboration to end tax avoidance".[49] The fact that more than 130 countries have subscribed to the delivery and implementation of this project shows that there exists a widespread consensus that tax avoidance is increasingly becoming unacceptable. The internal division, within tax avoidance, between what constitutes acceptable vs. unacceptable tax avoidance is shifting, limiting more and more the scope for acceptable 'tax planning'.[50]

2.1.4.1 Tax avoidance by shell entities

Although there is no precise definition of tax avoidance, tax practitioners and policy makers use it to describe the arrangement of a taxpayer's affairs that is intended to reduce their tax liability. In their input to the public consultation on this initiative, IBFD defined tax avoidance as "(…) actions or omissions of a taxpayer that are aimed at obtaining a tax advantage by exploiting the friction between the form (which is chosen from those that do not trigger the liability to tax) and the substance, which is akin to events that would otherwise trigger the liability to tax".[51] In other words, although tax avoidance could be strictly speaking legal, it is usually in contradiction with the intent of the law that it is meant to follow.

Tax avoidance includes treaty shopping. The latter consists of arrangements through which a person who is not a resident of one of the two States that concluded a tax treaty

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[48] Definition derived from the OECD Glossary of Tax Terms.

[49] Refer to the OECD BEPS website: https://www.oecd.org/tax/beps/

[50] A recent motion for a European Parliament resolution, for instance, makes clear the increasingly unacceptable nature of tax avoidance: "The European Parliament reiterates the importance of multilateral action and international coordination in the fight against tax evasion, *tax avoidance and aggressive tax planning*". The "fight" is against both tax evasion and tax avoidance, without any distinction between acceptable or unacceptable forms of the latter. Source: European Parliament resolution of 20 October 2021 on the Pandora Papers, paragraph 17.

[51] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by IBFD, p. 10

may attempt to obtain benefits that the treaty grants to residents of these States. Other forms of tax avoidance involves exploiting differences in national laws of different jurisdictions.

As put by IBFD in their input to the public consultation for this initiative, "(…) tax avoidance is typically arduous to estimate and quantify".[52] Focussing on the problem at stake, there are no robust, reliable estimates of tax avoidance caused by shell entities. Yet, raw estimates may provide an indication of the size of the problem. For instance, in the case of the US, it has been estimated that tax avoidance facilitated by Delaware companies, cost other US States USD 9.5 billion per year.[53] Other estimates of corporate tax avoidance[54] size the problem in the order of tens of billions of dollars in tax losses annually for large economies such as the US or the EU.

Businesses that operate cross-border can exploit the different tax rules that apply across the EU to set up structures with the ultimate aim of minimising taxation. They take advantage of the current European legal framework, which facilitates the flow of dividend, interest and royalty payments within the EU with a view to avoiding double taxation, while rules on applicable taxes, rates and the fight against artificial tax structures remain mainly the responsibility of national authorities.

In particular, the Directive on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, known as the Parent Subsidiary Directive (PSD), abolished withholding taxes on payments of dividends between associated companies of different Member States, thereby preventing economic double taxation. Similarly, the Directive on a common system of taxation for interest and royalty payments between associated companies of different Member States, known as the Interest and Royalty Directive (IRD), has eliminated withholding tax obstacles in the area of cross-border interest and royalty payments within a group of companies. Removal of tax obstacles as above can however be manipulated to give rise to tax avoidance in the cross-border context.

A similar case concerns the abuse of double tax treaties, commonly known as "treaty shopping". For example, when a group wishes to make a payment between two countries that have no tax treaty between them, this payment should be subject to the domestic taxation of both countries. However, there may be a third country, irrelevant to the transaction, which has an "attractive" tax treaty network, i.e. it has double tax treaties with both countries concerned. By routing the payment through such third country,

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[52] Ibid.

[53] Income received from intangible assets located in other US States are not taxed in Delaware: Abuse of Delaware Incorporation Rules https://jhulr.org/2018/10/15/the-siphon-state-the-9-5-billion-reason-why-corporations-love-delaware/

[54] SOMO, Centre for Research on Multinational Corporations, Keep watching: The tax avoidance structures of Viacom CBS, June 2021.

potentially using a shell entity there, the payment could benefit from relevant treaty benefits, including for example no or lower withholding tax rates.

Another mechanism to avoid taxation via the use of shell entities involves establishing entities in Member States with a favourable regime of outbound (out of the EU) withholding taxation of dividend, interest and royalties. As put by IBFD in their submission for the public consultation for this initiative:[55] "(…) third-country based MNEs take advantage of the interplay between the Parent-Subsidiary and Interest-Royalty directives (PSD and IRD) and the domestic laws of several EU Member States. The ultimate result is a withholding tax-free repatriation of profits from any EU Member State to a third country simply by relying on the withholding tax exemption of the directives (from the Member State of origin to the Member State of the interposed intermediary) and the subsequent lack of withholding tax in the domestic laws of a handful of Member States (from the Member State of the interposed company to the desired third-country, regardless of the existence of a tax treaty with that jurisdiction)."

Furthermore national tax systems can also grant exemptions to income received by resident entities from abroad, for example dividend income, irrespective of whether withholding taxes are levied on the payment of the dividend or whether the state of residence of the payee group company has a tax treaty with the state of residence of the shell entity.

While there have been a number of initiatives at international level to tackle tax avoidance, including by shell entities, for example, the OECD BEPS project and at EU level, through ATAD, none of these is targeted specifically to shell entities. In addition none provides objective criteria with which to assess lack of substance at the time when the tax benefit is requested.[56]

2.1.4.2 Tax evasion by shell entities

Tax evasion may be characterised as intentional illegal behaviour or as behaviour involving a direct violation of tax law in order to escape the payment of taxes[57]. The use of shell entities for illegal activities such as tax evasion purposes has been the subject of much research in recent years. As pointed out by one respondent to the public consultation for this initiative: "There is indeed evidence that shell companies might be

[55] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by IBFD, quote from p. 37.
[56] Further information on the necessity of EU action to tackle the problem is provided in section 3 as well as in Annex 9.
[57] IBFD glossary

used in the context of criminal activity to conceal funds, and move assets without authorities being able to identify those asset movements."[58]

In such scenarios, shell entities are often established in jurisdictions (i) with tax systems that have zero or next to zero tax at the level of the entity; (ii) that exempt from tax income received from abroad; and/or (iii) have no withholding taxes on distributions of income made from the entity.

Due to the criminal nature of tax evasion, estimates on direct tax evasion caused by shell entities are not widely available. However, a number of leaked data in recent years has pointed to the scale of the problem. For example, following revelations of the Panama Papers in 2016[59], tax authorities have recovered more than USD 1.3 billion. The leak concerned more than 214 000 shell companies created by specific law firms, among others, for tax evasion purposes.

Tax evasion is often associated with money laundering. The EU has now in place a strong framework against money laundering and terrorism financing. It includes the establishment of EU beneficial ownership registers to enhance transparency of beneficial ownership information in the EU. The 5th AML Directive extended the requirement of beneficial ownership registration to trusts and similar legal arrangements and granted access by the public to a certain amount of information relating to beneficial ownership of legal entities. More recently,[60] the Commission adopted a new AML/CFT legislative package to strengthen the EU's AML/CFT rules as part of the Commission's commitment to protect EU citizens and the EU's financial system from money laundering and terrorist financing. It includes four legislative proposals consisting of a regulation establishing a new EU AML/CFT Authority, a Regulation on AML/CFT containing directly-applicable rules, a sixth AML/CFT Directive replacing the existing Directive 2015/849/EU, and a revision of the 2015 Regulation on Transfers of Funds.

Despite having a strong AML framework in place, essentially preventing the existence of anonymous shell entities in the EU and reducing the risk of tax evasion, the issue of non-compliance with tax laws cannot be solved by AML rules alone.

2.2 What are the problem drivers?

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[58] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by Confédération Fiscale Européenne / Tax Advisers Europe (CFE), referring to a World Bank study: "Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities and Action Plan."

[59] Panama Papers and the abuse of shell entities – Carl Pacini and Nicole Forbes Stowell

[60] On 20 July 2021, the European Commission presented an ambitious package of legislative proposals to strengthen the EU's anti-money laundering and countering the financing of terrorism (AML/CFT) rules. More information at: https://ec.europa.eu/info/publications/210720-anti-money-laundering-countering-financing-terrorism_en

As indicated in Figure 2, there are three key drivers behind the problem, i.e. the use of shell entities by individuals or organisations to avoid or evade tax. The first driver is the lack of a common definition of substantial economic presence for tax purposes. The second driver is that tax administrations within the EU do not have sufficient information to prevent, detect or stop tax avoidance or tax evasion through the use of shell entities. Advertising and promoting the use of shell entities for tax avoidance or even tax evasion is the third driver considered. Each of these three drivers is described below.

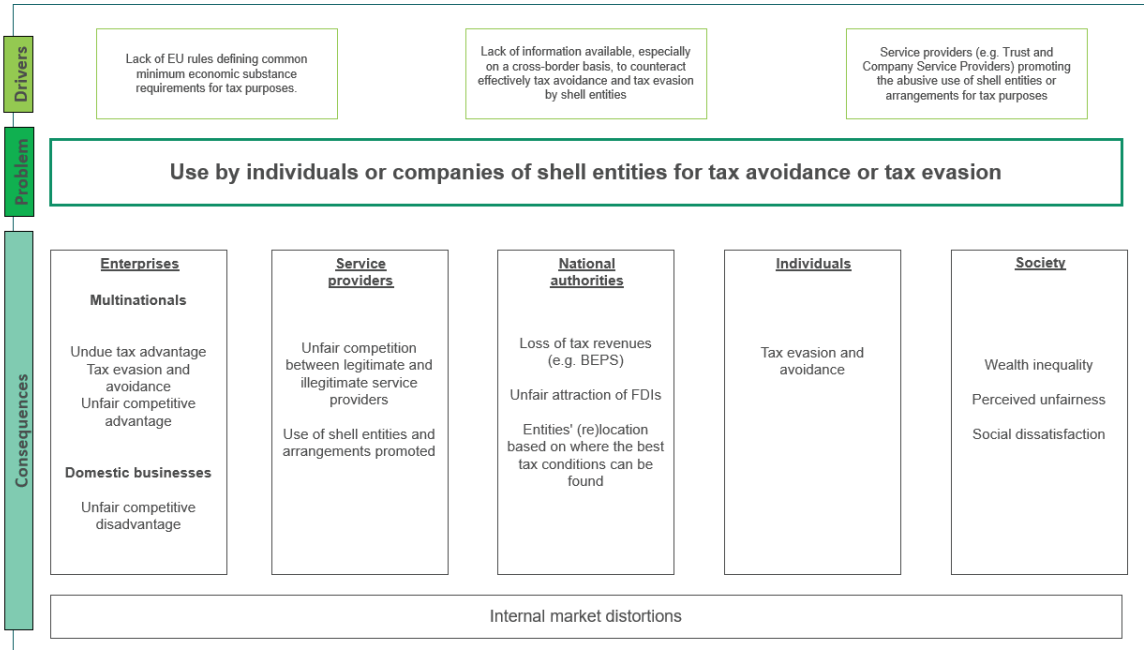

Figure 2 Problem Tree

2.2.1 Lack of EU rules defining common minimum substance requirements for tax purposes in the EU.

Substance criteria do exist at EU level in various contexts. Regarding taxation, the EU Code of Conduct for business taxation has used substance requirements when assessing preferential tax regimes in the EU. However, these requirements are non-legally binding and are limited in the context of specific regimes. In the context of the EU list of non-cooperative jurisdictions for tax purposes, substance requirements in line with the international standards established in the context of the BEPS project, need to be met in relation to preferential tax regimes adopted by third countries. Substance requirements also apply beyond specific regimes, in the context of national tax systems of third countries which have no or only very low corporate tax.

It follows that currently there are no legal requirements at EU level asking for common minimum substance requirements for tax purposes.

	Preferential tax regimes	General corporate tax systems
EU Member States	Yes	No
Third Countries	Yes	Yes - if third countries have no or minimal corporate tax

Figure 3 Absence of EU rules on substance requirements for corporate tax purposes is one of the drivers of the problem

Moreover, with some exceptions, most Member States do not have domestic substance criteria to prevent abuse.[61] While the tax treaties may include provisions like substance criteria and beneficial ownership rules to prevent abuse, these differ across Member States and may well differ in the double taxation treaties concluded by a single Member State with other countries.

As regards anti-tax avoidance rules, while common EU rules have been introduced, e.g. by virtue of ATAD, enforcement at domestic level may vary. For example, national courts may differ in the application of the EU and national anti-abuse rules to prevent a shell entity being used for tax avoidance or tax evasion. Sanctions may also differ among Member States. Differences can then be exploited by economic agents, resulting in shell entities used for tax avoidance or tax evasion purposes being set up in Member States with a more favourable tax framework. This context may also translate in weaker, fragmented and uncoordinated measures to combat tax avoidance or tax evasion by shell entities in the Single Market.

2.2.2 Lack of information to effectively apply existing rules

Member States also lack readily available information to levy taxes correctly in a cross-border context.

Even when Member States have in place anti-abuse rules[62], tax authorities do not necessarily have the necessary information to make effective use of such rules for cross-border transactions. This can be explained via a hypothetical example. A subsidiary

[61] More information on national measures is provided in Annex 5.

[62] Namely: anti-tax avoidance provisions included in the Parent-Subsidiary Directive, the Anti-Tax Avoidance Directive (ATAD) directives provisions concerning exit taxation rules, controlled foreign company rules, provisions against hybrid mismatches and the General Anti-Avoidance Rule (GAAR); as well as Principal Purpose Test (PPT) provisions linked with the application of bilateral tax treaties.

company established in Member State A pays a dividend to its parent company in Member State B. This dividend is paid "tax free", on the basis of the EU Parent-Subsidiary directive that exempts intra-company dividends from tax within the European Union. For the sake of this example, let us consider that the parent company in Member State B is a shell company. The general-anti abuse rule introduced by the EU anti-tax avoidance directive clearly says that: "(…) Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances." Even assuming the shell company getting the dividend was "not genuine", Member State A has limited information to check that is indeed the case. As put by IBFD in their input for the public consultation for this initiative, the main problem is that where the information is available (residence country i.e. Member State B in the example) and where the information is needed (source country i.e., Member State A in the example), are two different countries.[63]

As a result of complex cross-border arrangements/contexts, tax authorities lack readily available information to assess substance or whether an arrangement is genuine or not. They cannot prevent tax avoidance and tax evasion in a timely manner but can only attempt to recover part of the tax losses ex-post, following an audit for example, and with difficulties - as obtaining the information necessary to implement existing anti-abuse provisions is costly.

Lack of information makes the implementation of existing anti-abuse rules particularly challenging or indeed insufficient to address the problem described here. As put by IBFD in their contribution to the public consultation for this initiative: "(…) both the incentive for treaty and jurisdiction shopping and the consequences, should an abusive structure be discovered, suggest that traditional anti-avoidance measures do not suffice."[64]

It is also relevant to stress that under existing rules, even where information is obtained, it is corrective, rather than preventive, measures that apply: once tax avoidance or tax evasion is discovered, mainly through a tax audit, tax administrations can intervene to redress it.

2.2.3 Promotion of shell entities by certain intermediaries

Some intermediaries seem to play a catalyst role in the establishment and use of shell entities. They provide corporate administration and management services which are necessary to establish and operate shell entities in the EU. Shell entities can avail of the

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[63] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by IBFD, p. 48

[64] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by IBFD, p. 38

administrative support from such intermediaries, such as postal address, which allows the entity to have a minimum physical presence in the Member State to be deemed existing there. The use of intermediaries to set up such shell entity schemes have been cited in various leaks like the Panama Papers, and at international level through the FATF and the OECD[65]. At EU level, Directive 2018/822/EU ('DAC6') requires that intermediaries like trust and company service providers, to report cross-border tax arrangements to their national tax authorities.

[65] OECD publication: Ending the Shell Game – 'Cracking down on the Professionals who enable Tax and White Collar Crimes'

Different stakeholders' views on the problem

The public consultation survey included several questions to gain a better understanding of the problem.[66] Respondents' views are mixed when it comes to possible remaining causes of tax avoidance. The most relevant cause cited by all respondents was 'insufficient capacity of tax administration to process the available information on tax avoidance structures', followed by 'insufficient cooperation between EU Member States'. The least relevant cause appears to be insufficient information of tax administration on potential tax avoidance structures.

Respondents were asked whether they agree or not with a series of problem statements. The statement with which most respondents agreed is that current EU rules in the field of taxation already provide tools to tackle aggressive tax planning schemes including through the use of shell entities. Understandably, the most "opposed" statement on the other hand is that current EU rules cannot fully and effectively address the use of shell entities for tax avoidance purposes.

It is relevant to consider, however, whether and how stakeholders belonging to different categories perceive the problem differently.[67] Views vary significantly between business associations and companies (business stakeholders) on the one hand and civil society (NGOs and trade union) stakeholders on the other hand. While almost 50% of business stakeholders disagree with the view that shell entities are used in the EU mostly for abusive tax purposes, 66% of NGOs and trade unions agree. Almost all (95%) business stakeholders are of the view that current EU rules in the field of taxation already provide tools to tackle aggressive tax planning schemes including through the use of shell entities. A similar view is held by one third of civil society stakeholders, while half of this category of respondents disagree. 90% of business stakeholders do not agree that current EU rules cannot fully and effectively address the use of shell entities for tax avoidance purposes, while all civil society respondents agree.

[66] Further information on the public consultation is presented in Annex II. The results of the public consultation are available online at: https://circabc.europa.eu/ui/group/6868da3c-d21c-4ce4-98d9-d5448986e44e

[67] Results based on the analysis per category of stakeholders of replies given to public consultation question 3.5: "Please indicate the extent to which you agree or disagree with the following statements: Shell entities are used in the EU mostly for abusive tax purposes; Current EU rules in the field of taxation already provide tools to tackle aggressive tax planning schemes including through the use of shell entities; Current EU rules cannot fully and effectively address the use of shell entities for tax avoidance purposes."

2.3 How will the problem evolve?

In the absence of a public intervention, it is expected that tax avoidance and tax evasion through shell entities will persist. If both the European Union and its Member States do not act to tackle the problem, it is most likely that it will not be solved. The use of shell entities for tax abusive purposes will continue to lead to a loss of tax revenues for the national treasuries, negatively impacting on the provision of public services and creating an unlevelled playing field for companies and differences in the treatment of individuals.

A few Member States, for example the Netherlands and Italy,[68] have acted to ensure that legal entities and legal arrangements without substance are precluded from tax benefits[69]. However, as a key characteristic of the problem is its cross-border nature, unilateral, uncoordinated measures are unlikely to be effective solution to the problem considered here. Without EU action tax avoidance may be expected to continue to impact EU Member States. Individual and uncoordinated action may also lead to the costs of doing business cross-border going up. If Member States were to act individually establishing their own criteria, for a hypothetical, real "pan-European" group operating across all Member States, the costs of compliance with 27 diverse substance requirements would be higher than having to face one single rulebook. In the latter case, the group would be able to standardise some of its compliance activities and benefit from economies of scale. A patchwork of national interventions to tackle the problem may inadvertently increase, rather than reduce, distortions in the Single Market. This scenario would be a "lose-lose" evolution, where both public authorities and businesses would be worse off.

If economic agents are seen to react to incentives including regulatory settings, then one should not expect a change in their behaviour (i.e. increased tax compliance) if the 'rules of the game' and the existing tax-related incentives remain the same.

In sum, without public EU intervention, tax avoidance and tax evasion linked to shell entities could be expected to continue, as economic agents typically want to maximise their income. In a scenario of uncoordinated national measures to neutralise the misuse of shell entities for tax purposes, it is likely the problem will persist and worsen.

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[68] For Italy, reference is made here to provisions concerning *società di comodo* based on law 23 December 1994, n. 724, article 30.

[69] Please see Annex to have a complete overview of the measures enacted by Member States in this area.

3. WHY SHOULD THE EU ACT?

3.1 Legal basis

Article 115 of the Treaty on the Functioning of the European Union (TFEU) serves as the legal basis for the regulatory option of this initiative. Article 115 aims at ensuring the proper functioning of the internal market.

3.2 Subsidiarity: Necessity for EU action

The use of legal entities and arrangements without substance for tax avoidance or tax evasion purposes is usually not limited to the territory of only one Member State. Instead, it is a key feature of such schemes that they involve the tax systems of more than one Member State at a time. Some schemes involve a legal entity or arrangement being established in one Member State, where it has no premises and resources to perform an economic activity, to receive profits generated by a related entity in other Member States or even a third country. Several Member States could therefore be impacted by a scheme that would include the use of shell entities. In other words, the problem has a cross-border dimension. In addition, the problem has the same drivers and underlying causes no matter in which Member State it appears.

The review of Member States anti-tax avoidance rules[70] indicates that some Member States have developed targeted rules or practices, including criteria on substance, to counter abuse by shell entities in the area of taxation. However, most Member States do not apply targeted rules, but may rely on general anti-abuse rules, which Member States tend to apply on a case-by-case basis. Even amongst the few Member States that have developed targeted rules at national level, the rules differ significantly, and reflect more national tax systems and priorities, rather than target the Internal Market dimension. It follows that the majority of existing rules does not address the case where the existence of a shell entity affects a Member State other than the one where the shell entity or arrangement is located. Such differences could lead to tax and regulatory arbitrage.

The above findings have been confirmed in the context of the public consultation on the basis of the materials provided by the contributors. In particular, IBFD provided data ascertaining that "a comparative desktop review of the domestic rules of EU Member States shows that domestic rules targeting specifically shell arrangements are relatively uncommon".[71]

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[70] Information on Member States' practices is provided in Annex.

[71] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by IBFD.

Recent EU actions could be considered relevant to curbing the problem of shell entities and arrangements. These include the DAC and the ATAD, already cited above. However, there are some limitations in their use to tackle tax abuse by shell entities.

At EU level there are currently no legislative measures defining substance of an entity or arrangement for tax purposes. The Court of Justice of the European Union has established general principles regarding substance requirements for tax purposes in the context of the prevention of tax avoidance. In addition, the Code of Conduct Group (Business Taxation) has developed substance requirements, of a soft law nature, in the context of specific preferential tax regimes. However both case-law and current Code of Conduct practices cannot be used as self-standing provisions of general application. They are rather of limited scope, either by the circumstances of the specific case in dispute (for jurisprudence), or in the context of specific regimes (for the Code of Conduct review).

Importantly, existing instruments do not ensure timely identification of the cases of lack of substance and prompt communication of the information to all Member States that may be affected.[72] The persistence of the problem, described in the previous section, is reflected in the Open Lux investigation (see Annex 7).

In light of the above, specific EU level action appears a necessary course of action against shell entities. This is especially because a patchwork of individual actions, if at all, at national level could render some Member States vulnerable to regulatory and tax arbitrage especially if national action translates in some not imposing substance requirements or imposing more beneficial requirements. Importantly, as shell entities are commonly used to erode the tax base of a Member State, different from that where the shell entity is located, Member States might not have sufficient incentive to introduce robust rules at national level.

3.3 Subsidiarity and Proportionality: Added value of EU action

The current initiative does not seek to replace existing measures aimed at tackling tax avoidance and tax evasion through shell entities. Rather the initiative aims to reinforce, and complement existing measures by providing objective substance criteria to identify shell entities that may be used for tax avoidance and evasion with the aim to prevent such abuse in a timely manner.

The necessity to act in response to the problem and its drivers and the multi-country nature of the problem suggests that it would be preferable to establish a common set of rules across EU Member States that would ensure consistency on the definition of substance requirements for tax purposes as well as on the countermeasures to be applied. It will allow Member States to assist each other in identifying harmful schemes regardless of a) where they are located in the EU and b) which Member State's tax base

[72] In Annex, additional information is provided on why existing provisions are insufficient to tackle the problem. Please refer to Annex 9 - Additional Information on the Necessity of EU Action.

these schemes put under threat. EU level intervention would also minimise the risk of unfair tax competition amongst legal entities and legal arrangements in different Member States, potentially generated by unilateral definition and implementation of substance requirements. A common approach would ensure consistency of treatment of shell entities in the EU, irrespective of their location or residence or establishment and thus avoid tax arbitrage. Without such a common approach to the denial of tax benefits, the issue of profit shifting would not be addressed.

Due to the transnational nature of the problem, EU regulation would provide a common instrument for the exchange of information and ensure that the information timely reaches all concerned Member States. Given its extensive practical experience in operating the DAC, the EU is in a better position than any Member State individually to ensure the effectiveness and completeness of the system for exchanging information. In the evaluation of the DAC[73], tax authorities have indicated that the common exchange modalities, infrastructure and schemas have led to stronger and more effective cooperation. In this regard, better cooperation also been the outcome of using EU funds (disbursed under the Fiscalis programme), which generated economies of scale and lower transaction costs for tax administrations.

The preferred option has to respect the principle of proportionality, i.e. achieving the objectives yet minimising negative consequences for business.

The importance of ensuring in particular the proportionality of the initiative has been extensively stressed by business stakeholders.[74] When replying to the public consultation, for instance, the Malta Business Bureau expressed its disagreement with the need for EU coordination on defining what a shell entity for tax purposes is and how it should be treated in terms of taxation. This business association stressed that: “Coordination at EU level must strictly be based on the principles of subsidiarity and proportionality”. The intervention “must comply with a principle of proportionality regarding the objective of fraud repression”, according to the French Association of Large Companies (AFEP). Similar, explicit concerns on the proportionality of the initiative were also raised by the Cyprus International Businesses Association (CIBA), the American Chamber of Commerce in Belgium, the Institute of Certified Public Accountants of Cyprus and the Movement of the Enterprises of France (MEDEF).

To ensure proportionality and answer to concerns raised by business stakeholders, the intervention is meant to keep compliance costs to a minimum. Business would need to adhere to a single set of, rather than different, national rules in the EU. This would enhance predictability, provide legal certainty and ensure a common EU defence against tax avoidance via the misuse of shell entities for tax purposes. For a group active across

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[73] SWD (2019) 327 Final

[74] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", input by various business associations.

the EU, there would be gains in terms of economies of scale, as all its entities, no matter in which Member State, would need to follow only one and the same set of basic requirements. All affected entities would face the same minimum requirements for substance, which would promote a level playing field and fair competition. In this way, the integrity and functioning of the internal market are likely to be improved.

4. OBJECTIVES: WHAT IS TO BE ACHIEVED?

4.1 General objectives

The general objective of the initiative is to tackle tax avoidance and evasion via shell entities and in doing so contribute to the proper functioning of the internal market and to fair and effective taxation. The initiative would reduce the tax revenue loss caused by tax avoidance and tax evasion through the use of shell entities. When a shell entity has been identified in a Member State, all other Member States will be informed about its existence and can therefore take necessary action by denying tax benefits to the shell entity including cross-border transactions. A tax framework for businesses based on fairness, efficiency and effectiveness can support productive investment and entrepreneurship, while ensuring inclusive and sustainable social protection systems.

The initiative will allow Member States to describe and even quantify the extent of the problem of shell entity abuse in a more accurate and comprehensive way with the use of data to be submitted by Member States under the proposal. Ultimately the initiative should also further disincentive the creation of shell entities in the EU.

This general objective is rooted in the EU Treaties, fits within the political guidelines of Presidents' von der Leyen, the mission letter of Commissioner Gentiloni and is in line with several calls for actions made by the European Parliament.

4.2 Specific objectives

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 high risk of tax abuse. Such rules would define objective substance requirements and would ensure that shell entities used for tax abuse can be identified promptly. However, substance requirements alone are not enough to prevent tax abuse. To be effective, the initiative will set clear, pre-determined, common tax consequences throughout the EU in order to prevent tax losses and also to prevent tax and regulatory arbitrage in the EU.

Second, Member States need to know about the existence of shell entities being identified as such in another Member State. This would allow other Member States to take effective and prompt actions to address cross-border tax abuse by, for example, denying tax treaty benefits on withholding taxes paid to the shell entity by a company in their own jurisdiction. Timely availability of information on the existence of identified shell entities, both at national level and in other Member States, will provide Member States with an effective mechanism to prevent shell entity tax abuse in the EU.

Third, the initiative aims to disincentive the use of TCSP's from creating shell entities in the EU. If the substance requirements include criteria which aim at counteracting the services provided by TCSP's then demand for their services, for example setting up a postal address for a shell entity, would decrease which would have a significant negative impact on their business model.

If successful, the initiative could also translate into higher tax revenues for Member States, compared to a baseline scenario.

5. WHAT ARE THE AVAILABLE POLICY OPTIONS?

5.1 What is the baseline from which options are assessed?

In a baseline scenario, tax avoidance or evasion through the use of shell entities within the EU would be tackled primarily ex-post, and not prevented, via existing instruments, namely:

- At EU level: with the technical assistance of the Commission, Member States would continue to examine preferential tax regimes in a peer review manner in the context of the Code of Conduct Group, to assess if they are prone to be abused by shell entities not actually conducting the activities targeted by the regime. Legal entities and arrangements that benefit from preferential tax regimes within the EU should have substance, according to the Code of Conduct on business taxation.[75] However, beyond the scope of preferential tax regimes, the issue of substance is unexplored in the EU context and would remain so in a baseline scenario.
- At national level: implementation by Member States of a general anti-abuse rule (GAAR).[76] The GAAR is a last resort measure for tax administrations to stop artificial arrangements or structures to obtain tax benefits. For making use of it, Member States need substantial time and resources, having to look at the objective facts and circumstances of each and every case.
- Implementation of other anti-tax avoidance measures, mainly: limits to interest deductions, controlled foreign company rule, and exit taxation provisions. Such rules do not contain specific requirements for substantial economic activity of legal entities and arrangements as such.
- Member States would also continue to implement domestic measures for effective taxation which, in some cases, include measures targeting the use of shell entities for tax purposes.[77] These are not coordinated.
- Courts would continue to interpret obligations for taxpayers, including legal entities and arrangements, against the framework of existing EU law and case-law.[78] It is

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[75] Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy - Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation, at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31998Y0106%2801%29

[76] Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193/1 (2016) introduced the GAAR into EU law.

[77] See in annex for more details on Member States' measures.

[78] This includes binding EUCJ jurisprudence as regards what constitutes a wholly artificial arrangement designed to circumvent Member States' legislation.

likely that such interpretation would continue being linked to the specific circumstances of each case.

- At global level: more than 130 jurisdictions of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) have signed an agreement on the main features of a reform of the global corporate tax framework, comprising of two pillars: a partial reallocation of taxing rights to market jurisdictions (Pillar 1) and the establishment of a minimum effective corporate tax rate (Pillar 2). Pillar 2 is relevant to the assessment of the initiative. Signatories agreed to establish a minimum effective tax rate of "at least 15%" on the profits of multinational companies on a jurisdictional basis, meaning that, in principle, passive income paid to a shell entity established in a Member State should be subject to a 15% tax rate. However, Pillar 2 only applies to multinational companies that meet the EUR 750 million threshold as determined under BEPS Action 13 (country by country reporting), thus leaving all companies below this threshold out of the scope.

5.2 Description of the policy options

In addition to the baseline, the following options are presented and assessed:

Soft law option (or Option 1):

Expanding the mandate and scope of the Code of Conduct Group on business taxation to explicitly tackle the use, by taxpayers operating cross-border, of legal entities and legal arrangements with no or minimum substance and no real economic activities to reduce their tax liability. This soft-law option could also take the form of a dedicated, new Commission recommendation to address the problem.

Regulatory options (Option 2, 3 and 4):

- Option 2: Introducing 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, if not rebutted, would lead to pre-determined tax consequences, with the determination of sanctions for non-compliance left to the tax administrations.
- Option 3: Common substance requirements as above, backed up by exchange of information. As for the previous option, this option would introduce common substance requirements across the EU along with a definition of tax consequences in lack thereof, leaving the determination of sanctions for non-compliance to national tax administrations. In addition, this option would include the establishment of a mechanism for administrative cooperation and exchange of information concerning shell entities, expanding the existing DAC framework.
- Option 4: Common substance requirements along with tax consequences in lack thereof backed up by exchange of information and a definition of sanctions in case of non-compliances. This option maintains the features of Option 3 above, yet, it also

includes sanctions to be imposed by Member States' tax administrations to entities that do not comply with the new obligations.

It is worth emphasising that the regulatory options are cumulative. Option 4 builds upon option 3, which itself builds upon option 2, as shown in Figure 2 below. Option 1 is a soft-law option. Option 0 is the baseline scenario.

5.2.1 Option 1: Non regulatory option

With Option 1, tackling the use of entities and arrangements without substantial economic activity for tax avoidance and evasion purposes would continue on a soft-law basis at EU level. This Option 1 could be implemented following two sub-options: in the context of the EU Code of Conduct Group or as a standalone recommendation.

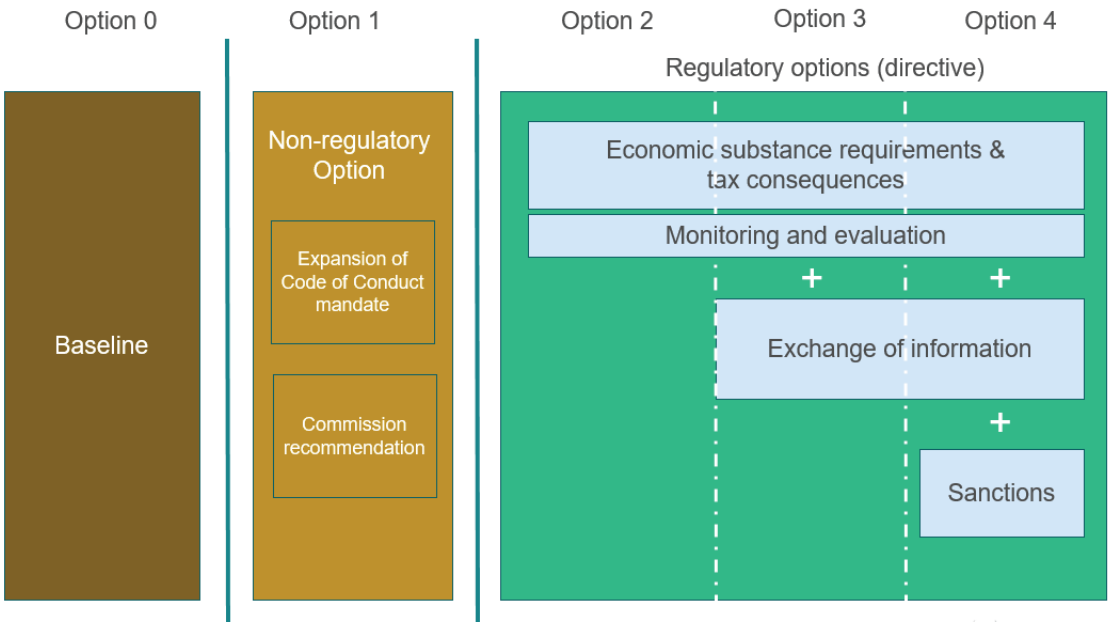

Figure 4 Overview of the policy options considered

5.2.1.1.Sub-option a): review of the scope of the EU Code of Conduct Group

Scrutiny of substantial economic activity is at the core of the work of the EU Code of Conduct Group for business taxation, assisted by the Commission. Yet, the scope of such work at EU level is limited in the context of identified preferential tax regimes. In essence the Group verifies if such regimes include adequate safeguards to prevent their abuse by entities without substantial economic presence. Option 1 would remove the existing limits and explicitly expand the remit of the Code of Conduct Group review beyond the context of preferential tax regimes. As a result, the Group would be entrusted to verify if the general tax framework in each Member States includes rules to prevent abuse by entities without substance. The option would not affect the external dimension of the Code of Conduct Group. The latter would continue to screen third countries and assess their compliance with, among others, substance requirements for offshore structures and arrangements. The Group would do so either in the context of specific

regimes or more generally, in the case of zero or almost zero tax jurisdictions. Member States would be primarily responsible for the implementation of this option. The Commission may well play an active role. Yet, ultimately it is only Member States which have the power to decide, at unanimity, whether and how to change the mandate and scope of the Code of Conduct Group.

5.2.1.2 Sub-option b): Commission recommendation on substance

In a different soft-law option, the Commission recommends a common approach to define what may be considered a shell entity or arrangement for tax purposes and how it should be treated by Member States. It could also encourage Member States to exchange information on findings regarding shell entities. In the past, the Commission has made use of recommendations in the tax area, most recently with its May 2021 recommendations on the domestic treatment of losses. Institutionally, the recommendation would be an initiative by the Commission, adopted by the Commission and addressed to Member States.

Key differences	**Sub-option 1 a)**	**Sub-option 1 b)**
Form / instrument	Revised mandate of the Code of Conduct Group	Commission recommendation
Decision-making	Consensus by all Member States	Commission's own initiative

Table 1 How the two soft-law sub-options differ

5.2.2 Option 2: EU wide common substance requirements

This policy option is the first and most basic scenario of a trio of regulatory options aiming at enhancing, in the area of taxation, the anti-avoidance and evasion tools available to Member States. Options 3 and 4 build on this basic scenario, including in addition further obligations for tax administrations, in terms of exchange of information, and a common approach on sanctions.

This option would establish a set of minimum substance requirements common across the European Union. It would introduce a common understanding of what constitutes a shell entity for the purposes of this tax initiative. It would allow tackling their use for tax purposes by defining the implications (tax consequences) of such findings. The introduction of substance requirements takes stock of existing experience, within the EU and internationally, on assessment of substance. As mentioned above, under Option 1, Member States have been using substance requirements to assess harmful tax regimes in the EU as well as in international fora. The substance requirements put forward in the context of this Option 2 (and subsequently Options 3 and 4) are in line with the standards used so far. Hence the actors involved, namely Member States, taxpayers, tax administrations, international partners, should be familiar with this notion. They should find relatively straightforward to implement it in relation to new concepts. In the same vein and taking into account that there is no commonly accepted definition of what is a shell entity, definition of substance requirements could offer a more familiar and acceptable approach to distinguish between shell and non-shell entities. In this context it is acknowledged that substance requirements have been established primarily in the

context of traditional business models and may be less apt when it comes to digital business models. Nevertheless, it must also be acknowledged that digitalisation of the economy is an ongoing process, which has altered the way business is done but not overhauled it yet: a certain physical presence seems to still be essential today and cannot be disregarded, at least not at the present stage.

Furthermore, this option, which constitutes a proposal for a directive, is consistent with actions recently taken in the EU in order to tackle tax avoidance. Namely this action builds on and follows up to the 2016 ATAD directive, as well as to the DAC as amended. It is nevertheless proposed as a standalone measure in order to allow, on the one hand, for a scope broader than the one of ATAD and, on the other, for the introduction of specific tax-related consequences that go beyond the mere reporting and/or exchange of information under the DAC. As a result, this option is envisaged to complement the existing EU directives, seeking to tackle tax avoidance and evasion through a specific practice identified to be used for tax avoidance or evasion purposes.

5.2.2.1 Carve-outs and exemptions

As the aim of this initiative is to tackle tax avoidance and evasion, situations or arrangements where no tax avoidance and evasion is expected to take place should not be burdened with the consequences of this initiative. As with previous initiatives in the area of tax avoidance and tax evasion, certain categories were carved out in order not to unnecessarily involve these businesses as these are not the ones targeted. For example, listed companies are subject to important transparency obligations already. Therefore, they are assumed to pose a relatively low risk of being exploited as shell entities for tax purposes. Equally, a low risk seems to arise with those holdings located in the same jurisdiction as their shareholder.

Similar carve-outs are used by a) the Code of Conduct Group when it verifies regimes including substance requirements in Member States and in third countries and b) the OECD Forum for Harmful Tax Practices which has a similar task at international level. These have been verified against and enhanced with the input from the public consultation, where contributors were asked to indicate specific structures that should be carved-out because they do not raise tax risks but are put in place for good commercial reasons, such as joint ventures.

However, carve-outs are general rules and might not preclude a genuine business from falling in scope of the initiative. Such business should be given the chance to evidence that lack of tax motives in its structure and obtain an exemption. An exemption mechanism should therefore complement the carve-outs. The exemption shall apply both for the required reporting and the tax consequences of the initiative. Entities that pass the gateways and/or do not have the minimum substance can choose to apply for an exemption. As the gateways provide further focus on the type of activities/income it is

expected that the entity will be pre-dominantly involved in intra-group transactions, an exemption should then only be granted if the interposing of the entity does not provide for a lower overall tax burden for the group of companies it is part of.

Carve-outs envisaged in Option 2[79]

(i) Companies of which the principal class of shares is regularly traded on one or more recognised stock exchanges.
(ii) Regulated financial undertakings.
(iii) Businesses whose main activity is holding shares in operational businesses in the same Member State while their beneficial owners are also resident for tax purposes in the same Member State.
(iv) Undertakings with at least 5 own full time employees exclusively involved with the activities generating the relevant income and having the necessary qualifications.

5.2.2.2 A gateway to focus on the highest risk

Entities not carved out and not exempt otherwise would have to fulfil certain requirements or "gateways". These requirements have been chosen on the basis of evidence[80] according to which shell entities typically do not produce goods nor provide services. Therefore it can be expected they mainly earn passive income,[81] are used as part of tax structures involving several jurisdictions, do not employ staff or do not have offices, etc. To reflect these characteristics, the gateways of Option 2 include:

1. The first gateway looks at the type of income to single out entities with geographically mobile activities. The latter means essentially that the entities that earn more than 75% of their income in the form of passive income (such as interests, royalties, dividends, rents or similar) would pass this gateway.
2. The second gateway seeks to identify a cross-border element as tax risks from shell entities are expected to arise in situations involving more than one taxing jurisdictions.
3. The third gateway focuses on the (lack of) resources necessary to carry on a business activity, i.e. staff, premises, equipment and singles out entities in need to rely on outsourcing of core activities (corporate administration and management or).

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[79] Actual carve-outs will depend eventually on whether this option is retained and on its final design.

[80] Please refer to the description of shell entities provided in Section 2, and in particular section 2.1.2.1.

[81] Passive income is a tax term that can be defined as: "Income in respect of which, broadly speaking, the recipient does not participate in the business activity giving rise to the income, e.g. dividends, interest, rental income, royalties, etc.". Source: OECD Glossary of tax terms, https://www.oecd.org/ctp/glossaryoftaxterms.htm

Entities and arrangements meeting all the three gateways should report to the tax administrations on whether they meet a set of substance indicators and provide evidence. The key policy rationale for including gateways are part of the regulatory option is the attempt at a balancing act between on the one hand the policy objective of tackling tax avoidance and tax evasion through shell entities on the one hand; and, on the other hand, the attempt at avoiding a disproportionate burden on the private sector.

5.2.2.3 Minimum substance

After an entity has crossed all the gateways, such entity would be asked to: a) run a self-assessment about whether it meets basic minimum substance criteria; b) to report to the tax administration where it is resident for tax purposes the results of such self-assessment.

It is challenging to define what substance amounts to. Option 2 proposed here would include the following substance indicators:

1. The entity has own premises in the Member State where it is resident for tax purposes.
2. The entity has at least one own bank account in the EU.
3. One or more directors of the entity are resident for tax purposes in the same Member State of the undertaking, or close enough to ensure they are able to fulfil their duties, and are qualified and authorised to take decisions in relation to the activities that generate relevant income for the undertaking.

In selecting the specific substance indicators, existing international and EU standards on assessing substantial economic presence for tax purposes have been taken into account. The latter have been developed and are applied by the OECD Forum on Harmful Tax Practices and the EU Code of Conduct Group. These standards focus on the existence of staff, premises and equipment that are essential to perform an activity. Given the geographically mobile nature of the activities in scope, equipment could be a non-appropriate requirement. At the same time, it is recognised that lack of own bank account is a key feature of shell entities used for evasion and avoidance of taxes, as also indicated by the results of the public consultation for this initiative.[82]

5.2.2.4 Tax consequences

Where an entity reports that it does not have the substance indicators set above, tax consequences would be triggered, to be specified under this option. Consequences would be triggered only if the entity fails to meet all minimum substance criteria. The indication

[82] A majority of respondents agreed that the lack of own bank account may be the most indicative feature of shell entities, source: DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes".

of specific tax consequences is a new feature that complements existing EU anti-tax avoidance rules regarding a lack of substance situation.

In addition to the interplay of carve-outs, gateway and substance indicators that would allow authorities to identify only those entities that are shells misused for tax purposes, taxpayers identified as shells should still be able to provide counter-evidence through a rebuttable presumption before consequences apply. This would allow the tax administration to make an individual assessment based on the facts and circumstances of each case. Should a tax administration ascertain that the taxpayer has substantial presence despite indications to the contrary, it would be able to certify so and relieve the taxpayer from the consequences.

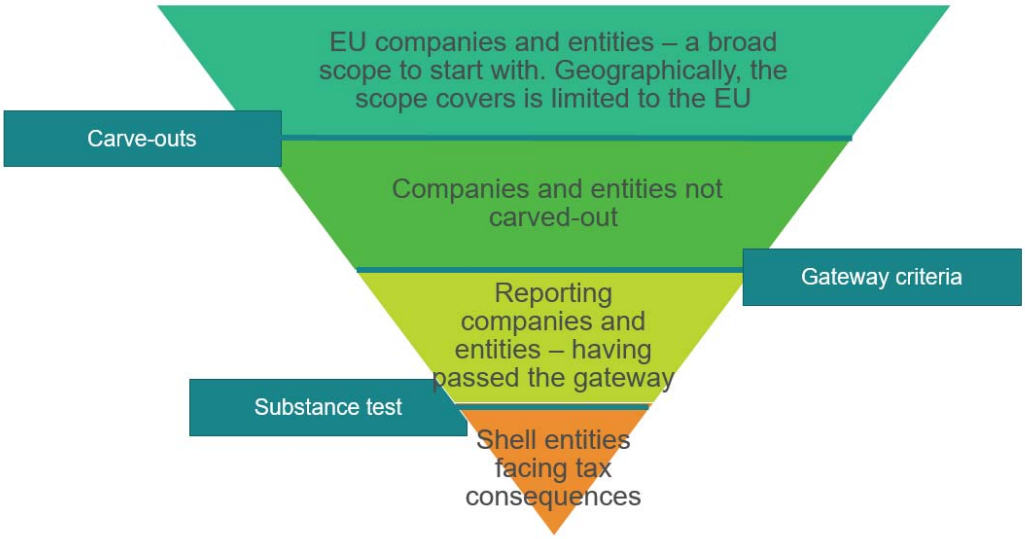

Figure 5 Key different steps envisaged in the basic regulation option (option 2), allowing to focus the effects of the intervention only on a limited number of companies or other legal entities

A mechanism to monitor implementation of the measures in Member States (via reporting by Member States to the Commission) should also be envisaged. This is particularly important because the identification of shell entities and the application of consequences lies with the Member State of tax residence of such entities. As, in many cases, the Member States whose tax bases are eroded through the use of shell entities are different from those where the shell entities are tax resident. A monitoring mechanism should thus provide incentives for all Member States to apply the measures appropriately.

5.2.3 Option 3: EU wide common substance requirements accompanied by provisions for administrative cooperation

5.2.3.1 Overview

This option would build on the previous one. However, on top of option 2, it would envisage an EU wide mechanism for administrative cooperation and automatic exchange of information between tax authorities.

Since 2011 and the adoption of the Directive on Administrative Cooperation (DAC)[83], the EU has made large progress in the field. While there remains scope for improvement,[84] administrative cooperation and in particular exchange of information has empowered tax authorities with a key resource – information – needed to ensure cross-border tax compliance in a highly dynamic and integrated economy as the EU internal market.

The administrative cooperation element of this option would build upon, and complement, existing DAC mechanisms and tools. Currently, Member States can use the DAC to check the status of entities which are tax residents in other Member States but such mechanisms are not automatic. A Member State needs to ask another Member State for information. This is referred to as exchange of information on request. The requested Member State has up to six months for answering. In practice, responses are far from immediate and in some cases provided later than six months.[85]

This option would push administrative cooperation one step further by obliging tax authorities to automatically[86] inform each other about whether entities in scope which are tax resident in their jurisdictions fulfil the substance requirements or not. The basic flow of information would work in two steps: first, the entity will send its self-assessment (about whether it fulfils substance requirements or not) to the tax administration of the Member State where it has its tax residence. Second, the tax administration will upload the self-assessment, including its conclusion (whether an entity fulfils or not substance requirements) in a shared directory for all other tax administrations to be able to read.[87]

By introducing automatic exchange of information mechanisms, this option would enable all Member States concerned, e.g. because they are the place of tax residence of an entity belonging to the same group of the one having sent its self-assessment, to have information available on a timely basis in order to apply correctly the envisaged tax consequences. In addition, this could encourage Member States' tax administrations to implement properly and timely the obligations envisaged by the new initiative.

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[83] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 64, 11.3.2011, p. 1–12

[84] European Court of Auditors special report on Exchanging tax information in the EU: solid foundations, cracks in the implementation https://www.eca.europa.eu/Lists/ECADocuments/SR21_03/SR_Exchange_tax_inform_EN.pdf

[85] Commission staff working document, Evaluation of the Council directive 2011/16/EU on administrative cooperation in the field of taxation and repealing directive 77/799/EEC, SWD(2019) 327 final, p. 23.

[86] Automatically is to be understood as: systematic communication of predefined information to another Member State, without prior request, at pre-established regular intervals. Reference: Council Directive 2011/16/EU of 15 February 2011, article 3(9).

[87] This system replicates the functioning of the DAC3 on automatic exchange of tax rulings and advance pricing agreements. Annex 10 provides additional information on the envisaged flow of information.

5.2.3.2 Ensuring effective cooperation

Effective cooperation, including information exchange, between tax authorities would be ensured first of all by checking that data exchanged is accurate, complete and sent within the deadlines. Moreover, it is essential for effective cooperation that Member States make use of the information they receive. However, effective cooperation does not depend only on Member States. The Commission has a role to play. The Commission is responsible to check the correct legal transposition of provisions concerning administrative cooperation, among others. Furthermore, it is the Commission that needs to monitor how the system of information exchange is implemented and how effective it is in practice. As part of the monitoring of tax cooperation between Member States, and separately from this initiative, the Commission is planning to conduct on the spot visits in the Member States to monitor effectiveness.[88] The initiative will include specific monitoring provisions, as outlined in Chapter 9. Effective cooperation will also depend on the quality and quantity of resources allocated. A regulatory intervention is expected to provide a strong incentive (and stronger than in the case of a soft-law option) for Member States to ensure that adequate resources are dedicated to effective cooperation. Monitoring by the Commission will allow to assess to what extent resource allocation is fit for meeting the objectives of the intervention and whether its implementation leads to effective cooperation, including effective and useful information being exchanged.

5.2.3.3 Information exchange and personal data

Information exchanged will consist in the information reported by entities to tax administrations through their self-assessment of minimum substance. It will comprise primarily information about the entity.[89] However, Member States will also receive personal data, i.e. only what is necessary to identify the beneficial owner(s) of the entity. Interference with the fundamental rights to privacy and to the protection of personal data must be necessary and proportionate[90].

Personal data are protected under the General Data Protection Regulation (GDPR).[91] The processing of personal data must comply with the applicable data protection legislation (including with principles such as legality, data minimisation and purpose limitation, security etc.). The Directive on Administrative Cooperation includes specific provisions

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[88] Replies of the European Commission to the European Court of Auditors special report: "Exchanging tax information in the EU: solid foundation, cracks in the implementation".

[89] As described in section 5.2.2., presenting Option 2.

[90] See also the EDPS Guidelines on assessing the proportionality of measures that limit the fundamental rights
to privacy and to the protection of personal data, available at:
https://edps.europa.eu/sites/default/files/publication/19-12-19_edps_proportionality_guidelines2_en.pdf

[91] Regulation (EU) 2016/679 General Data Protection Regulation.

and safeguards on data protection. However, any legal intervention based on further amendments to this Directive will have to comply with GDPR.

Each time personal data is processed, there is a risk of a data breach, e.g., a data leak or an unauthorised disclosure. The most efficient way to reduce such risks is to reduce the amount of personal data processed (data minimisation principle). This is also the approach followed by this intervention. The vast amount of data exchanged within the meaning of this Directive will concern legal entities and not individuals. Personal data will represent only a small fraction of the exchange of information flow.[92]

Member States will also have to comply with GDPR with regards to the processing of data in their national systems. As data controllers they will have to implement appropriate technical and organisational measures to ensure and to be able to demonstrate that processing is performed in accordance with the GDPR. The exchange of the data will occur through a secured electronic system that encrypts and decrypts the data and, in every tax administration, only authorised officials should access the information.

5.2.4 Option 4: EU wide common substance requirements accompanied by provisions for administrative cooperation and a common sanctioning framework

This option would build on Option 3 with the addition of one more element: a common sanctioning framework, targeting non-compliance by the entities in scope. Given that the initiative establishes reporting obligations for entities and relies on the actual reporting of these entities for its effective implementation, it is important to ensure that such entities do report. This option would be enhanced in this direction, compared to the other two regulatory options. It would define specific, monetary sanctions that Member States' tax administrations would apply to entities that do not properly comply with their obligations. Having a basic, common EU sanctioning framework would provide a better guarantee that sanctions are dissuasive and proportionate, while maximising certainty for taxpayers. Any sanctions should be proportionate and non-discriminatory under EU law.

5.3 Options discarded at an early stage

As part of the process for identifying options, some alternatives have been considered and discarded upfront, for different reasons.

The introduction of a ban to shell entities was discarded almost at the start for the following key reasons: first, as said also earlier in this impact assessment, shell entities and the lack of a universal definition of what is a shell entity are not problems per se. Problems emerge from a tax perspective when they are used for tax avoidance and evasion purposes. It is evident that there are legitimate reasons why entities, including

[92] Annex 10 provides additional information on which personal data would be exchanged and how they would be handled.

legal arrangements may exist without conducting any substantial economic activity. As pointed out by one stakeholder: " (…) there are good commercial reasons for the use of special purpose vehicles, in particular in secured lending, securitisation, insurance-linked securities and similar transactions."[93] An EU-wide prohibition of shell entities would be a disproportionate and potentially costly measure, which could also be contrary to the fundamental freedoms, and in particular the freedom of establishment, in the single market. Secondly, the political and legal feasibility of such a ban appears thin.

The option of regulating intermediaries, such as in particular trust and company service providers, who enable the set up and maintenance of shell entities is another measure considered, as alternative or complementary. Such measure could function to discourage, in an indirect manner, the creation and maintenance of shell entities. However, action in this direction was discarded for three main reasons. First, as an EU-wide measure, this would regulate only intermediaries / service providers with a link to the EU but would not prevent the use of third country persons. Second, groups of enterprises would still be able to use associated enterprises in the role of intermediaries / service providers and would not need to have recourse to external, regulated persons. Third, such measure could risk being disproportionate in relation to its objective: it would be too broad a solution for a specific problem.

Furthermore, this assessment has also discarded options focussing on corporate tax rates or VAT, as put forward, for instance, by respondents to the publication for feedback on the inception impact assessment.

Namely, one respondent[94] suggested to harmonise and to lower the corporate tax rate (the contribution is not specific here, the assumption is that reference is made to the corporate tax rate) in order to reduce, arguably, incentives for tax avoidance and risks of non-compliance by taxpayers. Leaving aside considerations of legal feasibility, this option seems in any case disproportionate to the specific problem at hand, that is to say the misuse of shell entities for tax purposes. Another respondent called for introducing one single corporate tax rate and to use turnover as tax base.[95]

In the same vein, the option to harmonize withholding taxation (WHT) on outbound payments from Member States has been discarded. The lack of harmonized WHT was in particular cited in the context of the public consultation by the IBFD as one of the drivers for the use of shell entities in the internal market for tax abuse. Yet, a measure towards harmonization of WHT would imply a significant intervention in the freedom of Member States to define their tax rules, which would be disproportionate solution to the problem at hand.

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[93] Feedback to the inception impact assessment by Arthur Cox LLP, 17 June 2021.

[94] Feedback from Federazione Italiana Ristorazione.

[95] Anonymous feedback. The same feedback also called for changes to capital requirements of companies, stating that any EU company must be owned at more than 50% by European nationals and companies.

Another discarded option from the feedback on the inception impact assessment, would entail stricter regulation and oversight of e-commerce. While sales via e-commerce contribute to certain companies' profits, such option is not directly relevant to tackle the problem at hand, namely the misuse of shell entities for tax avoidance or tax evasion.[96]

6. WHAT ARE THE IMPACTS OF THE POLICY OPTIONS?

6.1. Introduction

The section is organised as follows. First, there is a brief introduction on the typologies of impacts considered in the analysis. Second, the impact on SMEs is considered. Third, the impact of each option, including the baseline, is assessed in terms of: a) regulatory charges; b) administrative burdens for businesses; c) enforcement costs for tax administrations; and d) direct and indirect benefits. Certain types of costs as well as the impact on the environment are not assessed, for the following reasons:

- **Substantive compliance costs** are not assessed because no equipment, labour, materials or external services will be necessary to comply with the intervention. Businesses will incur only administrative burdens or non-substantive compliance costs, due to the nature of the information requested. Requested information should be readily available for them, thus limiting the costs of compliance to processing of information.
- No impact on the **environment** can be readily identified. The proposal does not have an environmental policy dimension and is aimed at behavioural changes that would affect financial flows.

6.2. Impact on Small and Medium Enterprises (SMEs)

The impact on SMEs producing and selling goods and services is expected to be negligible if any. As the definition of SME is based on thresholds of number of employees, turnover and total balance sheet, it would be possible that some shell entities would fall under this definition (e.g. a shell entity with no employee, EUR 50 million turnover and EUR 40 million onto the balance sheet could theoretically qualify as a SME). However, this definition should not be interpreted rigidly: the initiative aims at covering those entities that do not have substance and are set up to avoid or evade taxation[97].. The criteria that trigger reporting obligations to the tax authority are strictly limited to companies with a high 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 (see section 5 above) 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

[96] Anonymous feedback by a German citizen, 14 June 2021.

[97] Evidenced in the last OpenLux investigation showed more than 1000 companies registered at the same address with no employee.

owned mainly by foreign owners and have outsourced essential aspects of its operations).

Another possibility is that SMEs use shell entities to carry activities in the EU. The population of SMEs using shell entities is expected to be negligible. In addition, and importantly, it is not possible to assess the specific impact on SMEs given the lack of data. As shown in this impact assessment, the lack of data makes it a complicated and inaccurate exercise to quantify the use of shell entities by businesses in general, and impossible to differentiate between SMEs or larger companies, something this initiative would improve.

When it comes to SMEs, also the findings of the public consultation are of limited help in terms of impact assessment. Respondents are divided on how to include SMEs in the scope of a possible regulatory initiative to tackle tax avoidance or tax evasion via shell entities. Eleven respondents indicated that there is no need for specific rules for SMEs, while ten indicated that a threshold could be used to exclude SMEs from the scope. Hence, the negligible impact expected on SMEs, both in terms of SMEs qualifying as shell entities and SMEs using shell entities, and lack of data to allow us to assess the specific effect on SMEs, justify the lack of an in-depth assessment of the specific impact on SMEs.

6.3. Data limitations and assumptions

The analysis in this section builds on limited evidence. The initiative addresses a certain type of entities for which there is a severe lack of data. For shell companies, no data is available as such. Indeed and relatedly, there is no universal definition of shell entities and no commonly agreed way of giving them a legal qualification. It is thus difficult to distinguish between entities with substance and actual operations and a "shell". All this generates a high level of opacity surrounding these entities. Nonetheless, a relatively wide range of data sources is used to try and quantify the impact of the problem. These including: a) international organisations (Eurostat, OECD and IMF); b) commercial databases (ORBIS); c) journalistic sources (OpenLux) and d) academic literature, including contacts with scholars in the field.

For a detailed analysis it would be key to estimate the number of entities in scope, i.e. those that will pass the gateway criteria and will have to report and, in a second step, those that could be identified as "shell" as a result of applying the substance test. However, there is no data source available that allows a reasonable estimation of the effect of the gateway criteria and substance test on the number of entities in scope. For this reason, impacts presented in this section will rely often on assumptions, partial data or circumstantial evidence and should be treated with caution.

6.4. Option 0: the baseline scenario (no change)

Tax avoidance and tax evasion through shell entities continue to occur in this scenario. As said, shell entities can take the form of companies, trusts or foundations settled in an EU country with revenues coming in from (or revenues going out to) a third country. Such structures' main purpose may well be business-related. As already indicated, there are many legitimate reasons why shell entities are set up. However, the end result of

having financial flows going through a shell entity may be to decrease its owner's tax liability, for instance by hiding assets and income from the jurisdiction where owners are tax resident and where tax rates are comparably high. Recent literature[98] shows that MNEs may also use shell entities, mostly finance and holding entities, to decrease their effective tax rate, over and above other (and main) legitimate commercial reasons.

As pointed out earlier, DAC and ATAD have tackled some main tax abuse, but there is still a lack of commonly shared substance criteria to ensure that tax advantages are not granted abusively. The ongoing reform of the global corporate tax framework, and especially the introduction of a minimum effective tax rate for corporates (Pillar 2) only applies to multinational companies that meet the EUR 750 million threshold as determined under BEPS Action 13 (country by country reporting) and currently it is difficult to predict when it will start being applied.

6.4.1. Compliance costs for businesses

As this option does not require any new obligation, there is no additional cost expected for business.

6.4.2. Regulatory charges

According to research on Member States' practices performed as part of this impact assessment[99], only the Netherlands[100] have objective substance criteria that can be used ex-ante to assess whether a tax benefit should be granted. There is no indication that sanctions are currently applied and recovered by national authorities due to failure to report by shell entities at national level. Hence, no regulatory charges are currently applied to entities.

6.4.3. Enforcement costs for tax administrations

As this option does not require any new obligation, there is no enforcement cost expected for administrations.

6.4.4. Direct costs and benefits

In a no change scenario, Member States' treasuries will continue to experience a shortfall in their finances because of tax avoidance or evasion via shell entities. Due to considerable data limitations it is **not possible to deliver a robust estimate of the loss of corporate tax revenues due to tax avoidance through the use of shell companies**.

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[98] CICTAR, January 2020, Failing to Care: Global Tax Dodging by a German Healthcare Multinational.

[99] For more information, please refer to Annex 5.

[100] In the case of the Netherlands, substance criteria are used to assess whether an Advance Pricing Agreement should be granted. For an overview of Member States' measures concerning shell entities and substance, see Annexes.

Empirical evidence about the extent of the resulting tax advantages of shell companies is sparse, but some indications may be drawn from the extrapolation of USA data. Most recently, Demeré et al (2020)[101] have estimated for the USA that Special Purpose Entities (SPE) could generate additional tax savings equivalent to 6% of the US federal corporate income tax collection. SPEs are usually seen as 'Phantom FDI' in the absence of any real business activity.[102] If one applied that rate to the EU27's 2019 corporate income tax revenues, this would imply tax savings for SPEs of some EUR 23 billion per year. It is important to underline that this does not mean all SPEs are considered shell entities, but some SPEs are used in tax structures for tax avoidance purposes and share characteristics with shell entities, and can thus be used as a proxy given the lack of more accurate data. Moreover, and as explained above, caution should be exercised when extrapolating from the US to the EU, but it gives an order of magnitude of the phenomenon.

The analysis presented in **Annex 4(A)** suggests that an upper bound of the current EU-wide tax loss sustained through the use of SPEs could amount to around EUR 60 billion per year. The majority of this amount (some EUR 40 billion) stems from investors outside the EU. These figures stem almost exclusively from those two EU countries showing by far the highest inward FDI in SPEs[103] and income flows (and thus: imputed forgone tax revenue): **the Netherlands and Luxembourg.** A study by the IMF lists those two countries on top of a list that ranks OECD economies with respect to their inward FDI position, based on IMF and OECD data.[104] Luxembourg and the Netherlands combine the largest chunk of the world's 'Phantom FDI'.[105] Luxembourg's inward FDI position is an estimated 56-fold of its GDP. More than 90% of this amount is due to SPEs.[106] For the Netherlands, another study[107] finds that Dutch SPEs are often used for indirect income transfers between two countries (e.g. flows of royalty or interest

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[101] Demeré, Donohoe, Lisowsky 2020 - The Economic Effects of Special Purpose Entities on Corporate Tax Avoidance, Contemporary Accounting Research Vol. 37 No. 3 (Fall 2020) pp. 1562–1597.

[102] For example, Damgaard, Jannick, Elkjaer, Thomas and Nils Johannesen, "The Rise of Phantom Investments", Finance & Development, September 2019. The key statistical concept 'SPE' is explained by the OECD as an entity within "complex structures" which is often used "to channel investments through several countries before reaching their final destinations". Available online at: https://stats.oecd.org/OECDStat_Metadata/ShowMetadata.ashx?Dataset=FDI_POS_CTRY&Lang=en&Coords=%5bTYPE_ENTITY%5d.%5bRSP%5d

[103] Damgaard, Jannick and Thomas Elkjaier – The Global FDI Network: Searching for Ultimate Investors, IMF Workig Paper WP/17/258, November 2017, Annex 1.

[104] Ibid, p. 14 and Annex 1.

[105] Damgaard, Jannick, Thomas Elkjaier and Niels Johannesen, "What is Real and What is Not in the Global FDI Network?" IMF Working Paper WP/19/274, December 2019. The authors estimate the world's Phantom FDI to account for $15 trillion (40% of total FDI). Of this amount, Luxembourg and the Netherlands accounts for $3.8 trillion and $3.3 trillion, resp. (p. 26).

[106] Damgaard et al (2017), Annex 1.

[107] Lejour, A., Mohlmann, J., van't Riet, M., & Benschop, T. (2019). Dutch Shell Companies and International Tax Planning. (CentER Discussion Paper; Vol. 2019-024). Tilburg: CentER, Center for Economic Research.

payments from one country to another via Dutch SPEs). If 'tax havens' are involved in these bilateral transfers, the likelihood of those payments being channelled through Dutch SPEs is significantly higher.

These findings have to be carefully interpreted in the light of **significant data gaps**, but one can indeed deduce from the regression analysis in Annex 4(A) that the SPEs and 'regular' entities (non-SPEs) follow a different pattern in the context of capital flows from one country to another, and that tax treatment of FDI plays a role in explaining these differences. In particular, all else being equal, SPEs seem to be more often used for shifting EU capital to countries where the statutory corporate income tax rate is lower than in the country where the investor is located.

Moreover, after controlling for nominal corporate income tax rates, it appears that **Luxembourg** remains the dominant EU destination of investments of EU SPEs. The absence of withholding taxes on interest and royalty payments, and exemptions from a withholding tax on dividends in Luxembourg may explain this finding.

Such absence of withholding taxes on many outbound payments also applies in **the Netherlands** and in **Ireland**.[108] The regression analysis in Annex 4(A) confirms that those two countries stand out when considering income flows in both directions (i.e., FDI income flowing into *and* income flowing out of EU countries from/to those two countries). However, this finding holds only if SPEs are involved in the transfer, not in the case of 'regular' non-SPEs.[109] One possible explanation is that FDI income flows to third countries are often channelled through the Netherlands and Ireland, especially if SPEs are involved in these payments.

More generally, the IMF-study finds that the share of non-SPE FDI tends to go down when the total FDI-to-GDP ratio goes up. In other words, there is "clear tendency that economies with a high total inward FDI-to-GDP ratio are more likely to host SPEs than economies with low ratios."[110] SPEs can therefore be seen as a driving force behind current uncommonly large flows FDI at least in some countries. Indeed, "phantom investment into corporate shells with no substance and no real links to the local economy may account for almost 40 percent of global FDI".[111] In a given country, any policy that

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[108] Data of the analysis stems from 2019. By that time, the Netherlands had applied a withholding tax on outbound payments of dividends, not on payments of interests and royalties. The scope of the withholding taxes was expanded only from 1st January 2021 to cover outbound payments of interests and royalties. Ireland applies a withholding tax on outbound payments, but many exemptions apply.

[109] This finding remains stable if one controls for bilateral differences in the level of CIT. Note that the Irish official CIT rate (12.5%) is one of the lowest in the EU.

[110] Damgaard, Jannick and Thomas Elkjaier – The Global FDI Network: Searching for Ultimate Investors, IMF Workig Paper WP/17/258, November 2017, p. 14.

[111] Damgaard, Jannick, Thomas Elkjaier and Niels Johannesen, "What is Real and What is Not in the Global FDI Network?" IMF Working Paper WP/19/274, December 2019, abstract.

limits the use of SPEs is therefore likely to reduce total FDI, at least in the short term.[112] Note that, as per the scope of this initiative, this would be FDI flows that have no associated employment or economic activity.

In the longer term, there could be (non-quantifiable) positive **second-round effects** of limiting the use of SPEs with no economic activity since firms will seek investment opportunities with substance. Note that more generally, tackling the lack of skilled labour, infrastructure or regulatory market barriers[113] would also increase the likelihood of increase 'real' FDI and decrease the misuse of shell companies for tax purposes only, with a positive economic impact in destination countries.

Because no regulatory change is planned, no tax gain for national treasuries is expected. There are only foregone benefits in terms of tax revenues.

6.4.5. Indirect costs and benefits

A no change scenario would maintain the current tax revenues forgone due to continued aggressive tax avoidance and evasion through the misuse of shell entities. 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.

Continued tax avoidance and evasion through shell entities and the absence of action by the EU may be negatively perceived by EU citizens, or even seen as a form of complaisance. The pandemic may strengthen this perception, as tax revenues are needed to finance the recovery and financial efforts from citizens will likely be required in the near future. In an environment of rising scepticism toward the EU, inaction does not seem to be an appropriate option.

No effect is expected on competitiveness for the EU as a whole.

Regarding competition, the playing field would remain unlevelled as multinational corporations using shell entities for tax avoidance and evasion purposes would still be able to generate cost saving through this channel, and thus preserve an unfair competitive advantage comparatively to smaller firms and those with better practices.

6.5. Option 1: Soft-law option, sub-option a): review of the scope of the EU Code of Conduct Group

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[112] However, the share of pure shell companies without substancesubstancesubstance in all SPE is not known. It is therefore not possible to estimate the extent of the decline of inward FDI that follows a removal of shell companies.

[113] Damgaard et al (2017), p. 14.

The feasibility and effectiveness of this sub-option are limited. In terms of feasibility, delivering this sub-option requires Member States' political commitment to act. The mandate of the Code of Conduct Group can only by modified by consensus. Currently, the mandate of the Group remains essentially the same since 1997. When it comes to effectiveness, even a consensually agreed reform of the Code of Conduct Group mandate to cover assessment of substance would not be binding for Member States.

6.5.1. Compliance costs for businesses

Businesses would face some compliance costs. The absence of binding provisions will limit legal certainty and predictability. As any soft-law option, there is a risk that the compliance costs for cross-border activities may increase due to possible divergences in the actual implementation of the measure.

6.5.2. Regulatory charges

As no sanctions are planned, no regulatory charges are implemented. However, given the discretion that soft law instruments allow for Member States, regulatory charges could apply in some Member States if they so wish.

6.5.3. Enforcement cost for tax administrations

Some enforcement cost may be entailed if some Member States decide to act and put in place a definition of shell entity and attach tax consequences to such entities. However, the cost of auditing and making sure that tax consequences are effectively applied will be borne by participating Member States only. Without exchange of information between tax administrations, it may be more costly, in terms of time and resources, for Member States willing to act to identify the relevant shell entities, when compared to a common regulatory scenario.

6.5.4. Direct costs and benefits for Member States treasuries

The effect on Member States' treasuries would depend on the form and effectiveness of the national measures chosen, and on businesses' potential escape strategies. Without an EU-wide implementation, the misuse of shell entities for tax purposes may merely move from the Member State(s) that will effectively implement substance requirements to another that does not implement them, rather than be effectively addressed across the EU. Thus, at aggregate EU level, tax gains remain hypothetical.

6.5.5. Indirect costs and benefits

By leaving a degree of discretion to Member States on how they will implement measures, this option allows for discrepancies and creates complexity for entities with cross-border operations. Potential loopholes can remain and still be used for tax avoidance purposes. Hence, the tax loss roughly estimated for the no change scenario could still hold for this scenario. The risk of limited effective coordination of Member States' measures may translate in fragmenting the Single Market and additional complexity for businesses.

The impact on competition among firms would depend on how coordinated Member States' measures will be. The more coordination, the more levelled the playing field will be. In the Member States that effectively implement the revised mandate it may also incentivise voluntary tax compliance. However, as explained above, circumvention of the new rules may occur, due to divergent implementation across Member States. This situation may fuel disappointment in the public opinion and may be as detrimental as the no change scenario, or even more so, showing the incapacity of the EU to act effectively and make best use of its resources.

6.6. Option 1: Soft-law option, sub-option b): Commission recommendation on substance

As in the case of sub-option a), effectiveness would be limited overall. In relative terms, a Commission recommendation should be less effective than for a consensually agreed reform of the Code of Conduct Group's mandate. This is because in the latter case, Member States would demonstrate some degree of ownership and commitment. On the other hand, the implementation of a Commission recommendation would depend even more on Member States' willingness to act. Compared with sub-option b), however, the feasibility of a Commission recommendation is very high. Its adoption would depend on the Commission's own initiative and would not depend on Member States' consensus.

6.6.1. Compliance costs for businesses

Compliance costs for business will depend on how many Member States will follow the recommendation at national level to make sure shell entities are not used for tax avoidance purposes. Different implementations of the recommendation could impact the Single Market, increasing complexity and costs of compliance for businesses with activities in different Member States. It is possible that overall compliance costs for business would be lower for this sub-option than for the previous one, as there would be a risk of having one or more Member State not implementing the recommendation (hence without new compliance burden and costs for businesses).

6.6.2. Regulatory charges

As no sanctions are planned, no regulatory charges are implemented. However, given the discretion that soft law instruments allow for Member States, regulatory charges could apply in some Member States if they so wish.

6.6.3. Enforcement cost for tax administrations

Member States that implement the recommendation would face enforcement costs. As in the case of the previous sub-option, without exchange of information between tax administrations, it may be more costly, in terms of time and resources, for Member States willing to act to identify the relevant shell entities, when compared to a common regulatory scenario. Overall, it is likely enforcement cost for tax administrations would be lower for this sub-option than for the previous one, as there would be a risk of having one or more Member State not implementing the recommendation (hence without enforcement and related costs).

6.6.4. Direct costs and benefits for Member States treasuries

The effect on Member States' treasuries is unclear as this would strongly depend on how many and which decide to implement the recommendation. If most Member States – especially those most used for misuse of shell entities and those that suffer most from erosion of their tax base – decide to act effectively, this could encourage an overall reduction of the misuse of shell entities in the EU and tax gains for the EU as a whole. However, if only some Member States decide to implement the recommendation, this would likely trigger a behavioural response with a relocation rather than a reduction of shell entities: firms may react to action taken in one Member State by establishing entities in other Member States not implementing the recommendation. Member States hosting shell entities may not have an incentive to act as a reduction of tax avoidance opportunities may incentivise shell companies to relocate in another Member State, and thus erode their tax base. The effect of this sub-option on Member States' revenues is expected to be very limited overall, and likely even more so that for the previous sub-option.

6.6.5. Indirect costs and benefits

As the previous sub-option, the implementation of a Commission recommendation implies a risk of divergent implementation, increasing complexity for entities with cross-border operations. Potential loopholes would remain, especially if one or more Member State did not act to implement the recommendation. Tax losses, as estimated for the baseline scenario, would likely remain the same if this sub-option was chosen.

The impact on competition among firms would depend on the number of Member States that decide to act and how. The more Member States decide to act and the better the measures, the more levelled the playing field will be. In the Member States that follow the recommendation it may also incentivise voluntary tax compliance. As the initiative would originate from the Commission, the latter could be seen as promoting a fairer and more cohesive society. However, the effectiveness of this scenario would be limited, even more so that in the case of the previous sub-option. Ineffectiveness would disappoint the public opinion, as the EU would be seen as not capable to act effectively to tackle the problem.

6.7. Option 2: A Directive that requires reporting of shell entities but without automatic exchange of information or common sanctions.

A directive would ensure homogeneity of criteria to define a shell entity and the resulting tax consequences, when used for tax avoidance or evasion. This option should nonetheless be well calibrated in terms of the scope of entities concerned by the reporting request to the tax authority. We note that the risk of tax avoidance or tax evasion is higher for entities involved in geographically mobile activities. It is equally important that entities which give rise to similar risks due to their activities are treated in the same manner, regardless of their form and size. To ensure that the burden created by this additional reporting request is proportional to the risk of tax avoidance or tax evasion, two steps are taken. First, as explained in section 5, some sectors or types of entities already highly regulated and therefore representing a lower risk are exempted. Second,

reporting criteria, strict and cumulative, are defined to limit the reporting obligation to only the entities most at risk of practicing tax avoidance or tax evasion.

Taking into account the exemptions and the reduced scope, due to strict gateway criteria, to fall under reporting obligation, the directive will focus on the entities most at risk.

Such entities will have to self-assess and report to the tax administration of the Member State where they are resident for tax purposes whether they fulfil minimum substance requirements as detailed in section 5.

If one of these indicators of minimal substance is not met, the entity will be deemed shell and face tax consequences, unless the entity manages to obtain an exemption or to rebut the presumption.

6.7.1. Compliance cost for businesses

Compliance costs will increase in a limited manner. There will be a significant share of entities that will not have to do anything as the reporting is not applicable or they are covered by one of the carve-outs or exemptions. For the rest, with regard to the gateway criteria, to check whether a reporting is required, this should involve no or very limited costs as information is readily available to the company (share of relevant income, type of cross-border activities, and information related to the outsourcing of management or reliance on associated enterprises for certain activities in the preceding two tax years). Additional compliance cost will be low because:

- Those reporting entities will represent a small share of the total number of companies in the EU: an estimated max of 0.3%, corresponding to some 75 000 firms. This rough estimation is based on a study carried out by the Central Bank of Ireland which estimates the number of shell companies in Ireland. It thus assumes the share of entities in scope being the same in the EU as it is in Ireland. It can therefore be considered an upper-bound estimation for the EU.
- Those max 0.3% of all companies would be required to provide a limited amount of *non-complex* information.
- Much of these costs incurred by information requirements should be one-off costs or would decline steeply over time due to learning effects and IT-solutions, which will likely be developed quickly.
- Only a fraction of these max 0.3% of companies would fail to meet basic minimum substance criteria. Only these firms will be considered for denial of tax advantages.
- Even lower than that fraction will be the share of companies for whom additional cost will incur in the form of requests for a tax ruling to establish proof of substance. It is impossible to deliver an accurate cost estimation for these part of the compliance cost. However, those costs will represent a very small percentage of an already small share of companies. In addition, these costs constitute mainly one-off costs.

The restrictive approach described will thus minimize the number of companies with legitimate business models that could be obliged to report additional data. The following paragraphs will develop the different elements described above.

- **Assessing the gateway criteria**: Gateway criteria are defined in a restrictive manner, therefore easily assessable. Information to be gathered comprises a firm's very core characteristics rather than the evaluation of legally difficult issues as is often the case with, e.g., new legislation affecting tax or (staff-related) social security matters where the assessment of legal uncertainties may be part of the task. For example, the German National Legislation Control Council (*Nationaler Normenkontrollrat* - NKR) has laid down for the economy a checklist of typical tasks related to the compliance with new legislation[114]. Typical labour-intensive steps on that list are, e. g., training, complex calculations, filling forms, holding internal and external meetings, or the adjustment of internal processes or surveillance-related tasks. In the specific context of information requirements related to the gateway criteria, these steps are relevant only to a very limited extent or not relevant at all.
- **Tax audits:** To ensure correct reporting by the company, tax audits will be conducted by tax authorities. Given the limited resources of tax administrations, audits will not be conducted for all companies and will likely be based on the level of risk of misreporting or randomly. While this cannot ensure full compliance, the possibility of being audited will provide an incentive for companies to report properly.
- **Assessing the substance criteria:** Those in scope will have to report further data (i.e. indicators of minimum substance) to the tax administration of their Member State of residence. Again, the information requested should be readily available for the entities[115] and the cost of processing and transmitting this information should be limited. The specific targeting of the initiative should limit the impact of additional reporting to a very specific type of entities. Undertakings may need to accompany their tax return declaration with additional documentary evidence.
- **Tax rulings:** In case an entity reports, based on the self-assessment, that it is a shell entity, but considers it is not, it could prove the contrary to the tax administration by requesting a tax ruling. This would require providing additional information to the tax administration, and thus generate additional administrative costs. However, these costs are expected to be limited as this would be information readily available to the company.

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[114] See here the Federal Government/*Normenkontrollrat*'s guidelines for complying with new federal legislation (checklists on pp. 21,22), published by *Statistisches Bundesamt*.

[115] As presented in the description of policy option 2, in section 5: amount of gross revenue, amount of business expenses, type of business activities performed to generate the relevant income, number of full-time equivalent employees qualified to perform the business activities that generate the relevant income, outsourced business activities, number of directors, their qualifications, authorisations and place of residence for tax purposes, and bank account number)

In the absence of regular and comprehensive data and information, estimating the number of entities potentially in scope of the directive, which would then have to report substance criteria is difficult. Indeed, this is an area where this EU initiative would clearly add value: it would increase data availability and knowledge on the use of shell entities for tax purposes and in scope of the initiative, in a comparable manner across the EU, and lead to more transparency on the scale and role of shell entities used for tax purposes. To try to give an estimate, different data sources can be used (ORBIS, SPEs lists, see annex 4 on methodology). Between 29 000 and 75 000 companies could be found to be potentially requested to report within the EU (without taking into account legal arrangements or other type of entities, such as partnerships, for which no data are available). Yet, these figures are more an order of magnitude than a proper estimate due to the difficulty in having reliable data on the existence of such companies, which are commonly underreported and for which, when they are reported, only limited data is available (see the section on methodology). The upper bound of this estimation represents a max of 0.3% of companies in the EU.

From a tax compliance cost point of view, one could assume that shell entities are close to SMEs (low number of workers). According to the 'Study on tax compliance costs for SMEs'[116], the corporate income tax (CIT) compliance cost for small companies in 2018 was around EUR 6 000 per year, slightly less for medium companies. Using this as a proxy, this initiative estimates a slight increase in compliance costs of around 5-10%. This range is probably already too high as the additional data to provide are not so numerous and should be readily available. As mentioned in that same study, around 50% of the time spent in CIT compliance is in collecting data. The corresponding effort would be very small as the required additional data should be readily available and not require cost-intensive tasks. Moreover, according to the 'Doing Business' project[117], the average amount of hours that medium sized companies invested in pay taxes in the EU in 2019 was around 173. A range of 5-10% will represent between 8.7 and 17.3 hours, which should be enough to collect and provide the additional information required. That will represent a cost per company and year of EUR 300-600 and the total costs for the companies reporting would be in the range of EUR 9 to 45 million – a low amount, relative to the potential tax gains[118]. The need to assess and report will be a recurrent cost for business, but the cost burden for companies will decrease over years due to experience gained in the process.

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[116] 'Study on tax compliance costs for SMEs', DG GROW, 2018, https://op.europa.eu/en/publication-detail/-/publication/0ed32649-fe8e-11e8-a96d-01aa75ed71a1/language-en,

[117] https://www.doingbusiness.org/en/doingbusiness

[118] see 6.4.4 above and Annex 4(A).

6.7.2. Regulatory charges Regulatory charges

No sanctions are planned so no regulatory charges will be implemented.

6.7.3. Enforcement cost for tax administrations

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 (in a check-the-box approach). For entities that self-assess as being non-shell, the costs for tax administrations are limited (in case of an audit) or none. Where the self-assessment leads to a reporting as non-shell, the reporting shall feed the possible audit processes of the tax administration. It is worth noting that audits are conducted by tax administrations to ensure the enforcement of the law, and thus auditing costs generated by this initiative would be part of the recurrent cost for the administrations, not necessarily, or at least in a limited extent, an additional cost.

However, when the company's self-assessment leads to a reporting as shell, tax consequences apply, and the entity should have the opportunity to prove otherwise, by requesting a tax ruling. This would require an assessment of facts and circumstances by the tax administration which involves a cost.

The proposal provides new tasks to tax administrations, but this proposal aims, by design, to find a good balance between impact and additional burden. To facilitate the handling of new responsibilities for tax administrations, the proposal relies on a limited amount of companies in scope (as described above) and self-assessment on a check-the-box approach that facilitates the information analysis.

The main risk could be related to the management of tax rulings, especially in the first round of the exercise, and the audit strategy. Tax administrations should put in place capacity plans to deal with these new requirements. There may thus need be some training effort. But again, there should be substantial cost reduction over time through learning-effects.

6.7.4. Direct costs and benefits for Member States

Tax gains can be expected due to reduction in the number of shell entities used for tax abuse purposes, because such entities would be identified throughout the EU and disqualify for tax residence in the Member State in which they are located, thus not benefitting from its tax regime. The criteria chosen as detailed above to identify whether an entity needs to report or not will target effectively the population of entities which are most likely to be prone to aggressive tax planning practices and have no or very little substance.

Entities particularly at risk of being used for tax avoidance or tax evasion purposes are those receiving passive income (interests, royalties, dividends or rents) from abroad. Such entities can be part of a group, play a conduit role to minimise taxes, or can be set up by an individual or a family, mainly to derive tax advantages when receiving income from assets located in another country. Overall these entities usually have no or just one employee, no own premises and use the services of a Trust and Company Service

Provider (TCSP). In the case of an entity belonging to a group, it may have more employees but with a disproportionately high ratio of profits over employees, indicating that there is a risk of tax avoidance being committed.

Concerning professional intermediaries, such as TCSP, a recent OECD report[119] highlighted how crucial some of them are in enabling tax evasion and how important it is for States to design a proper strategy to counter their tax avoidance or tax evasion practices. It highlights that "once a particular structure or nefarious service provider is uncovered, this gives tax authorities the ability to target other structures established by the same professional enablers", and stresses that some indicators are a sign of structures possibly being used for tax avoidance or tax evasion, among them addresses of entities or directors which are not traceable, multiple shell companies from the same address, multiple companies with directors in common and company's address registered at a P.O. Box address known for illegitimate businesses[120].

Quantifying the impact of the implementation of the directive is difficult due to data limitations and any figure must be taken cautiously. A first approximation of the phenomenon showed that the tax loss could be estimated at around EUR 23 billion, so a small decrease of 10% of tax avoidance through shell entities would recover EUR 2.3 billion per year for Member States' public finances. Such a percentage is low, meaning that 90% of tax avoidance through shell entities would continue to occur. Yet, under this option, neither AEOI nor automatic sanctions are planned, which implies that the incentive for tax payers to comply and the possibility for tax authorities, whose tax base is being eroded, to take action would remain low. The above figure on potential revenues recovered (EUR 2.3 billion) also takes into account behavioural changes of entities that can try to relocate outside of the EU to avoid being caught by the reporting obligation.

6.7.5. Indirect benefits

Valuable information will be collected to better characterise the phenomenon of use of shell entities for tax purposes. This directive will, as a first result, increase our knowledge about the phenomenon in the tax field, making reporting compulsory for entities that are captured by certain criteria. In addition, this option may have behavioural effects on other taxpayers or companies not within the scope of the initiative but with tax arrangements that can also be used for tax avoidance purposes. Such taxpayers could decide to voluntarily comply with their tax duties. Another possible change is the dismantling of the structures that, due to the new requirements, could no longer fit its purpose of tax avoidance or tax evasion. While difficult to anticipate the impact in this

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[119] OECD (2021), Ending the Shell Game: Cracking down on the Professionals who enable Tax and White Collar Crimes, OECD Publishing, Paris.
http://www.oecd.org/tax/crime/ending-the-shell-game-cracking-down-on-the-professionals-who-enable-tax-and-white-collarcrimes.htm

[120] OECD (ibidem), p.24.

specific case, this kind of behavioural changes was seen for example in Luxembourg where the introduction of a new registry for beneficial owners triggered a significant decrease in the number of companies, suggesting that many of these beneficial owners did not want to appear in a registry.

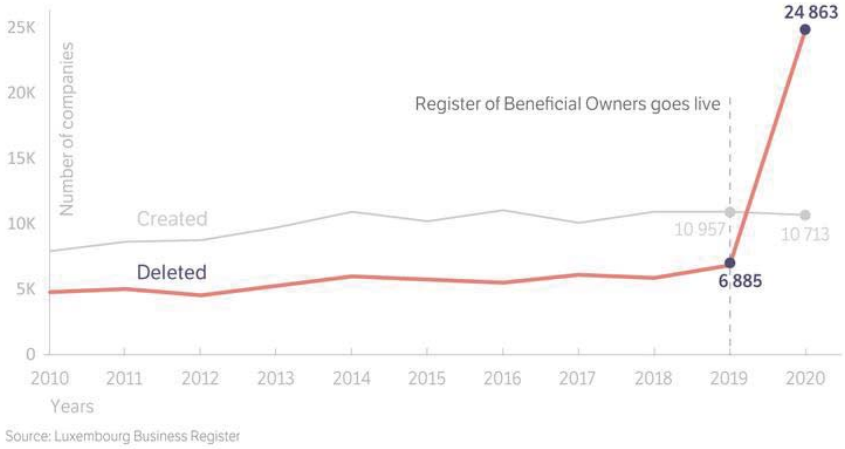

Figure 6 Deletions of companies in Luxembourg (Source: Organized Crime and Corruption Reporting Project https://www.occrp.org/en/openlux/shedding-light-on-big-secrets-in-tiny-luxembourg)

At social and political levels, and for the general public, the EU will be seen as addressing a sensitive topic and ensuring that everybody pays their fair share.

6.8. Option 3: A Directive that involves reporting of shell entities with automatic exchange of information (AEOI) but without common sanctions

6.8.1. Compliance costs for businesses

As the conditions for business do not change in relation with Option 2 in terms of assessments and data to be provided, compliance costs for businesses are similar to those of the previous option.

6.8.2. Regulatory charges

No sanctions are planned so no regulatory charges will apply.

6.8.3. Enforcement costs for tax administrations

The companies that will be caught by the gateway criteria will be put on a list that will be exchanged between national tax authorities using a model that exists already for similar provisions of the Directive on administrative cooperation, minimizing extra work for the tax authorities. Moreover, the initiative, complemented by the exchange of information, will ensure that the tax administrations of all Member States receive the relevant information and thus be given the opportunity to better protect their tax base.

In addition to the costs mentioned in the previous option, there are some additional costs related to the adjustment of[121]the established Commission system[122] for the automatic exchange of information concerning reporting entities and the required arrangements for uploading the information on the national level. These costs[123] will mainly be IT-related and linked to the development and maintenance of the technical platform required for the exchange of information. They can be structured as:

Table 2 Estimated costs on the implementation of the exchange of information IT platform (in EUR million)

	Development costs (one-off)	*Recurrent costs (yearly maintenance)*
National Tax Administrations	2	0.8
European Commission	1	0.12

6.8.4. Direct costs and benefits for Member States

A direct regulatory benefit will be an increase in tax gains due to better information by tax administrations about the existence of entities that may be shells used for tax avoidance purposes. This is the main difference and value-added compared to the previous options: not only the tax authorities of the Member State where the entity is tax resident but also the tax authorities of the Member State(s) whose tax base(s) is/are being eroded, will be made aware, through AEOI, of the existence of certain shell entities. It turn, this will provide them with the opportunity to act to recover tax that should have been paid. Greater transparency through information exchange would therefore also further discourage companies to use the shell entities for tax avoidance purposes.

Herwig Heller, Chair of the OECD Task Force on Tax Crimes and Other Crimes, in its last report[124], recognises that "many crimes are facilitated through shell companies which operate across multiple jurisdictions". He calls for quicker procedures of exchange of information between criminal investigators and better access to tax information by financial intelligence units.

An increase in tax revenues in the EU as a whole is expected and which is higher than under option 2, as the AEOI would make the identification of shell entities easier and quicker by all Member States, and thus make the fight against tax avoidance and tax evasion more efficient by the authorities whose tax base is being eroded.

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[121] The platform could reuse in some extent existing elements of the DAC platforms.

[122] The platform could reuse in some extent existing elements of the DAC platforms.

[123] Estimated with support from TAXUD IT experts and costs from DAC3 as a similar approach.

[124] OECD (2021), Fighting Tax Crime – The Ten Global Principles, Second Edition, OECD Publishing, Paris, https://doi.org/10.1787/006a6512-en.

A quantification of the impact of AEOI, compared with option 2 (no AEOI), is always difficult due to limited data about tax gain that can be achieved thanks to AEOI. Still, a recent study by the OECD[125] has shown that the AEOI has had a positive impact[126] on the amount of bank deposits held in international financial centres (IFC) by non-bank actors (including households, corporates, general government, non-corporate enterprises such as trusts, and other non-financial institutions (e.g., charities and foundations)). The impact of AEOI, implemented since 2017, on the decrease of bank deposits held in IFCs has been estimated at 17%. It shows that greater transparency has an impact on the way wealth is located and thus most probably declared. This gives an indication that AEOI may have a significant impact on the compliance rate of shell entities and will bring additional tax gains.

6.8.5. Indirect benefits

The impact of AEOI would be stronger than the simple request to report to the tax authority where the entity is registered, as in option 2. It may also incentivise a better compliance by taxpayers in general, knowing that more information is exchanged and that more people are paying their fair share of taxes. The DAC evaluation has also insisted on the pedagogical value of AEOI to increase general compliance behaviour[127].

A stronger impact would be a synonym of a more levelled playing field between firms so they can compete on a fairer basis. Fairer competition would in turn potentially stimulate innovation and productivity, and encourage lower prices for consumers.

The impact on EU competitiveness is unclear. From the point of view of pure attractiveness, discouraging the misuse of shell companies for tax purposes could reduce certain investments and financial flows. However, the flows at stake may not be desirable in themselves as they benefit tax avoiders, are linked to little if any real economic activity, distort the playing field, may be associated with illegal activities and fuel social discontent regarding tax avoidance. As both the interest and royalty directive and the parent-subsidiary directive do not apply to entities located outside of the EU, it is not

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[125] O'Reilly, P., K. Parra Ramirez and M. A. Stemmer (2019), "Exchange of Information and Bank Deposits in International Financial Centres", OECD Taxation Working Papers, No. 46, OECD Publishing, Paris, https://doi.org/10.1787/025bfebe-en.

[126] There is early evidence of the importance of bank deposits in the academic literature on tax evasion. Using data on Swiss bank liabilities, Zucman (2013) estimates that bank deposits form approximately 25% of global hidden wealth. Using data from the Italian voluntary disclosure programme for hidden assets, Pellegrini, Sanelli, and Tosti (2016) find that while bank deposits are the most commonly repatriated asset class, they comprise 13.5% of total disclosed wealth. A more recent study by Alstadsaeter, Johannesen and Zucman (2018) allocates a wealth equivalent of about 10% of global gross domestic product (GDP) to IFCs.

[127] Commission staff working document, Evaluation of the Council directive 2011/16/EU on administrative cooperation in the field of taxation and repealing directive 77/799/EEC, SWD(2019) 327 final.

certain that genuine shell companies would be relocated in third countries, given that associated financial flows (interest, royalties, dividends) would be taxed before leaving the EU (through withholding tax or non-deductibility of interest and royalty costs), especially with the increased pressure on all Member States to put in place adequate defensive measures against outbound payments leaving the EU untaxed. Moreover, even if EU Member States become less attractive for these financial flows, companies in scope would still need to remain within the Single Market to benefit from its advantages, thus making it unlikely they would be rerouted outside, at least not in a significant proportion.

The social impact may be more positive than in option 2 because the measure will bring more in terms of tax gain and will be felt as more effective, as more actions will be taken. Clearly, audits will be needed to ensure that entities in scope report in an appropriate manner and it would also be important to ensure that these reporting be correctly and timely exchanged by all tax authorities. The obligation for Member States to proceed with the AEOI which is reported to them may also be expected to encourage Member States towards a better implementation of the initiative in their jurisdiction. This is particularly important because the Member State "hosting" the shell entity may (and usually will) be different from the Member State whose tax base is being eroded due to the use of the shell entity.

6.9. Option 4: A Directive with automatic exchange of information (AEOI) and common framework of sanctions

6.9.1. Compliance cost for businesses

As the conditions for business do not change compared to Option 2 in terms of assessments and data to be provided, compliance costs are similar as for the previous two options.

6.9.2. Regulatory charges

This option is the same as the third option but provides, in addition, for establishing a common framework of sanctions, which can be considered regulatory charges for the entities that would not comply with their obligation to report or false report. The effectiveness of sanctions will depend on their level and their applicability. As a principle, the sanctions shall be effective, dissuasive and proportional. The Member States will remain competent to define concrete sanctions for each violation of obligations described in the Directive.

6.9.3. Enforcement cost for tax administrations

On top of the charges estimated for the previous two options, additional costs are expected for the sanction process. The size of these costs 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. This is expected to be more than compensated by the income generated by the fine. If more serious sanctions are considered (e.g. possible imprisonment), provided by the applicable national law, additional resources would be needed to engage in legal proceedings.

It is worth noting that these costs are limited to the necessary costs an administration normally bears to ensure enforcement of the law. If no common framework of sanctions was planned, the national administration would still have to apply certain sanctions to ensure compliance, so enforcement costs should not be fundamentally different for the national administration between option 2, 3 and 4.

6.9.4. Direct costs and benefits for Member States

In this scenario, the tax gains are expected to be higher than for the previous two regulatory options due to the deterrent power of sanctions to ensure the compliance. Moreover, a certain harmonisation of sanctions across the EU would ensure that the rules are enforced in a coherent and similar way by all Member States. Crucially, this would prevent companies in scope to 'shop around' the EU and relocate in those Member States that apply softer sanctions.

6.9.5. Indirect benefits

The use of sanctions will send a signal that tax avoidance and tax evasion are not tolerated anymore and it could also have a positive effect on tax compliance as a whole and not only concerning the scope of the initiative. The deterrent effect will be stronger than in the previous option considered. The effectiveness of sanctions schemas are generally explained by the deterrence model[128]:

- The impact of the sanction (severity of the sanction and probability to be sanctioned) is higher than the expected benefit for breaking the rules.

  This option would send a strong political signal that the EU is committed to ending tax avoidance and tax evasion within its borders and have a positive impact in terms of social cohesion as well as may increase EU citizens' willingness to comply with their tax obligations. Citizens would thus reckon that the EU is taking action to ensure everybody pay their fair share.

  The impact on the Single Market is expected to be positive as a common framework of sanctions would remove the risk of fragmenting the Single Market with a multiplication of national sanctions. This would also improve transparency and certainty for businesses to operate within the Single Market.

  As this option is expected to be more effective than the others, the incentive not to use shell companies for tax purposes would be more significant under this option. Thus, the unfair competitive advantage of these companies provided by tax savings would decrease, in turn levelling the playing with other companies.

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[128] See Michael G. Allingham & Agnar Sandmo, Income Tax Evasion: A Theoretical Analysis,1 J. PUB. ECON. 323 (1972)

Fairer competition would have a positive impact on competition within the Single Market, with a potential positive spill-over effect on innovation, productivity and lower prices for consumers.

As with the previous option, the effect on the EU competitiveness is unclear. A common sanction framework should make the use of shell companies for tax purposes within the EU even less attractive than with previous options as this option is expected to be more effective. Moreover, companies will likely need to remain within the Single Market to benefit from its advantages, thus a significant relocation of companies performing real economic activity to non-EU countries is unlikely.

7. HOW DO THE OPTIONS COMPARE?

The chart presents a qualitative summary of the comparison of the four main options[129] against several criteria. The higher the score along the axis of the chart, the more performing the option for the criterion considered.[130]

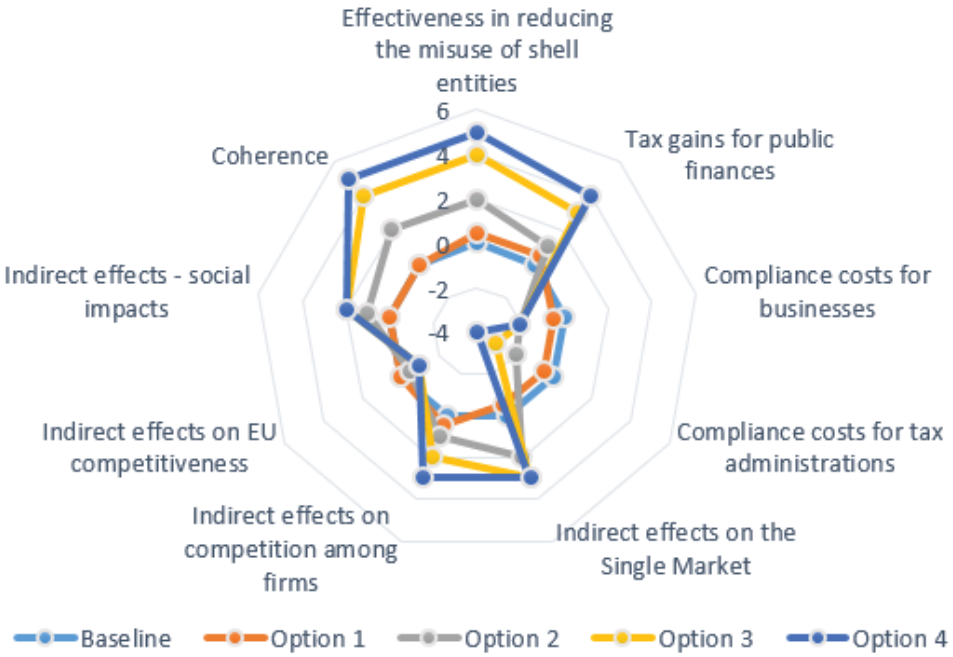

Figure 7 Comparison of options

7.1. Effectiveness in reducing the misuse of shell entities for tax purposes

The policy options show increasing levels of effectiveness in reducing the abusive use of shell entities for tax purposes with a clear difference between soft and hard law options. The soft law proposal provides some uncertainty about the benefits that it could bring as actions by Member States cannot be fully anticipated. In that sense, options with compulsory and homogenous substance criteria seem to be much stronger in terms of addressing the problem.

Effectiveness increases substantially with the inclusion of provisions for the AEOI as Member States will be able to identify which groups or individuals are using shell

[129] The two soft-law sub-options are here assessed jointly. Both of them are considered of limited effectiveness overall.

[130] Annexes (Annex 8) include a table and more details on such comparison.

entities. In particular, Member States will be receiving information which they could then use in identifying whether a shell entity is engaged in a tax planning scheme that erodes their tax base. A further increase of the effectiveness is expected with the use of common sanctions, because this is a point that increases compliance by ensuring that sanctions are adequate and effective in all Member States and sends a signal that can have indirect positive effects on general tax compliance, beyond shell entities.

7.2. Tax gains for public finances

Tax revenue gains for public finances are closely link to the effectiveness in reducing the abusive use of shell entities for tax purposes. Fever opportunities for tax avoidance and tax evasion should lead to an increase the EU tax base and thus to positively impact tax revenues. As for the effectiveness of the measure, there is a clear difference between soft and hard low option, with the former having no to little positive impact on tax revenue and the latter a positive impact. Tax revenue gains are expected to increase substantially with the inclusion of a provision for the AEOI as this would make the measure significantly more effective. The use of common sanction is expected to further increase potential tax revenue gains by further decreasing the misuse of shell entities for tax purposes, as explained above.

7.3. Compliance costs

The policy options present increasing levels of tax gains which are however accompanied by higher costs for businesses and administrations. As these costs are expected to remain below the expected tax gains for public finances, the most efficient option is also the most complex. Costs for the business remain equal for all hard law options, while costs for tax administrations increase where the options include AEOI. These costs, mainly related with the development of platforms for exchanging data, have an important investment (one-off) component and lower recurrent costs (as experienced with DAC has shown).

In determining the most suitable option, it is important that benefits remain greater than the costs under each option. In the options that include AEOI, the annualised cost over 10 years (including one-off and recurrent costs, for both Commission and national tax administrations)[131] would be around EUR 1.2 million (for all EU Member States and the European Commission). That represents a small fraction of the estimated yearly tax gap due to the use of shell companies, less than 0.01%[132]. Thus, it is likely that the benefits of the provisions for AEOI have a positive and significant return on investment.

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[131] The annualised costs are calculated for the Commission and National Tax Administrations. It is the result of dividing the one-off costs (EUR 3 million) by 10 years (EUR 0.3 million/year) and adding this to yearly recurrent costs (EUR 0.92 million): Total of EUR 1.22 million annualised costs.

[132] Approximate estimate obtained by dividing the estimated annualised cost over 10 years (EUR 1.2M) with the estimated potential tax revenue gain in paragraph 6.7.4 (EUR 23 billion).

Similarly, sanctions have a positive effect on compliance which adds to the revenues specifically linked to the imposition of sanctions. Such revenues are higher than the cost of applying sanctions. This is why tax administrations use sanctions at national level. Here the use of the same set of sanctions at EU level aims to ensure that the incentive to comply will be the same in all Member States. The use of sanctions will be an additional tool to increase compliance.

7.4. Coherence with other policy initiatives

The initiative responds to the central strategy of the EU to create an economy that works for people, by ensuring that everybody pays their fair share. Such a proposal is even more relevant in a time of post COVID-19 recovery, where public finances are so strained. The Commission has been consistent in its policies for fighting tax avoidance and tax evasion and in its latest Communication on Business Taxation for the 21th century emphasised the need to address the issue of tax avoidance and evasion through shell entities, as this is not specifically covered by (existing) EU directives.

The coherence of the proposal is clearly higher for the regulatory options 2 to 4, because these options ensure a coherent framework throughout the EU. This is a cornerstone of the EU strategy against tax avoidance and tax evasion and is currently reflected in the ATAD and the DAC. In fighting tax avoidance and tax evasion, it is vital to make sure not to create loopholes by having different rules or levels of implementation between Member States. AEOI brings a clear advantage to ensuring better compliance and is in line with increasing transparency, as promoted by the successive amendments of the DAC. Moreover, having a common sanction framework between Member States will incentivise all entities to comply with the Directive irrespective of their place of registration within the EU. This would be consistent with the Single market dimension and create a level playing field. The protection of the level playing field between countries, firms and citizens of the EU is a crucial element of EU action.

As shown above, in Figure 7 Comparison of options, policy options 2, 3 and 4 are considered to be, to some degree and despite their costs, effective in meeting the various objectives set out for this initiative. The option 4, however, appears to perform best among the options, for the reasons outlined below.

7.5. Different stakeholder views on the opportunity for an intervention

The various options presented above in chapter 6 can be clustered into three main categories: baseline, soft law option and regulatory intervention, in the form of a directive. On the basis of information gathered through the public and targeted consultation, it is possible to present different stakeholder views on the opportunity of the intervention.

Stakeholders of category ‘Member States’, which includes civil servants in organisations such as ministries of finance and tax authorities in the specific case of this initiative, are mainly supportive of the intervention. The views of Member States’ stakeholders have been gathered via: a dedicated meeting of the Commission expert group Working Party IV on Direct Taxes, position papers by Member States and bilateral meetings.

Stakeholders of category: 'business', including business association and companies are generally not in favour of an intervention. Business stakeholders seem to prefer the status quo, or the baseline. The views of business stakeholders have been gathered via: the public consultation, publication for feedback of the inception impact assessment, the meeting of the Platform for Tax Governance held on 9 July as well as bilateral meetings.

Stakeholders of category 'civil society', including NGOs and trade unions, are in favour of the intervention. The views of civil society have been gathered via the public consultation, publication for feedback of the inception impact assessment and the meeting of the Platform for Tax Governance held on 9 July.

EU citizens have expressed divergent views on an intervention. The views of citizens have been gathered via the public consultation, publication for feedback of the inception impact assessment. In total, 9 EU citizens replied to these consultations, 3 however without a specific input on the topic at stake.

Finally, one Member of the Italian Parliament and one tax think tank, the International Bureau of Fiscal Documentation (IBFD) also expressed their views replying to the public consultation. IBFD expressed a rather neutral view, while the parliamentarian expressed a view in favour of the intervention.

8. PREFERRED OPTION

This impact assessment has analysed a number of policy options, while making clear that data unavailability makes any attempt to quantify the impact of each option very arduous. However, taking into account such limitations, option 4 appears to be the most effective and efficient while ensuring coherence with the EU action against tax evasion and avoidance practices: a Directive to set up common substance requirements that lead to the application of common tax consequences to entities that qualify as 'shell' while the system is coupled with AEOI and a common sanction framework.

8.1. Description of the preferred policy option

Among all options presented, option 4 appears best suited to meet the objectives of this initiative. In other words, option 4 is the preferred option. Compared to the baseline and to other options, the preferred option effectively and efficiently identifies and tackles the problem, the use of shell entities for tax avoidance or tax evasion.

In terms of effectiveness, the preferred option ensures the highest level of compliance by entities. Compliance is achieved mainly thanks to deterrence. With its system for the AEOI between tax administrations and the creation of a common sanction framework, the preferred option has the highest deterrent effect on taxpayers. AEOI would ensure that Member States whose tax bases are being eroded by the use of shell entities which are registered in other Member States are made fully aware of this. A common framework in terms of reporting requirements and definition of minimum substance indicators would ensure equal treatment for all entities in the EU, independently of their place of registration and reinforce compliance. 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 Single Market by avoiding its fragmentation via the various possible choices of sanctions.

In terms of efficiency, thanks to the higher tax revenues that it is expected to generate with a limited additional cost of enforcement, the preferred option appears to be the most efficient of all options. Higher benefits (higher tax revenues, more efficiency in reducing tax avoidance and evasion) imply higher costs of enforcement to ensure the compliance. However each additional feature (AEOI, and sanctions) is expected to provide higher benefits than costs. Therefore, option 4 should be more efficient than option 3, building on the deterrent effect of the common framework of sanctions among Member States, while not imposing a disproportionate cost for tax authorities.

It is important to stress that effectiveness and efficiency are achieved also thanks to a robust filtering mechanism. The preferred option includes provisions (carve-outs and exemptions as well as the gateway criteria)[133] that will allow tax administrations to focus

[133] Please refer to section 5.2.2. for more information on these elements.

on the entities that pose the highest risk of being used for tax avoidance and tax evasion. While the filtering mechanism is not unique to the preferred option, it is the latter than maximises its potential effect and efficiency, combining the filtering mechanism with tools to make sure it is properly complied with, namely AEOI and sanctions.

In terms of coherence, the preferred option ensures an appropriate match with the current EU agenda on fighting tax evasion and avoidance. Thanks to its AEOI system, it complements current means of AEOI which are already in place for financial accounts, tax rulings, country by country reports, cross-border tax arrangements and platform revenues. That is true for options 3 and 4. In addition, the preferred option provides a common set of sanctions for all EU Member States, which increases effectiveness of this policy option, which provides for a common minimal substance definition, which was lacking in the current anti-tax abuse framework of the EU.

The current model of governance for administrative cooperation will be followed for the implementation of the preferred option. To support its actual delivery, the Commission will organise meetings of Member States' experts with the purpose of providing guidance on implementation. In the context of provisions concerning administrative cooperation, this is done via regular meetings of the Commission expert group Administrative Cooperation in Direct Taxation. The expert group includes an IT sub-group to assist on the implementation of exchange of information matters, a crucial aspect of the preferred option.

8.2. Different stakeholder views on the preferred option

Different groups of stakeholders have expressed different views on the preferred option. From the consultation activities conducted for preparing this initiative, business stakeholders prefer the status quo, or baseline, while civil society stakeholders prefer an EU intervention.

Table 3 Different stakeholders' views on the preferred option

Category of stakeholders	**View**
Member States	Mainly supportive
Business stakeholders	Not in favour of the intervention
EU citizens	Mixed views
Civil society	Supportive
Other (one think-tank and one Member of the Italian Parliament)	Neutral (think tank) and supportive (Italian MP)

Specifically, some business stakeholders contested elements of the preferred option, sanctions and tax consequences in particular. For instance, the Investment Association considers sanctions and tax consequences for shell entities as "extremely anti-competitive".[134] Sanctions and tax consequences would go against the "freedoms and guarantees of the taxpayer", according to the French Association of Large Companies (AFEP).[135] In general terms, "no additional compliance or reporting should be forced upon EU businesses because they already face high compliance costs today and most of the compliance rules have quite harsh sanctions", according to the American Chamber of Commerce in Belgium.[136] The opinion that current, existing rules against tax avoidance are already sufficient is widely shared among business stakeholders which, overall, far and large are not in favour of an intervention and would rather favour the status quo.

On the other hand, civil society stakeholders have supported the preferred option and/or some of its key features.[137] In their reply to the publication for feedback on the inception impact assessment for this initiative, Oxfam International expressed their preference for a regulatory intervention, including, among others: "penalties for non-compliant companies or companies that report false information".[138]

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[134] DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", written input by The Investment Association.

[135] Ibid., written input by AFEP.

[136] Ibid., written input by AmCham EU.

[137] It should be noted that while most business stakeholders have provided written input, in addition to the replies to the public consultation survey, none of the NGOs / trade unions has done so.

[138] DG TAXUD (2021) – Publication for feedback "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", written input by Oxfam International. Online at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12999-Tax-avoidance-fighting-the-use-of-shell-entities-and-arrangements-for-tax-purposes/F2636045_en

9. HOW WILL ACTUAL IMPACTS BE MONITORED AND EVALUATED?

Monitoring is a key element of this initiative, regardless of the policy option to be finally selected. This is in particular because any measure will necessarily rely on Member States where the potential shell entities are located to identify such entities, while another Member State's tax base is most likely to be eroded due to the presence of the shell entity. Monitoring should therefore act as an incentive to Member States to implement and properly enforce measures, the primary positive impact of which is for other Member States. Within this context, monitoring should be twofold:

1. Reporting of data by Member States on the implementation and enforcement actions as dictated by the initiative; such reporting should be public, at least in part, for the purpose of transparency and to enable public scrutiny in Member States; and
2. Reporting by the Commission of its assessment on the implementation and enforcement of the initiative in the various Member States, on the basis of data, including reports by Member States and data on administrative cooperation in line with, or due to, the initiative. This report will include data under 1) and will be made public.

Publication of data under 1) and 2) is required to ensure transparency to ensure the compliance of legal entities and arrangements in the EU with the obligations under the Proposal. Furthermore, publication of such data will contribute to greater knowledge of the existence of shell entities in the EU.

The following table illustrates the indicators to be used for the objectives of the initiative identified in chapter 4.

Table 4 Monitoring indicators

Specific objectives	Indicators	Measurement tools
1) The use of common substance criteria to identify shell entities to prevent tax revenue loss due to tax evasion and tax avoidance.	Additional tax revenues secured thanks to the initiative preventing shell entities from obtaining a tax benefit at national or cross-border level.	Yearly assessment of automatic exchange of information (source: Member States' tax administrations)
2) Providing information to Member States to identify shell entities used for tax abuse purposes.	Number of shell exchanges made and compliance activities of Member States	Data to be submitted by Member States to the Commission under 1) to 8) below (source: Member States' tax administrations)
3) Deterrent effect on TCSP's creating shell entities in the EU.	Qualitative assessment by Member States of the impact of the initiative on deterring TCSP's from offering services to set up	Yearly assessment of automatic exchange of information (source: Member States' tax administrations)

	shell entities.	

The data to be collected from Member States under specific objective 2) should include the following.

1. Number of entities in the Member State that are subject to reporting under the initiative;
2. Number of entities that reported in line with the requirements;
3. Penalties imposed for non-compliance with the requirements of the initiative;
4. Number of entities presumed not to fulfil the minimum substance requirements and number of those that rebutted such presumption;
5. From an advance exemption from the requirements of the initiative by virtue of a decision of the authority of the Member State;
6. Number of audits to entities that are subject to reporting under the initiative,
7. Number of cases where an entity presumed to meet the minimum substance requirements was found not to have substantial activity, in particular following an audit;
8. Number of requests for exchange of information submitted and number of requests received.

Information on the indicators for the specific objectives in Table 4 Monitoring indicators, including data to be submitted under 1) to 8) above, should be supplied to the Commission on an annual basis. The challenge of gathering comprehensive and accurate information is acknowledged, as monitoring and evaluation will be dependent on data gathered by Member States. However, past results[139] show that it is feasible to deliver a sufficiently detailed and robust assessment of policies' implementation mainly on the basis of data collected by Member States.

Monitoring will build upon existing monitoring arrangements for the directive on administrative cooperation in direct taxation.[140] The same approach seems relevant to monitor the implementation of the preferred option. In line with existing monitoring arrangements, five years after the implementation of the instrument, the Commission plans to evaluate the results of the policy, with respect to its objectives and the overall impacts on tax revenues, businesses and the internal market. In this context, the data collected from Member States as above will be taken into account, together with any data collected from businesses. The evaluation will consider international multilateral developments in the area of substance requirements and substance, in particular at the level of the OECD. Based on these elements, the evaluation will also determine if there is

[139] Key examples are: European Commission (2019) Evaluation of the Council Directive 2011/16/EU on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC; European Commission (2018) Report on overview and assessment of the statistics and information on the automatic exchanges in the field of direct taxation.

[140] As put in the directive 2011/16/EU, article 27 and recital 24 in particular.

a need to review the scope of the measures (carve-outs and gateway criteria) as well as the substance requirements prescribed. The report shall be published.

ANNEX 1: PROCEDURAL INFORMATION

1. Lead DG, Decide Planning/CWP references

DG TAXUD, Planning reference: PLAN/2021/10793.

The initiative is part of the Commission Communication on Business Taxation for the 21st Century.

2. Organisation and timing

An interservice steering group was set up to steer and provide input to this impact assessment report. The steering group, led by the Secretariat-General, met on: 18 May, 24 June, 14 July and 14 September 2021.

The report was submitted to the Regulatory Scrutiny Report on 23 September 2021.

3. Consultation of the RSB

On 23 September 2021, DG TAXUD submitted the draft Impact Assessment to the Regulatory Scrutiny Board. The Board meeting took place on 20 October 2021. The opinion of the Board, as issued on 25 October 2021, was "positive with reservations". The Board's recommendations have been addressed as presented below.

RSB recommendation	**How have the recommendations led to changes to the report?**
The report should better justify why it addresses both tax evasion and tax avoidance, in particular discussing and distinguishing between legal and illegal aspects as well as what is fair and unfair.	The recommendation has been addressed by expanding the discussion of the problem, adding a new section (section 2.1.4). Overall, the revised report now includes an extensive discussion of illegal and legal/fair and unfair uses of shell entities.
The report would benefit from clearer definitions of the terms, accounting for how the perceptions of tax evasion and tax avoidance have changed over time.	This recommendation has been addressed by clarifying the terms used, with a focus in particular on tax avoidance, the topic of new text box within section 2.1.4, and of additional clarifications in section 2.1.4.1.
In addition, the report should better explain why the existing EU legislation and the international tax frameworks are not sufficient to address the problem.	To better explain why the existing EU legislation and the international tax frameworks are not sufficient to address the problem, the discussion in Section 2 has been extensively expanded (refer in particular to section 2.1.2.).
The problem description needs to distinguish clearly between shell entities that are problematic because they are set up to avoid or evade taxes and legitimate shell entities. It should clarify that shells can be	The recommendation has been addressed by clarifying the problem (i.e. problematic uses of shell entities). Changes have been made in particular to section 2.1.1., where the discussion has been enriched with

RSB recommendation	How have the recommendations led to changes to the report?
set up for 'fair' tax purposes, such as avoiding double taxation.	clarifications of cases of shell entities set up for "fair" uses, including avoidance of double taxation, and clarification about what Special Purpose Entities (SPEs) are.
The report needs to present the options of the initiative within the context of possible alternative and complementary measures, such as regulating trust and company service providers or advisory services that advocate the use of problematic shells.	To address this recommendation, the option of regulating trust and company service providers has been presented in section 5.3.
It should make clear that it considered a wide range of feasible options and explain why it discarded some of these.	The discussion in section 5.3 concerning discarded options has been expanded to address this recommendation.
It should clearly outline whether and to what extent the introduction of substance requirements is the most feasible option.	To provide more clarity on whether and to what extent the introduction of substance requirements is the most feasible option, the discussion in section 5.2.2. has been expanded.
The report should better justify the scope and thresholds for the exemptions, carve-outs and gateway criteria. It should explain to what extent the preferred option can precisely and effectively identify the problematic shell entities. It should analyse what type of companies would need to use exemptions or tax rulings to avoid being treated unduly as a problematic shell entity,	The recommendation has been addressed by a clearer explanation of the exemptions, and how they interplay with carve-outs and gateway criteria. Changes have been made to section 5 (5.2.2.1 and 5.2.2.2).
It should estimate to the greatest extent possible how many companies would be affected. The report should more clearly describe the trade-offs between a large scope and costs for legitimate companies and shell entities.	Estimates of the number of companies impacted have been expanded with a new analysis based on extrapolation from Dutch letterbox companies (Annex 4(B)). Moreover, clarifications have been made on the estimations in section 2.1.3. T
In addition, the report should clearly outline how the two soft-law sub-options differ, and separately analyse their impacts.	The recommendation has been addressed by clearly outlining the differences between the two soft-law sub options, with clarifications and explanations added in Section 6, in particular sections 6.5 and 6.6.
In view of the claimed low compliance costs for businesses and tax administrations, the report should better describe and substantiate the robustness of the related estimates. The report needs to be transparent about what is known and	Several changes have been made to address this recommendation. The estimates of compliance costs have been revised and enhanced, with changes done in particular in Section 6 (6.7.1). To reflect better possible negative effects on the capacity of

RSB recommendation	How have the recommendations led to changes to the report?
what is unknown, in particular in case of cost estimates. In addition, when describing the impact of the options, the report should pay more attention to possible risks such as the capacity of Member States' tax administrations to handle additional responsibilities and the risk of imposing unnecessary burden on legitimate shell entities.	Member States' tax administrations, changes have been made to Section 6, in particular when describing the Option 3 (which includes administrative cooperation) (6.8).
The report should better account for how the options consider an effective implementation and governance of the initiative. It should explain how effective cooperation (including information exchange) between tax authorities of affected Member States and the availability of adequate resources would be ensured.	The recommendation was addressed by expanding the discussion under the presentation of option 3, introducing administrative cooperation, including exchange of information (Section 5). An additional paragraph was introduced, outlining that effective cooperation depends on quality, use and timeliness of exchanges as well as adequate resources being allocated to it. The explanation clarifies the importance of the role of the Commission for incentivizing effective cooperation, via monitoring activities mainly, as well as through its role in checking correct legal transposition. Furthermore, additional clarifications have been added on governance and implementation issues (Section 8.1).
The report should explain to what extent the preferred option is contested or supported by different groups of stakeholders. It should better explain how and why it took into account different stakeholder views in the main analysis. In particular, the report should better integrate the concerns raised by business associations on the proportionality of the initiative.	In section 8 on the preferred option, the different views of various groups of stakeholders and in particular business and civil society stakeholders are now clearly presented and explained. In the discussion of proportionality (Section 3.3), the concerns of business associations are now better integrated, providing details (including quotes) of key opinions expressed on the matter by this group of stakeholders. In Annex 2, a new section (section 2) has been added explicitly on the use of the consultation results.
When defining the objectives and the monitoring arrangements, the report needs to define clearly what success would look	The recommendation has been addressed by more clearly defining success and the definition of general objectives (Section 4).

RSB recommendation	How have the recommendations led to changes to the report?
like for this initiative. Furthermore, the description of the objectives should not pre-determine the policy choice.	In Section 4, the specific objectives have been redrafted to link to problem drivers: lack of substance/tax consequences; lack of information; and curtailing the activities of TSCP's. The effects of the objectives are now emphasised rather than how to achieve the specific objectives, to avoid to pre-determine the policy choice.
The report should also improve the description of the planned monitoring arrangements to explain more clearly how they build on the objectives, collect information on results, address the feasibility of the data collection, and explain how they will feed into robust future evaluation. This is particularly important given the current lack of data on shell entities. It should adjust the timing of the reporting by Member States to the needs of the planned evaluation.	Section 9 has been updated to include the following: (i) Evaluation indicators linked to the specific objectives in Section 4; (ii) including new indicators to quantify the reduction of tax losses due to shell entities; (iii) Member States to assess the impact of the intervention on TCSP's setting up shell entities; (iii) Alignment of evaluation (and monitoring/reporting) with that of the Directive on Administrative Cooperation.

Table 5 RSB recommendations for improvement

4. Evidence, sources and quality

The evidence for the impact assessment report was gathered through various activities and from different sources:

- Feedback on the Inception Impact Assessment
- Replies to the public consultation, including a very comprehensive reply by a tax think tank (IBFD).
- Meetings with stakeholders, including meetings with Member States representatives.
- Other input gathered from stakeholders.
- Desk research (please see a selective bibliography below).

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Selective list of relevant case law

Interest and Royalty Directives (ECJ cases C-115/16, C118/16, C-119/16 and C-299/16) and Parent-Subsidiary Directive (cases C-116/16 and 117/16)

ANNEX 2: STAKEHOLDER CONSULTATION

1. The stakeholders' engagement strategy

For the preparation of this initiative, the Commission designed a stakeholder´s consultation strategy, which is summarized in the chart below. The aim of this report is to present the outcome of the consultation activities and to show how the input has been taken into account.

The consultation strategy encompasses both public and targeted consultations. Further details are given in the chart below:

Methods of consultation		Stakeholder group	Consultation period	Objective/ Scope of consultation
Inception Impact Assessment (feedback mechanism)		Academic/research institution Business association Company EU citizen Non-EU citizen Trade Union NGOs	20 May – 17 June 2021	Collect feedback on the inception impact assessment outlining the initial structure of the project
Targeted Consultation	Member States	Public authorities	June – September 2021	Gather information on Member States' existing rules. Gather views on possible EU initiative.
	Expert group for Member States (WPIV – Direct Tax)	Public authorities	22 June 2021	Gather views of experts from national authorities on the need for EU action and on possible policy design
	Stakeholder's meetings (Platform for TGG)	Public authorities Business associations NGOs Companies	9 July 2021	Gather views of business and NGOs on a possible EU initiative
Public consultation		Academic/research	4 June – 27	Ascertain the

	institution Business association Company EU citizen Non-EU citizen Trade Union NGOs	August 2021	views of a broad range of stakeholders mainly on the added value of a European action and the potential scope of the initiative

Table 6 Overview of the stakeholders' strategy

The main objectives of the different consultation streams are (i) provide stakeholders and the wider public with the opportunity to express their views on all relevant elements, (ii) gather specialised input to support the analysis of the impact of the initiative and the risk it may entail, (iii) contribute to design the technical aspects of the future initiative, (iv) satisfy transparency principles and help to define priorities for the future initiative.

The consultation began with the launch of the Inception Impact Assessment published on 20 May 2021 and continued until end September 2021.

2. Use of the consultation results

Different stakeholder views are referred to in several points in the main analysis:

- As part of the problem definition, in chapter 2 of the main analysis, the results of the consultation are used to present different stakeholders' opinion of whether the use of shell entities is problematic or not from a tax perspective.
- Concerns raised by business associations on the proportionality of the initiative are integrated to the discussion on "Why should the EU act?" in chapter 3 of the main analysis.
- Different stakeholder views are presented as part of the comparison of different options, in chapter 7 of the main analysis.
- In chapter 8 of the main analysis, on the preferred option, it is explained to what extent the latter is contested or supported by different groups of stakeholders.
- At various points in the main analysis, there are several quotes and references to input received during the consultation to provide evidence and context for the arguments and statements made.

3. Feedback on the inception impact assessment

The consultation period through this feedback mechanism took place between 20 May and 17 June 2021 via the Commission website[141]. The period started when the inception impact assessment was published outlining the initial structure and options of the project. Thirteen comments were submitted during this consultation period by the following categories of stakeholders:

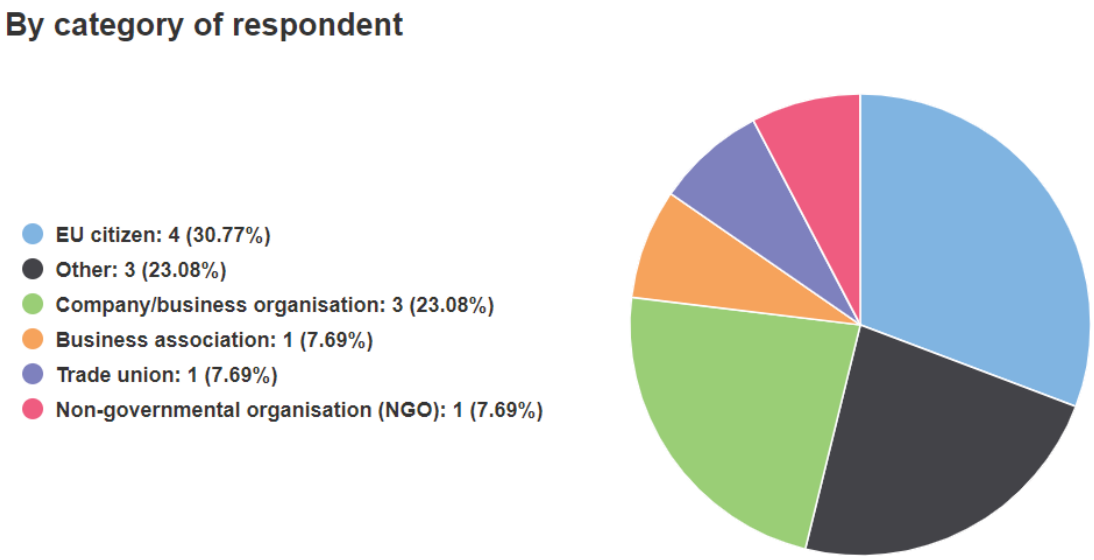

Chart 1 Overview of stakeholders providing feedback to the inception impact assessment

Key results:

Overall, the persisting problem of tax avoidance in the EU was recognised and the need for further EU action in this direction was acknowledged. Respondents expressed mixed views on the appropriate content of a potential new initiative with several of them arguing for further harmonisation of taxation in the single market rather than anti-tax avoidance measures. Some respondents expressed concerns on the increased compliance burden on EU taxpayers under existing rules and the risk that new rules are abused by Member States' tax administrations.

In more specific terms, at least four respondents suggested that further EU action should aim at harmonising taxation amongst Member States. Two NGOs warmly welcomed a potential initiative to discourage the use of entities and arrangements without substance for tax purposes. One feedback was received from a business association expressing scepticism that the additional obligations such initiative could entail for EU business would be disproportionate in relation to its added value.

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[141] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12999-Tax-avoidance-fighting-the-use-of-shell-entities-and-arrangements-for-tax-purposes_en

4. Public consultation

Overview

The public consultation was launched on 4 June 2021. It remained open until 27 August 2021 for a total of 12 weeks. A derogation has been granted with respect to the language of the consultation questionnaire, which has been published first in English alone and two weeks later in the other 22 official EU languages.

In addition to the general identification questions, the questionnaire of the public consultation consisted of 32 questions which cover all impact assessment elements in terms of problem, subsidiarity, options and impacts of the initiative. In particular, information was requested on the different uses of entities that may have low substance for tax purposes, including potential abusive schemes, the key features commonly observed in abusive schemes, the business sectors and legal forms most prone to abuse. Furthermore, input was requested on the appropriate form and objectives of potential EU action in relation to abuse of shell entities for tax purposes, on the appropriate treatment from a tax perspective and on mechanisms to monitor implementation by Member States. Stakeholders could also upload additional contributions. In order to increase the visibility of the public consultation, the Commission promoted this consultation on social media. In total, 50 responses were received (33 of them chose to attach position papers instead of or in addition to the replies to the standardized questions), coming from the following respondents

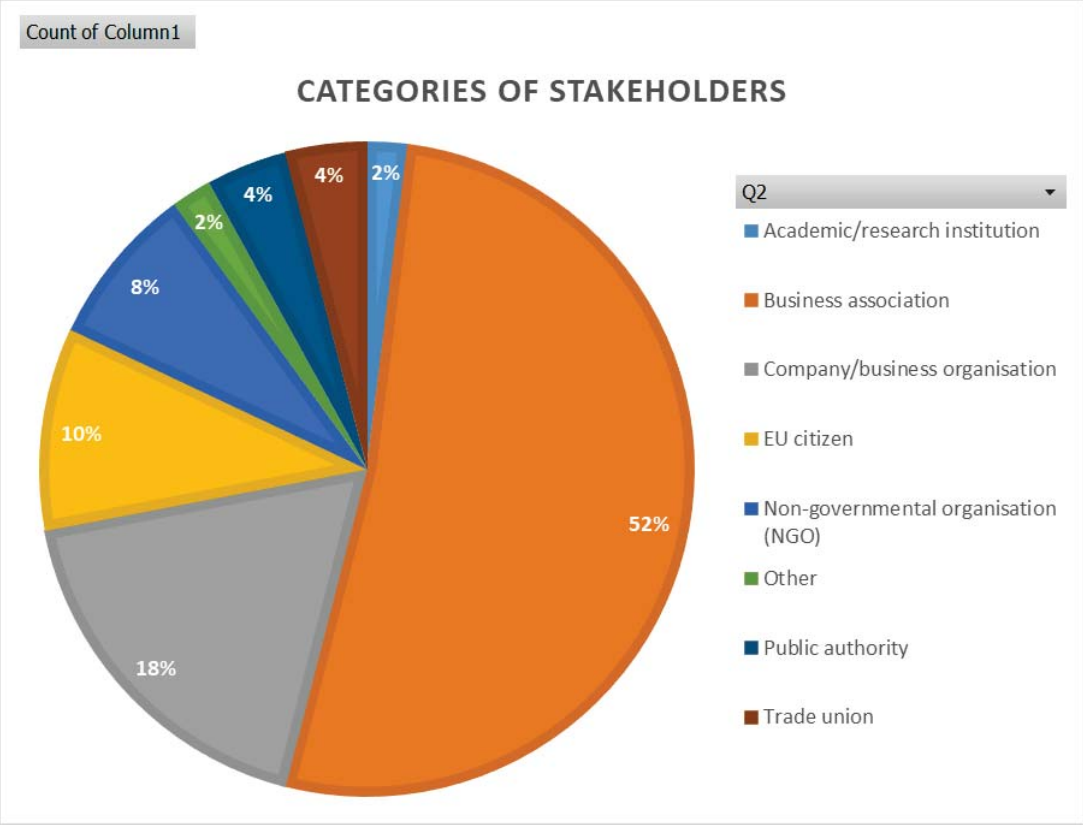


Chart 2 Overview of stakeholders providing feedback to the public consultation

Type of respondent	Total
Academic/research institution	1
Business association	26
Company/business organisation	9
EU citizen	5
Non-governmental organisation (NGO)	4
Other	1
Public authority	2
Trade union	2
Grand Total	50

Table 7 Overview of stakeholders providing feedback to the public consultation

In terms of breakdown among origin countries of the respondents, the chart below shows a diverse representation. The increased number of respondents from Belgium may be explained by the fact that Belgium hosts several professional and business associations at EU level:

Chart 3 Country of origin of stakeholders providing feedback to the public consultation

From the point of view of the size of the organisations replying to the survey, 6 are micro (1 to 9 employees), 18 small (10 to 49 employees), 9 medium (50 to 249 employees) and 12 large (more than 250 employees).

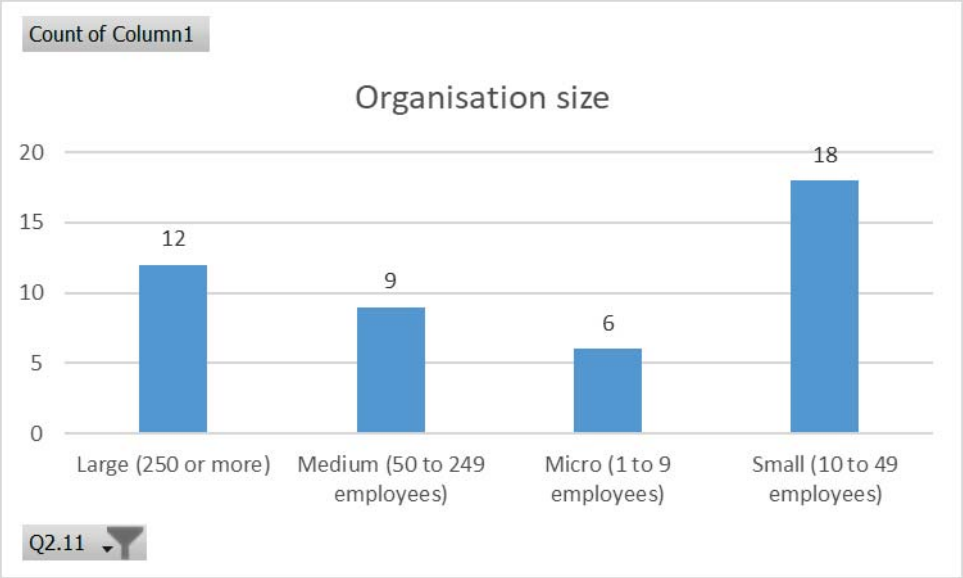


Chart 4 Organisation size of stakeholders providing feedback to the public consultation

Thirty three position papers were submitted by stakeholders in addition to the answers provided by them to the standardized questionnaire. Position papers were submitted, mainly, by research institutions and business associations.

A comprehensive presentation of the results of the public consultation is available, alongside the questionnaire and position papers received, on the CIRCABC website of the European Commission.[142]

Summary of main results:

Challenge and possible solution

Overall the respondents acknowledge the ongoing challenge of tax avoidance, including through the misuse of shell entities. However, they are divided when it comes to solutions. While some respondents support action to tackle tax avoidance via shell entities, others take the view that an EU legislative initiative in this direction may be premature.

Causes of tax avoidance

Furthermore, several respondents point out the lack of capacity in Member States' tax administration and the insufficient administrative cooperation between Member States in tax matters as main hurdles in the EU fight against tax avoidance. This comes in contrast to the argument expressed above that the EU should not take

[142] https://circabc.europa.eu/ui/group/6868da3c-d21c-4ce4-98d9-d5448986e44e

legislative action before the impact of the recent directives is quantifiable: an important part of the recent initiatives regards administrative cooperation.

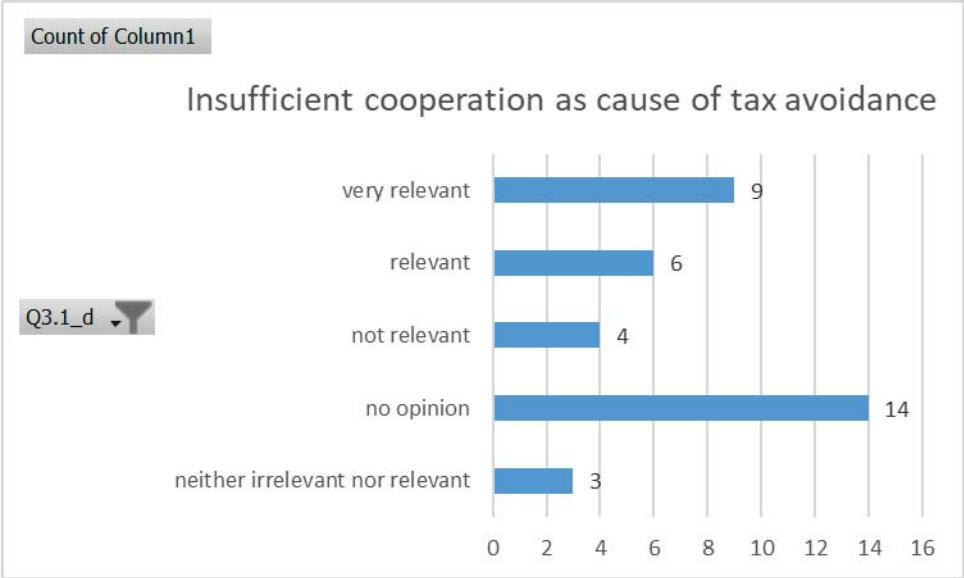


Chart 5 Causes of tax avoidance, results for feedback on insufficient cooperation

Assuming that legislative action is taken at EU level to target harmful tax practices using shell entities, respondents identified the indicative elements of relevant structures. 19 respondents[143] agreed that the lack of own bank account may be the most indicative feature of shell entities.[144]

[143] Sum of 3 (very indicative) replies and 16 (indicative) replies.

[144] Note that answer options range from very indicative to not indicative at all.

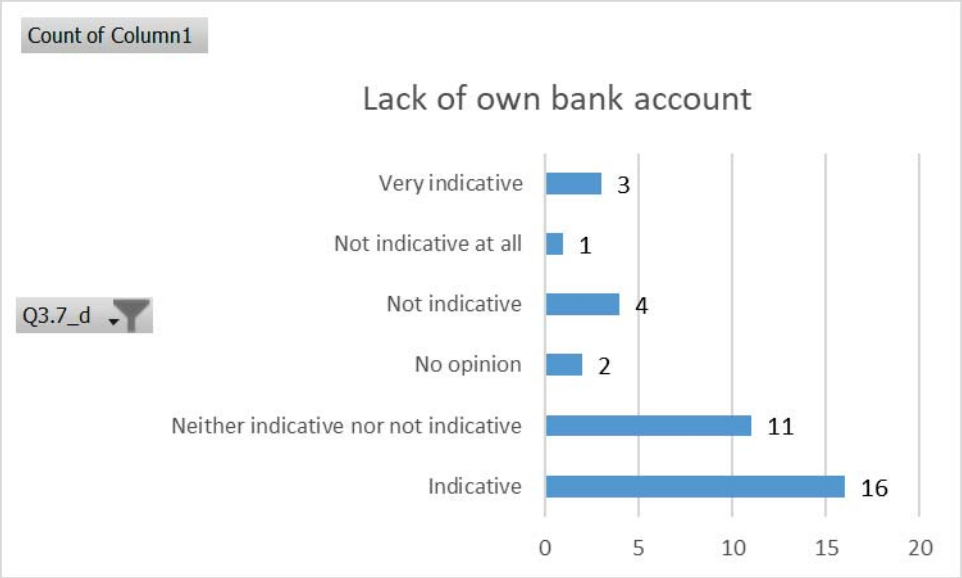
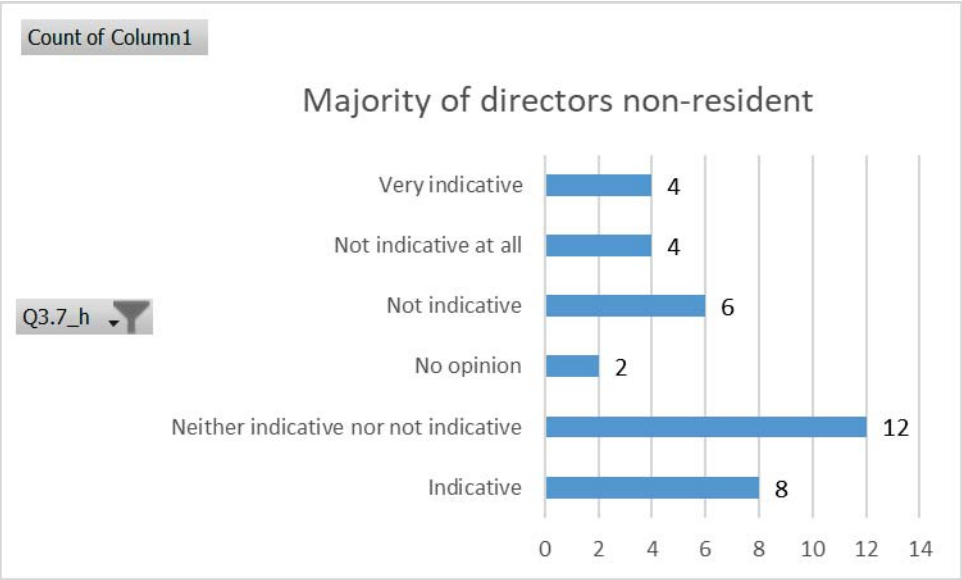


Chart 6 Lack of own bank account and its relevance as indicator for a shell entity

12 respondents[145] also considered[146] indicative the place of residence of the directors of the entity: it is more likely that an entity is a shell entity where the majority of the directors reside in a jurisdiction other than the jurisdiction of the entity.



[145] Sum of 4 (very indicative) replies and 8 (indicative) replies.
[146] Note that answer options range from very indicative to not indicative at all.

Chart 7 Residency of directors and its relevance as indicator for a shell entity

On the other hand, respondents did not attach significant indicative value to the type of income received by the entity, the lack of own employees or the employment of third parties to provide administration and management services.

Activities most often performed by shell entities and legal forms

In relation to the range of activities usually performed by shell entities abused for tax purposes, several respondents identified the following business activities as most relevant:

(i) Holding and managing equity (11 respondents)

(ii) Holding and managing intellectual property (10)

(iii) Financing and leasing activities (9)

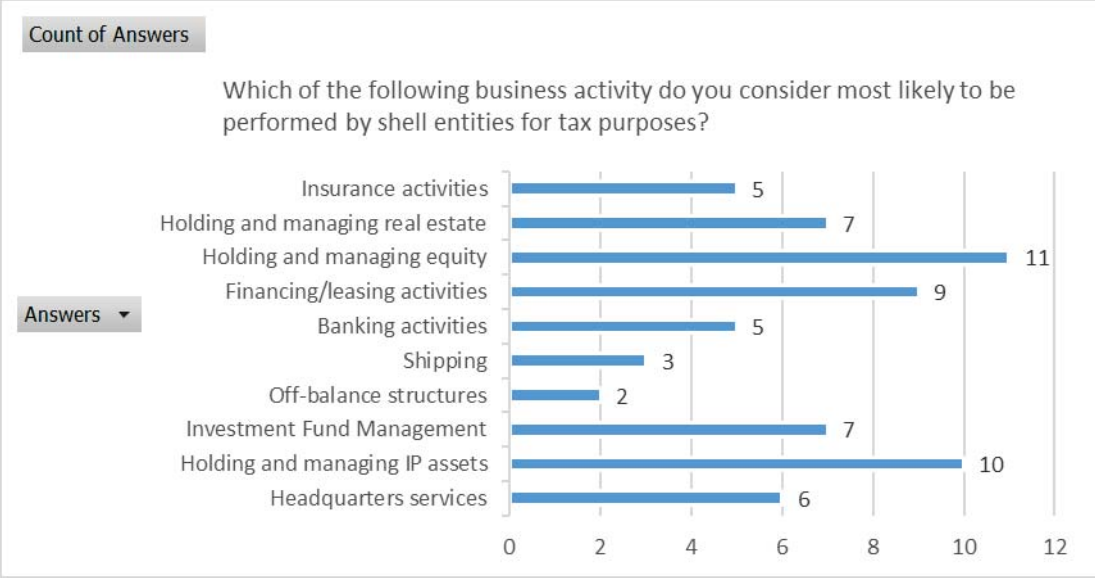


Chart 8 Business activities most likely to be performed by shell entities

In relation to the legal forms normally used to incorporate entities aimed to serve as shell, 14 respondents agreed that trusts or fiduciary entities may be preferred for this purpose and can be considered at high risk. Companies, partnerships and foundations were also considered relevant, at a slightly lower rate.

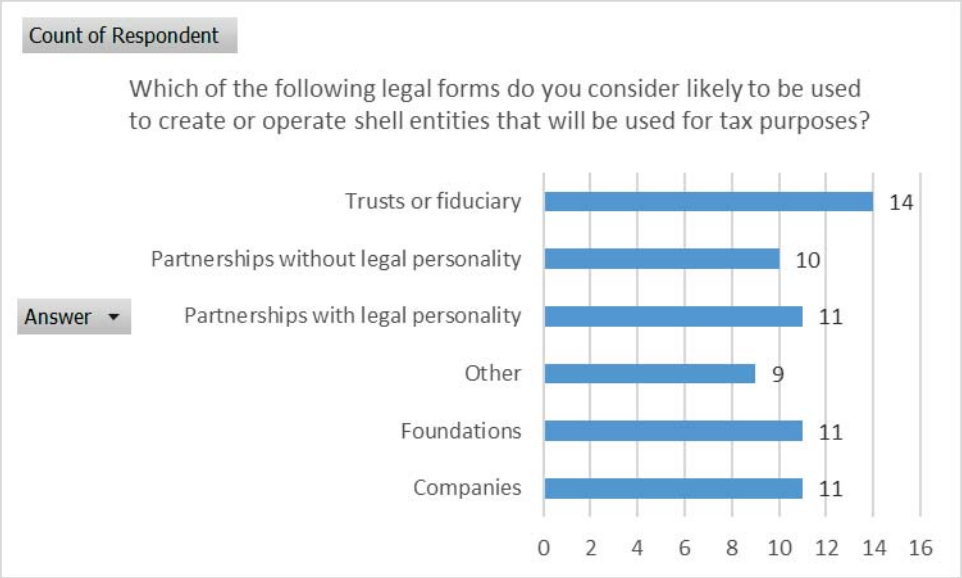


Chart 9 Legal forms which could be used by shell entities

Nevertheless, the above results have to be considered with the caveat that a significant percentage of the contributors to the survey did not provide replies directly to the questions but submitted own comments through position papers.

Position papers

A total of 33 position papers has been received. A synopsis of the comments received in position papers is provided below. Such feedback is grouped in 4 categories depending on the industry / sector of the respondent:

- Professional associations of tax consultants and firms providing tax consultancy services (8 respondents)
- Business associations (11 respondents)[147]
- Associations representing funds and investment managers (13 respondents)
- Contributors from the academic research area (1 respondent)

Eight respondents come from the area of tax consultancy. Respondents of this category argue, first, that in the continuous fight against tax avoidance and evasion, including through shell entities, the evaluation of the existing framework should be a priority. A new framework to complement the existing EU rules entails a risk to increase the cost of doing business in the EU. Furthermore, this group of respondents draws the attention to the fact that shell entities can be misused in various areas, including taxation and anti-money laundering. Therefore, it is essential that any new EU initiative be clear as to the misuse it seeks to target. Should the EU opt, indeed, to take further targeted action in this

[147] One paper was a joint contribution of two business associations.

domain, soft law options should be prioritised to binding acts. Any such action should also depart from the identification of tax avoidance elements before entering into a control of substance.

Ten respondents qualify as associations representing business from at least 6 Member States and from outside the EU. Respondents of this category expressed the view that the current EU framework is adequate to curb tax avoidance through shell entities. The outstanding problem of tax avoidance is due to the fact that the existing tools have still not produced quantifiable impact. In any case, as business associations stressed, a new international tax framework is taking shape, through the negotiation of Pillars 1 and 2. This new framework is expected to effectively contribute to curb tax avoidance practices, including through the misuse of entities that lack of substance. In a scenario where EU took the decision to take further action, this category of respondents pointed out that any action should duly take into account taxpayers' rights to evidence the business reasons for maintaining entities that have little or no substantial activity. It was also recalled that what constitutes substance is a matter of facts and circumstances that can only be assessed taking into account the specific circumstances of each business case. In the same vein, this category of respondents pointed to the element of tax avoidance, which, in their view, should be the entry criterion for any scrutiny of substance: in absence of a tax avoidance element the question of substance should not arise. At least two respondents in this category also proposed that substance should be measured by reference to a jurisdiction and not by reference to an entity. Finally, the respondents of this category called for the EU to minimize burden on taxpayers and to ensure that any new initiative does not replicate obligations already imposed under other EU legislation, in particular directives on administrative cooperation.

Position papers have also been submitted by thirteen respondents from the banking and investment fund management industry. All of these respondents point out the extensive regulation of their activities in the EU, which ascertains a particularly high level of transparency for their sector. In the view of this category of respondents, so highly regulated entities should be excluded from the scope of a new initiative targeting shell entities. In the same vein, the respondents of this category have provided various examples of common structures built for investment purposes, which while may be considered to have little substantial economic activity, they are not put in place for tax avoidance purposes but for good business reasons including to facilitate investment. The respondents of this category, further, stress the risk that new rules result in double taxation of investment vehicles in the EU, which could discourage doing business in the single market. One of the respondents from this category also raises concerns that an EU wide initiative on substantial economic activity could imply discrimination of foreign investors.

Furthermore, one research organisation submitted its views through a detailed position paper welcoming an EU initiative targeted to shell entities while drawing the attention to the challenges of such undertaking. It is argued that existing anti-avoidance measures in the EU do not suffice to curb tax abuse involving shell entities, especially because of the patchwork of rules in the Member States as regards withholding taxation and consequences attached to findings of abuse. It is also recognised that domestic tax rules against shell entities are rather uncommon in Member States. In light of the above, this

respondent welcomes an EU comprehensive tax initiative on shell companies as coordinated action promoting cross-border consistency in the applicable tax treatment to shell arrangements. This should allow to have one single EU standard definition of what is admissible and what is not, also providing tax certainty to taxpayers and advancing the internal market. As regards a potential solution to the problem, this could lie with a general denial of tax benefits provided by EU law to arrangements identified as shell. However, in this context, the respondent calls for caution to ensure that fundamental freedoms are respected and restricted only in a proportional manner. The respondent also calls for any action to take into due account the challenges inherent in assessing substance, which cannot be compatible with a non-rebuttable presumption.

5. Targeted consultation

Working Party on tax questions (Working Party IV, Member States)

On 22 June 2021, the Working Party IV expert group met through Webex to exchange views on a potential initiative to fight the use of shell entities and arrangements for tax purposes. The meeting focused on the need for such initiative to complement the recently adopted EU rules against tax avoidance, in particular the Anti-Tax Avoidance Directive, as amended and on Member States' existing rules and practices in this area. The meeting benefitted from the participation of delegates of the 27 Member States.

Overall Member States expressed broad support for an EU initiative to tackle the use of entities with little substance for tax avoidance purposes. Several Member States provided detailed information on domestic rules and practices to tackle the tax-related problems posed by entities without sufficient substance. Many of the tools mentioned by Member States are based on the anti-tax avoidance directive.

On the problem identification and the need for EU action, most Member States expressed general, even if preliminary support, stressing that common rules and a framework for cooperation were considered useful to tackle the problem. Some Member States highlighted the thin line between tax avoidance and other problems linked to the abuse of entities without substance, especially money laundering.

On the scope of a potential initiative, some Member States expressed in favour of a broad scope of a potential initiative, underlining that SMEs should not be excluded from the scope as such. Some Member States also draw the attention to the existing rules on tax avoidance that should be duly considered when tailoring new rules. Taxpayers' rights should also be taken into account: taxpayers should have an effective opportunity to provide evidence on a case-by-case basis.

On the appropriate type of EU action, some Member States favoured explicitly a regulatory intervention, acknowledging that soft law instruments should also be analysed. Caution should be paid to ensure the proportionality of any administrative burden that might result from a new initiative.

Platform for tax good governance (businesses, NGOs and Member States)

On 9 July 2021, the Platform for Tax Good Governance met informally through Webex to discuss a potential Commission initiative to fight the use of shell entities and arrangements for tax purposes.

The Platform is a Commission expert group whose members are: Member States' representatives and the following 15 organisations, representing business, civil society and tax/accountancy practitioners as well as researchers/academia:

1. Accountancy Europe (tax/accountancy professionals)
2. ActionAid (NGO, civil society)
3. American Chamber of Commerce in EU (business association)
4. BEPS Monitoring Group (NGO, civil society)
5. Business Europe (business association)
6. European Confederation of Independent Trade Unions (CESI) (trade union)
7. European Association of Tax Law Professors (EATLP) (researchers/academia)
8. European Centre for International Political Economy (ECIPE) (researchers/academia)
9. European Network on Debt and Development (EuroDaD) (NGO, civil society)
10. Confédération Fiscale Européenne (CFE) Tax Advisers Europe (tax/accountancy professionals)
11. International Chamber of Commerce (ICC) (business association)
12. Oxfam (NGO, civil society)
13. SMEunited (business association)
14. Tax Executives Institute (TEI) (business association)
15. Tax Justice Network (TJN) (NGO, civil society)

The meeting of the Platform focused on the structure such initiative could take to effectively target such entities and arrangements in the internal market. Stakeholders expressed views on the risk such an initiative could entail to discourage genuine economic activity in the EU and how it can be tackled. The meeting benefitted from the participation of delegates of several business and professional associations.

Participants in the informal meeting of the Platform for Tax Good Governance expressed rather tacitly their consensus on a potential EU action to tackle shell entities. No objections were raised on the objective of such Commission initiative.

One participant expressed strong support for common EU rules to prevent the use of entities or arrangements without substance for tax purposes. It was argued that such common rules are all the more important following recent CJEU jurisprudence that renders challenging the use of transfer pricing rules against tax avoidance through such structures.

Another participant stressed the challenges in identifying a proper definition for shell entities and arrangements reminding the difficulties in defining hallmarks in the context of DAC6.

Bilateral meetings with Member States (Germany, Ireland, Luxembourg, Netherlands)[148]

The consultation focused on abusive practices identified by Member States' tax administrations to involve entities without adequate substance and the available domestic and EU rules to fight such practices. Purpose was to gather data on the appropriate form of EU action and the scope of a potential initiative. Purpose was also to gather information on the existing domestic rules and practices.

Overall, Member States consulted bilaterally welcomed a potential initiative to tackle the use of entities without substance for the purpose of obtaining tax advantages in the single market. Member States highlighted that a new framework should fit with the existing rules for anti-tax avoidance.

In more specific terms, two Member States, while expressing general support for a potential initiative, raised questions on how it would fit with the General Anti-Abuse Rule (GAAR) in the ATAD and with the Principal Purpose Test (PPT) in DTAs. In this context, it should be explored whether a new initiative should take the form of a directive or the form of guidance on the application of existing rules. The same Member States stressed that identifying appropriate indicators of lack of substance may be a particularly challenging exercise, while a case-by-case analysis may be more appropriate.

Other two Member States expressed support for the Commission initiative and provided information on domestic initiatives in the same direction. One Member State explained that introduction of measures to tackle the abuse of entities without substance in the tax area has been a domestic policy priority in recent years. However, domestic efforts faced challenges due to relevant jurisprudence of the CJEU in the area of substance. Common EU rules in this direction are necessary to facilitate identification of this type of entities and abusive practices.

Another Member State explained that it has recently introduced some requirements on substance for specific types of entities, while a specific committee has been designated to analyse the tax challenges linked to conduit companies. This Member State shared the difficulties in defining a set of elements to identify lack of substance in an entity. In terms of consequences, denial of tax advantages could be an appropriate solution, which can be implemented in practice through appropriate indication in the certificate of tax residence.

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[148] These Member States were selected because they have developed / are in the process of developing rules to target entities without substance or they host a significant number of entities that might be targeted by a potential initiative or because they requested a bilateral discussion with the Commission on this subject.

ANNEX 3: WHO IS AFFECTED AND HOW?

1. Practical implications of the initiative

Legal entities and legal arrangements

All legal persons and legal arrangements that are resident for tax purposes in a Member State would need to check whether they meet the reporting requirements to self-assess for the substance indicators under the initiative. The reporting requirements provide that only entities and arrangement that are most at risk of tax avoidance or tax evasion are required to self-assess. The reporting requirements are based on information already available to the entity and arrangement, therefore any additional burden is considered negligible, and would just require an additional box to be checked in the tax declaration. Furthermore, in order to ensure that the measures are proportionate, there are a number of exemptions from the reporting obligations, for example, businesses already regulated at EU level and not-for-profit organisations, are not required to self-assess.

At the self-assessment stage, entities and arrangements would need to verify if they pass the substance indicators. The indicators are objective and readily verifiable using available information. Additional information would need to be provided to their tax authority that may not be provided currently under their national tax and accounting systems. Nevertheless, such information is already at their disposal in their accounting and registration records even if not publically disclosed.

The proposal recognises that entities and arrangements that fail the substance indicators may also be used for legitimate purposes. Such entities and arrangements may avail of the rebuttal provisions of the proposal in order to carry on their legitimate activities and be entitled to tax benefits. The rebuttal procedure is an additional burden but is justified by the need to counter tax avoidance or tax evasion by entities and arrangements with high-risk characteristics that do not meet substance requirements.

The main benefit for entities and arrangements in the EU is that the proposal will contribute to creating a level playing field between businesses in the EU who operate domestically and those that are part of a cross-border structure. This level playing will ensure a fairer taxation burden, and reduce the likelihood of tax avoidance and tax evasion in the EU.

Tax Authorities

Tax authorities will incur costs for implementing the new system, notably on staff resource allocation or hiring and staff training. However, this is not considered significant as the new system could be accommodated by the existing human and IT resources used to address tax avoidance and tax evasion, notably the exchange of information provisions under Directive 2011/16/EU on administrative cooperation in direct taxation. The main costs for tax authorities would be to process the self-assessments and, if the case of entities and arrangements not fulfilling the substance indicators, sending the information to the national tax authorities of other Member States. The verification of the self-assessment by the entity or arrangement will be required to be undertaken by the tax authorities in addition to any other normal controls. However, as

this verification will take place at the time of the audit then the additional burden is minimised.

The main benefits of the scheme could be to act as a deterrent to tax avoidance and tax evasion, in addition to risk management and for audit purposes. Furthermore, the initiative is complementary and contributes to the effectiveness of existing national, EU and international measures like OECD BEPS to combat tax avoidance and tax evasion by shell entities.

2. Summary of costs and benefits

Table 8 Overview of costs and benefits

I. Overview of Benefits (total for all provisions) – Preferred Option (Option 4: Directive with automatic exchange of information (AEOI) and common sanctions)		
Description	Amount	Comments
Direct benefits		
Tax revenue gains	Not quantified, but the estimated revenues lost is around 23 billion. A small share of that tax gap would be very significant. In this preferred option revenues should be higher than in other options due to the more significant deterrent effect of sanctions included in this option	Public administrations are the main beneficiary. A higher amount of tax revenues should be collected as schemes used to minimize tax payments via shell entities will be tackled.
Regulatory charges		Public administrations are the main beneficiary.
Indirect benefits		
Social impact		EU Citizens are the main beneficiary of positive social impacts. With this initiative the EU show its commitment to tackle schemes leading to tax avoidance and evasion. It will reinforce the role of the EU and increase the willingness of taxpayers to comply with tax obligations
Single Market		EU companies are the main beneficiary. Common substance requirements, combined with AEOI between tax administrations and a common framework for sanctions would ensure a uniform treatment of all legal entities and arrangements and remove the risk of fragmenting

		the Single Market.. This would also improve transparency and certainty for businesses to operate within the Single Market, as well as ensuring a level playing field.

II. Overview of costs – Preferred option							
		Citizens/Consumers		Businesses		Administrations	
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
Substance criteria	Direct costs				For companies in scope they need to provide self-assessment on substance requirements		Tax Administrations will need to assess self-assessments. They will need to provide tax rulings in certain cases
	Indirect costs						
Automatic Exchange of Information	Direct costs					EUR 2 Million for the national tax administrations and EUR 1 Million for the EC	EUR 0.8 Million for the National tax administrations and EUR 0.12 Million for the EC
	Indirect costs						
Sanctions Regime	Direct costs						Tax administrations will need to execute regular

							audits and inspection. These could be followed by legal proceedings
	Indirect costs						

ANNEX 4 (A): METHODS FOR ESTIMATES - ESTIMATION OF POTENTIAL TAX LOSSES

1. Introduction

Due to strong data limitations it is not possible to deliver an accurate estimate about the current loss of corporate tax revenues due to corporate tax avoidance and evasion through shell companies. Empirical evidence about the extent of the resulting tax advantages of shell companies is sparse. Most recently, Demeré et al (2020)[149] have estimated for the US that Special Purpose Entities (SPE) could generate additional tax savings equivalent to 6% of the US federal corporate income tax collection. If one applied that rate to the EU-27's 2018 corporate income tax revenues, this would imply tax savings of some **EUR 23 billion per year**.

One could try to roughly estimate an **upper bound** of the current loss, i.e., a pessimistic scenario of potential tax savings through SPE by looking at Eurostat's Balance of Payment Statistics (BPM6), more concretely: the statistics on direct investment income in the EU. It is important to underline that this approach is not intended to provide an accurate figure – which would require data that is not available. The statistics show **income** from Foreign Direct Investment in EU countries, where the partners may be located in another EU country or outside the EU. Income in this context thus 'represents the return accruing to direct investors, during a reference year, for the provision of financial assets.'[150] BPM6 explicitly distinguishes between direct investments in SPEs from investment in other entities (despite there being significant data gaps).

Following that approach, the (hypothetical) upper bound of foregone tax revenue through the use of SPEs could amount to some EUR **60 billion per year,** as show in Table 9. The majority of this amount (some EUR 40 billion) stems from investors outside the EU. This figure stems almost exclusively from those two EU countries showing by far the highest inward FDI in SPEs[151] and income flows (and thus: imputed forgone tax revenue): **the Netherlands and Luxembourg,** 'the world's largest recipients of FDI also ranked in the global top three for outward FDI along with the United States.'[152]

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[149] Demeré, Donohoe, Lisowsky 2020 - The Economic Effects of Special Purpose Entities on Corporate Tax Avoidance, Contemporary Accounting Research Vol. 37 No. 3 (Fall 2020) pp. 1562–1597.

[150] See Eurostat on European Union direct investments (BPM6) (bop_fdi6) (europa.eu).

[151] Damgaard, Jannick and Thomas Elkjaier – The Global FDI Network: Searching for Ultimate Investors, IMF Workig Paper WP/17/258, November 2017, Annex 1.

[152] Damgaard, Jannick and Thomas Elkjaier – The Global FDI Network: Searching for Ultimate Investors, IMF Workig Paper WP/17/258, p 4.

Table 9 Income from inward FDI in EU countries (from Special Purpose Entities), hypothetical maximum tax savings through the use of SPEs

	Direct investment income on inward FDI		Statutory CIT rate	Foregone	
	Total	.. of which: Extra-EU27		CIT revenue	.. of which: Extra-EU27
	1	2	3	4 (=1x3)	4 (=2x3)
Netherlands	129,291	*81,596*	25.0%	32,323	*20,399*
Luxembourg	104,583	*78,772*	24.9%	26,083	*19,646*
Cyprus	22,233	*20,283*	12.5%	2,779	*2,535*
Hungary	3,816	*1,844*	9.0%	343	*166*
Ireland	783	*-111*	12.5%	98	*-14*
Denmark	342	*96*	22.0%	75	*21*
			Sum	61,702	42,753

Sources: Col. 1,2: Eurostat series 'bop_fdi6_inc'; col. 3: OECD statistics (Corporate Income Tax rates)

This upper-bound estimation of foregone CIT taxes is bound to a number of very strong assumptions and is thus to be treated with due car. It implicitly assumes that:

1. all registered income flows back to the foreign partner (investor), i.e.: there is no reinvestment;
2. all these payments were used to avoid taxes in the EU (i.e., all SPEs' only purpose is to avoid taxes);
3. there is no behavioural change, i.e., firms adjusting to the new situation.
4. taxes are fully avoided (zero tax in the EU)
5. CIT rates are the relevant tax rates when calculating potential tax losses. However, to the extent income from FDI flows back to the investor as outbound payment in the form of royalties or interest/dividends, withholding taxes may be applied. As the level of withholding taxes on outbound payments from the countries displayed in Table 7 is usually much lower than the statutory CIT, so would be the tax losses. This holds at least in the absence of further defensive measures taken by Member States to address aggressive tax planning (ATP) by abolishing generous exemptions from the application of a withholding tax on those payments. Indeed, all but one Member State displayed in the table have received a Country Specific Recommendation on ATP over the last two years[153] and are therefore analysed by the Commission in the framework of the Recovery and Resilience Facility (RRF).[154]

[153] This does not hold for Denmark.

[154] The Netherlands have expanded the scope of the withholding taxes from 1st January 2021 to also cover outbound payments of interests and royalties.

The OECD's FDI statistics[155] with information on partner countries is used to analyse more in depth the stocks of foreign capital and the income flows thereof. A regression analysis is carried out, based on this data which also distinguishes 'regular' firms/entities from Special Purpose Entities (SPE). For both type of entities, the regression tries to identify determinants of (1) FDI position of EU countries relative to partner economies and (2) income generated by FDI in partner economies.

2. FDI Position as the dependent variable

From the point of view of an observed EU country, **the dependent variable** is the FDI position of that country vis-à-vis its partner countries.

Assets : Parent companies, subsidiaries resident in the country observed (either SPEs or non-SPEs) invest in subsidiaries, Parent companies resident in the partner countries (equities and lending)

Liabilities : the other way around; that is: investment from the partner country in the observed country

The FDI position is expressed as percentage of the EU country's GDP. There are major data gaps concerning SPE. Therefore, the FDI position of six countries is considered: SI, PT, IE, HU, FR, EE, AT.

Explanatory variables:

- The bilateral difference in statutory corporate tax rates, that is, CIT in the country observed minus CIT in the partner country
- Fixed effects capturing specificities of the resp. country hosting the partner entity abroad: a dummy variable for each EU country, a dummy for the 'basket' of countries where there is a statutory CIT rate of zero (15 jurisdictions), a dummy for the US, a dummy for the UK. Those dummies would also capture favourable tax treatment of FDI (beyond low CIT) that may apply in the respective partner country, for example: the absence of a withholding tax on outbound payments as income from the FDI.

Further control variables are:

- country fixed effects for capturing specificities of the observed country which are not captured explicitly by the model. Those also (implicitly) control for cross-country differences in data quality.
- time fixed effects as we look at time series 2005-2019

Core findings

All else being equal:

[155] BMD4 database, see here.

- **SPEs are disproportionally often used to shift EU capital to where CIT is lower:** One expects that the bilateral difference in STR-rates vis-à-vis a certain partner countries is positively linked with the level of assets held by domestic entities against firms in that partner country. EU firms would shift capital to where CIT rates are lower. However, this tendency is visible only if one considers SPEs resident in the sending countries, not for resident operating units (non-SPEs) where the link is even negative[156]. It seems that SPEs, rather than 'regular' firms, are used as vehicle for shifting capital to lower-tax destinations.
- **SPEs have a specific geographic investment profile:** As of the geographical profile where EU capital is being channeled: Investment of 'regular' firms (non-SPE) is being attracted to a number of EU countries. However, the profile of SPEs is very different: Only the dummies for Luxembourg and the US are positive and (highly) significant. After controlling for cross-country differences, those two countries host by far the most foreign capital stemming from EU countries.[157]
- **Also when looking at liabilities (SPEs/non-SPEs in observed EU countries as debtors), the pattern SPE vs non-SPE is different:** Capital from around the world, invested in EU SPEs, originates mainly in Ireland, the Netherlands, Spain and zero CIT jurisdictions while the profile for non-SPEs is much more diverse.

3. Income from FDI as the dependent variable

From the perspective of SPEs or non-SPEs resident in some EU country, income from foreign FDI are payments they make to their foreign investors. In turn, if domestic SPEs or non-SPEs are investors as they receive income from capital they have invested in foreign countries (income from outward FDI).Both magnitudes are taken as dependent variables in a regression model[158] (). The independent (explanatory and control variables) are the same as mentioned above in the case of FDI position.

Core finding:

EU payments through SPEs are mainly being channeled through Irish and Dutch entities. With regard to both payments *and* receipts of firms in EU countries, the Netherlands, Ireland, the UK and the US stand out as destination/origin of these payments (partners). This finding holds much more for payments and receipts of SPEs than for non-SPEs. With a view to the first two (EU) countries, it implies that a high volume of payments is *done* by EU SPEs to the Netherlands and Ireland, and a high volume of payments is *received* by EU SPEs from the Netherlands and Ireland. This could imply that SPEs are used for channeling many payments from and to third

[156] Hence, other factors not captured by the regression model kick in.

[157] The coefficients in the regression model show a multiple of non-SPE investment despite serious under-reporting of SPE investment.

[158] As above, income is expressed as percent of the GDP of the country in which the EU SPEs/non-SPEs are located.

countries via the Netherlands and Ireland. This finding is all but new. *Damgaard et al* confirm a high volume of "transfers of profits between subsidiaries in Ireland and the Netherlands with tax havens in the Caribbean as the typical final destination."[159]

[159] Damgaard, Jannick, Elkjaer, Thomas and Nils Johannesen, "The Rise of Phantom Investments", Finance & Development, September 2019, p. 12.

ANNEX 4 (B): METHODS FOR ESTIMATES - ESTIMATION OF COMPANIES IN SCOPE OF THE INITIATIVE

To approach the population of firms potentially targeted by the substance criteria mentioned in section 5, the focus is on certain sectors of mobile and cross-border activity with a majority of passive income. These includes mostly: (i) holding and managing equity, (ii) holding and managing assets/real estate, (iii) investment/fund management, (iv) financing/leasing, (v) IP holding, (vi) HQ, and (vii) Services entities. The NACE codes to approximate these sectors are:

Table 10: List of NACE codes selected to approximate gateway criteria

NACE Code	Description of activity
64.2	Activities of holding companies
64.20	Activities of holding companies
64.3	Trusts, funds and similar financial entities
64.30	Trusts, funds and similar financial entities
64.9	Other financial service activities, except insurance and pension funding
64.91	Financial leasing
64.92	Other credit granting
64.99	Other financial service activities, except insurance and pension funding n.e.c
70.1	Activities of head offices
70.10	Activities of head offices
82.99	Other business support service activities n.e.c.

These sectors match to a great extent the preferences expressed by respondents to the public consultation for this initiative. When asked "which of the following business activity do you consider most likely to be performed by shell entities for tax purposes?", a relative majority of respondents indicated holding and managing equity followed by holding and managing IP assets and then financing and leasing activities, all covered by the NACE codes listed above.

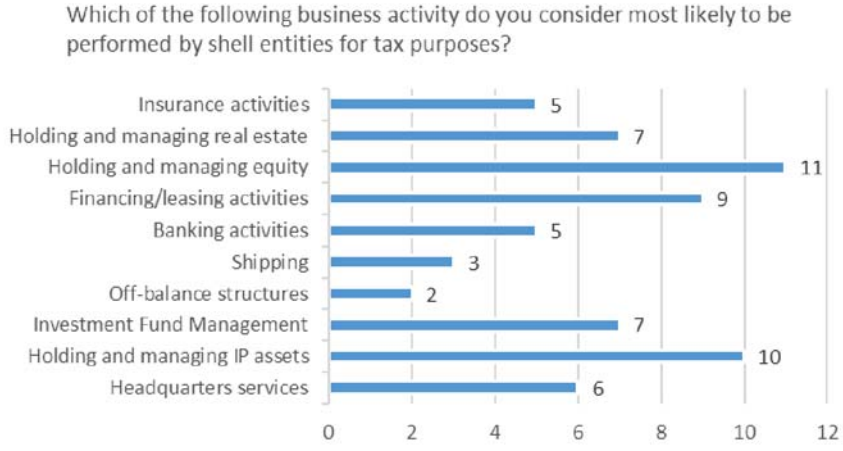

Figure 8 DG TAXUD (2021) – Public Consultation "Tax avoidance - Fighting the use of shell entities and arrangements for tax purposes", replies to question 3.9.

Data on companies on these sectors is gathered from ORBIS, one of the biggest commercial databases on company data. The identified sectors show significantly higher levels of ratios per employee for turnover, profit and fixed assets than companies from other sectors, as shown in Table 11. In particular, a remarkable difference can be seen on the 'Others fixed assets per employee indicator', which represents primarily financial assets. Companies in the selected sectors significantly report less data on the number of employees and turnover as seen in Table 11. There is around 1.9 million companies in those sectors and the share per Member State can be seen in Chart 10.

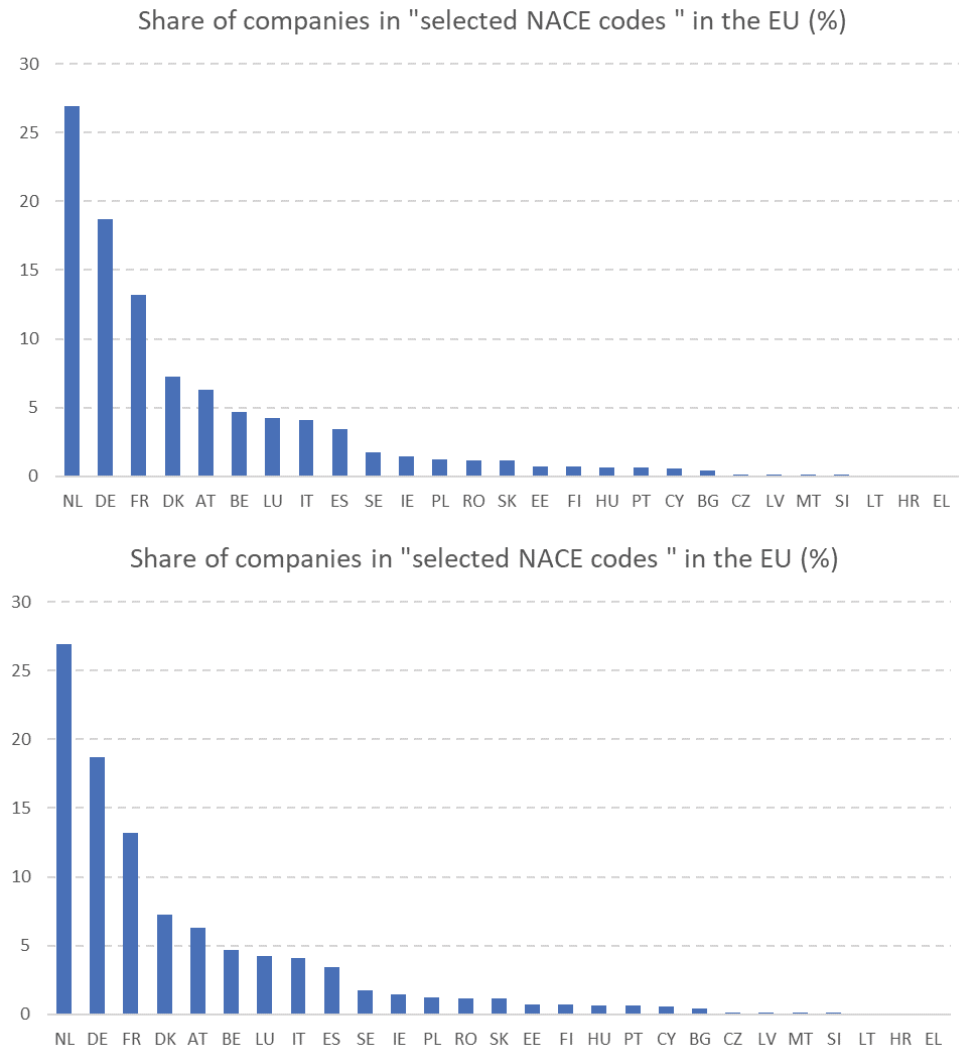

Chart 10 Share by country of companies in selected NACE codes in the EU (source: ORBIS)

Table 11: Comparison for selected indicators between selected NACE code and the rest of economy

	Selected NACE codes	All other sectors
Average number of employees	8.2	9
Share of companies with less than 3	81.8	63.2

employees (%)		
Turnover per employee (000's €)	407.0	176.4
Profit per employee (000's €)	126.7	90.9
Total fixed assets per employee[160] (000's €)	7409.6	298.0
Intangible fixed assets per employee (000's €)	63.5	9.2
Other fixed assets[161] per employee (000's €)	6972.0	191.0
With data on employees (%)	43.9	78.2
With data on turnover (%)	18.1	37.9
With data on profit (%)	14.0	5.9
With data on fixed assets (%)	75.9	50.4
With data on intangible fixed assets (%)	64.4	43.7

Source: ORBIS, financial data 2019

Precise estimations of the number of companies in scope of the initiative are not possible due to the lack of detailed data. To estimate the number of companies in scope three different methods were used to provide a range.

Method 1: Extrapolation from Irish SPEs

According to the Bank of Ireland[162] there are, in 2018, approximately 1120 entities considered as 'Other Special Purpose Entities (SPEs)' which share several characteristics with the entities in scope of this initiative. In Ireland, according to ORBIS, there are around 29 000 companies in the identified NACE codes. Applying the same ratio to the EU, the amount of companies in scope could be around 75 000.

This could be an over estimation and could work as an upper-bound-limit if Ireland has a higher than average incidence of this kind of companies.

Method 2: Detecting outliers

In this case, the goal is to detect the companies from the selected NACE codes with higher ratios of turnover, profit and total fixed assets (including tangible, intangible and other fixed assets) per employee. The threshold to define the outliers were rounded from the mean plus 1.5 times the standard deviation.

This calculation is based on the 2019 financial data from ORBIS and the main limitation of this method is the low reporting rate of the data. This lack of representativeness has

[160] In ORBIS 'Fixed assets' represented the total amount (after depreciation) of non current assets (Intangible assets + Tangible assets + Other fixed assets).

[161] In ORBIS 'Other fixed assets' represents primarily financial assets such as long term investments, shares and participations, pension funds etc.

[162] https://www.centralbank.ie/docs/default-source/publications/economic-letters/vol-2018-no-11-shining-a-light-on-special-purpose-entities-in-ireland-(golden-and-hughes).pdf?sfvrsn=8

been compensated applying some weights to represent the missing values. This introduces additional uncertainty in the results.

The thresholds defined are:

- Turnover/employee: 4M€
- Profit/employee:3.5 M€
- Total fixed asset/employee: 75M€

To calculate the ratios for companies with 0 employees, 0.5 employees was imputed in those cases.

With these values, around 29 000 companies were estimated to be in scope.

Method 3: Extrapolation from Dutch letterbox companies.

According to the Dutch Central Bank[163], there are around 14.000 letterbox companies in the Netherlands. Assuming this kind of companies to be a proxy for companies in scope of this initiative, this can be extrapolated to the EU in a similar way as done in Method 1. The number of letterbox companies represents approximately 2.6% of the 530.000 Dutch companies in the selected sectors. That represents around 52.000 companies for the EU, a mid-point between the two previous estimates.

[163] https://www.somo.nl/dutch-efforts-combat-letterbox-companies-no-effect/

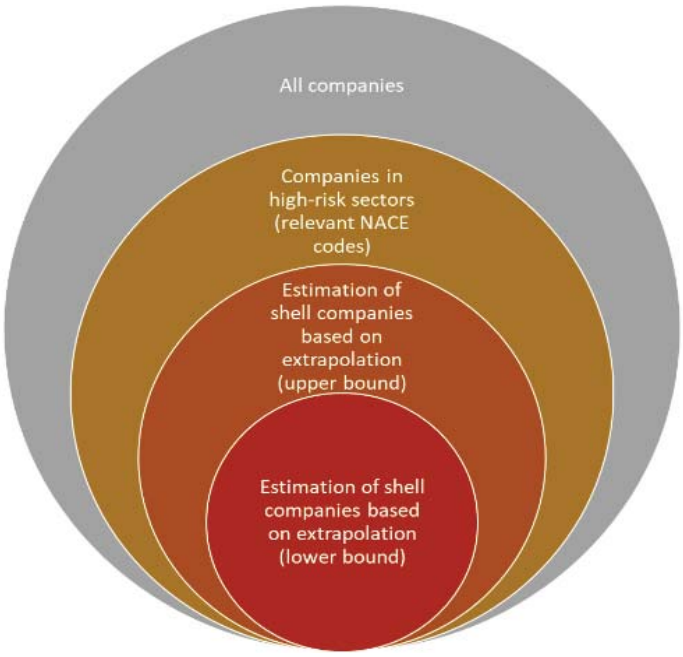

Figure 9 Illustration of the steps to estimate the number of shell entities

Datasources

ORBIS (Bureau van Dijk)

The ORBIS database provides commercially available firm-level data, which include financial accounts and ownership structures. The choice of the ORBIS database provided by Bureau van Dijk implies several advantages and limitations. The key advantages are the public availability which ensures that the analysis is (in principle) replicable by everybody with a commercial access to the dataset. The second and most important advantage is the wide coverage and consistency across countries in particular EU countries, which would be difficult to achieve using different national datasets.

There are also several important limitations in the choice of the ORBIS. First, the coverage in ORBIS is incomplete since it is not an administrative dataset. While the coverage for European companies has improved over the last years, the coverage of companies in the target sectors could be lower. The financial data reported for these companies usually are incomplete and unequally distributed among countries.

ORBIS utilises information from various domestic sources and there are differences between countries concerning the availability of information. However, a study compared data from commercial registers and previous research to the data in ORBIS

and found that the coverage of the companies included in ORBIS was good[164]. Nevertheless, there are some exceptions, and it is important to keep in mind that not all companies are included in the database. In addition, as larger firms often have stricter data reporting requirements, they are typically better covered in the database.[165]. Companies included in ORBIS are generally larger, older and more productive.[166]

[164] Gerner-Beuerele, C., Mucciarelli, F. M., Schuster, E. P., & Siems, M. M. (2016). Study on the Law Applicable to Companies. Publications Office of the European Union. Available at: https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1/language-en. Accessed on 28 June 2019.

[165] Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, https://doi.org/10.1787/9ea89b4d-en.

[166] Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C., & Timmis, J. (2020). Coverage and representativeness of ORBIS data. OECD Science, Technology and Industry Working Papers 2020/06. https://doi.org/10.1787/18151965

ANNEX 5: NATIONAL MEASURES TO TACKLE SHELL ENTITY ABUSE AND RELATED SUBSTANCE REQUIREMENTS

This Annex provided a summary of practices in Member States (AT/BE/BG/DE/DK/ES/IT/NL/PL/SE) regarding national provisions related to substance requirements for shell entities. Sources used for the analysis are the IBFD database, consultations with Member States, including WP IV meeting of 22 June 2021[167], and other relevant information. The aforementioned information sources are not exhaustive and Member States not listed may well have relevant substance rules for shell entities.

Summary

There are significant differences between Member States regarding provisions designed to counter abuse by shell entities and related substance requirements, which reflect their national taxation systems and national priorities. These differences in themselves may lead to tax and regulatory arbitrage and may undermine efforts of the EU to counter tax avoidance and tax evasion by shell entities in the Internal Market.

The substance rules in relation to shell entities can be mainly categorised into the following:

- Substance rules relating to non-financial characteristics of the shell entity, for example qualifications of the personnel and where management decisions take place;
- Substance rules relating to economic or financial criteria, for example whether the shell entity would have set up as an independent economic entity in its own right, or has sufficient capital to bear the default risk of financing transactions.

Often substance rules when they are applicable are defined at a high level and would need to be applied to the individual taxpayer at the later stage of the audit to assess whether abuse has taken place. This is understandable given that tax authorities may refrain from being over prescriptive in their anti-abuse rules as this may lead to abusive transactions not being caught by the specific provisions. However, this may also have the effect that abuse is not detected at an earlier stage when the tax benefit is obtained.

As outlined below, apart from objective substance requirements used for BE administrative practices and for NL Advance Pricing Agreements (APA), Member States lack objective substance criteria in their anti-abuse provisions to assess the risk of possible abuse of shell entities at the time a tax benefit is provided. The lack of information available to assess substance, especially in a cross-border context, makes an ex-ante assessment of substance prior to a tax benefit being granted. Member States can avail of the ATAD GAAR, and have specific anti-abuse rules in their national legislation,

[167] https://ec.europa.eu/transparency/expert-groups-register/screen/expergroups/consult?lang=en&groupID=953

however, these would have to be applied to the individual taxpayer at the time of an audit in order to assess the facts and circumstances. Any appeal lodged by the taxpayer would further delay any rectification of possible abuse.

National Rules

Austria

Austria had developed jurisprudence on tax treaty abuse through the use of entities without economic activity, for example, premises and personnel, and abuse of beneficial ownership rules under the relevant tax treaty.

Belgium

Belgian (tax) law does not provide for explicit requirements regarding substance, and must be analysed on a case-by-case basis. In general, under Belgian tax law, a transaction can be challenged on four grounds when not enough substance is deemed present, namely (i) taxable presence, (ii) beneficial ownership, (iii) (general) anti-abuse legislation and (iv) transfer pricing.

Despite no explicit requirements on substance, the Belgian administrative practice takes into account the following criteria regarding substance:

(i) active senior decision making location (preferable directors' residence);
(ii) taking of strategic decisions;
(iii) qualifications and authority of director;
(iv) day-to-day operations (e.g. management participation, negotiation and signature of contracts, business risk management, decision making on capital investments and funding) are managed by local qualified personnel (entity's daily management has the expertise and is empowered to oversee the actual entrepreneurial risk);
(v) experienced and qualified personnel;
(vi) entity's administrative management location;
(vii) entity's (main) bank accounts, along with administration and bookkeeping;
(viii) all correspondence is addressed to, and sent from, the entity's e-mail correspondence.

Bulgaria

Bulgaria applies a substance test as a precondition to the grant of a benefit under an agreement for the avoidance of double taxation. The test includes an assessment of whether the capital, assets and people of the entity requesting the benefit are adequate for the performance of its activity. Absence of adequate capital, assets and people may be considered to imply abuse. Benefits from agreements for the avoidance of double taxation are not granted to entities that have no substance.

Denmark

As from 1 May 2015, Denmark has introduced a General Anti-Abuse Rule that includes the following: (i) an anti-abuse provision for EU Directives; and (ii) a tax treaty anti-abuse provision.

As discussed in section 3.2. of the Impact Assessment, there have been a number of important ECJ rulings relating to Danish conduit companies with regard to abuse of beneficial ownership requirements under a tax treaty. If a Danish company is used as a conduit company facilitating the reduction of the foreign dividend withholding tax on dividends paid to the Danish company, Denmark imposes dividend withholding tax on the otherwise tax-exempt dividend distributions from the Danish company to the foreign parent. The dividend withholding tax imposed will be equivalent to the dividend withholding tax that Denmark is entitled to impose under the applicable tax treaty. The anti-abuse rule does not apply if the distribution of dividends from the Danish company is permitted by the EU Parent-Subsidiary Directive (2011/96).

Germany

The GAAR of Germany has the following three indicators:

(i) a third party, considering the economic facts and effects of the structure, would have chosen the same legal structure without the generated tax benefit; or
(ii) interposition of relatives or other closely related persons or companies solely for tax purposes; or
(iii) transfer or shifting of income or capital assets to other legal entities solely for tax purposes.

If there is an abuse of law, the structure is disregarded for tax purposes, and the tax is assessed in the same way as if a normal structure had been used. Furthermore, Germany has a specific anti-abuse Treaty Shopping provision which denies treaty benefits (mainly reduction of withholding tax) to a non-resident (intermediate) company under certain conditions, if such a company is not the beneficial owner of the income and its shareholders (the beneficial owners) would not be entitled to the treaty benefit if they would have invested directly.

Germany has a Treaty override provision/ exemption (and hence grant of treaty benefits if certain "substance requirements" are met), if the following conditions are satisfied:

a) there are economic or other important reasons for the use of the intermediary company in view of the respective income; and

b) it is adequately equipped for carrying out its own business activities and for participation in general commerce.

Italy

Italy has the following provisions to counter entities used for abusive purposes:

- A 26% withholding tax is levied on interest paid by resident taxpayers to the foreign permanent establishment of another resident person. The withholding tax is final if the interest is then paid to a non-resident person through the foreign permanent establishment (i.e. conduit financing where the true lender is a non-resident person). The withholding is only an advance payment of the taxes due in

any other case (e.g. conduit financing where the true lender is another resident person).
- "non-operative entity" refers to non-resident entity that has less than 5 employees and turnover less than EUR 800 million.

Netherlands

The Netherlands has the following anti-abuse provisions related to the use of conduit entities:

EU Parent-Subsidiary Directive: With effect from 1 January 2016, the corporate income tax rules for non-residents and the dividend withholding tax rules for Dutch resident cooperatives are amended to implement EU Directive 2015/121 (which introduced a general anti-abuse rule into the EU Parent-Subsidiary Directive 2011/96). As a consequence, non-resident entities that hold a substantial shareholding (5% or more) in a Dutch resident company are subject to corporate income tax if the substantial interest is held with the main purpose of avoiding taxation and if an artificial structure is put in place (i.e. a structure that does not have sufficient substance). In addition, Dutch resident cooperatives are also obliged to withhold dividend withholding tax on dividends distributed to their members, if tax avoidance is one of the main purposes and an artificial structure is put in place.

Interest and Royalty Conduit Companies: The law contains a specific provision[168] regarding the transactions of interest and royalty conduit companies if the company does not economically bear the real risk of default of the loan, for example, the company has insufficient capital.

Obtaining an APA in the Netherlands: An intermediate financial service company must comply with the following substance requirements:

- at least half of the statutory board members with decision-making authority live or are resident in the Netherlands;
- the board members living or resident in the Netherlands possess the required professional expertise to properly perform their tasks;
- the taxpayer employs qualified staff;
- management decisions are taken in the Netherlands;
- the taxpayer's most important bank accounts are held in the Netherlands;
- the financial records are kept in the Netherlands;
- the taxpayer's registered office is located in the Netherlands;
- the taxpayer is not treated as a tax resident in and by another country;
- the taxpayer runs a real risk within the meaning of the law; and

[168] Article 8c of the NL Company Tax Law ('VpB')

- the amount of equity held by the taxpayer is at least appropriate for the required actual risk.

Whether or not the substance requirements are met depends on the facts and circumstances. If the taxpayer does not meet the minimum substance requirements, the tax authorities automatically exchange information with the relevant foreign tax authorities.

Intermediate financial services companies are explicitly required to indicate in their corporate income tax return whether the substance requirements were met or not and whether the company bears sufficient risk. If the intermediate financial services company did not comply with the substance requirements, it had to provide to the tax authorities the information necessary to assess whether the substance requirements are met. Furthermore, if the intermediate financial services company applied a tax treaty provision or a provision of the EU Interest and Royalties Directive (2003/49), and it does not meet the minimum substance requirements, the Netherlands also automatically exchanges information with the relevant foreign tax administration.

With effect from 1 April 2018, the following additional substance requirements are required to be met:

- the holding company incurred employment costs of at least EUR 100,000 in relation to its intermediary holding functions; and
- the holding company had (for at least 24 months) own office space at its disposal used for carrying out the intermediary holding functions.

With effect from 1 July 2019, Advance Tax Ruling can only be granted if the economic nexus criterion is met, among other requirements. Under the new regime, the rulings can only be granted if:

- the entity requesting the ruling is part of a group of companies that undertakes sufficient commercial operational activities in the Netherlands (i.e. has an economic nexus there); and
- the requesting entity carries on such operational activities for its own account and at its own risk, with sufficient personnel, at the level of the group, present in the Netherlands; and
- such activities are commensurate with the function of the entity within the group.

The substance requirements which now apply to an Advance Pricing Agreement no longer apply for obtaining an Advance Tax Ruling.

Poland

In Poland, in order to benefit from preferential withholding tax treatment, the Polish corporate income tax provisions requires withholding tax agents to prove that the recipient of a given cross border payment is a beneficial owner of this payment.

Since January 2019, the test of beneficial ownership includes a verification of whether a given entity expected to benefit from a preferential withholding tax treatment carries out “real economic activity” in its country of tax residence. This is done by taking into account certain criteria namely premises, sufficient local staff, broad business rationale

and local board members, among others, so as to check that the entity is not a non-genuine, or artificial, structure lacking economic rationale.

Spain

Spain has several provisions dealing with substance related to shell entities:

- Article 16 of the General Tax Law[169]: regulates simulation, stating that the taxable event taxed will be the one actually carried out.
- Article 18 of the Corporate Income Tax Law[170]: regulates transfer pricing and, according to the OECD Transfer Pricing Guidelines, allows taking into account functions, assets and risks to analyze the substance of an entity.
- Article 100 of the Corporate Income Tax Law[171]: regulates Controlled Foreign Companies ('CFC's'). Paragraph 2 mandates the application of the regime to entities lacking substance when certain requirements are met.
- Article 91(2) of the Income Tax on Individuals[172]: regulates CFC (Controlled Foreign Companies) for individuals with the same wording as provision 100.2 in CITL.

Sweden

A company is treated as a shell company if its liquid assets, i.e. cash and similar assets, at the moment the company is sold, exceed 50% of the consideration received for the shares in that company (chapter 25, section 9(2) of the IL). The disposal of a shell company or the repurchase of the assets of a shell company may give rise to capital gains taxation under certain conditions. Exemption may be granted if a special shell company tax return is submitted.

[169] Article 16 of Ley 58/2003, de 17 de diciembre, General Tributaria
[170] Article 18 of Ley 27/2014, de 27 de noviembre, del Impuesto sobre Sociedades
[171] Article 100 of Ley 27/2014, de 27 de noviembre, del Impuesto sobre Sociedades
[172] Article 91 of Ley 35/2006, de 28 de noviembre, del Impuesto sobre la Renta de las Personas Físicas

ANNEX 6: THIRD COUNTRY MEASURES

1. Context

Substance requirements of general nature, i.e. not in relation to specific preferential tax regimes, for tax purposes do not apply in EU Member States at the current stage. However, since 2019, they apply in third country jurisdictions with no or only nominal corporate taxation, namely Anguilla, Bahamas, Bahrain, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Jersey, Isle of Man, Marshall Islands, Turks and Caicos Island and the United Arab Emirates. The above jurisdictions have been requested to introduce substance requirements in the context of the EU list of non-cooperative jurisdictions (EU list) as a safeguard, to ensure that such feature does not function to facilitate base erosion and profit shifting (BEPS) from high tax jurisdictions.

Substance requirements for third countries have been defined by the Code of Conduct Group (Business Taxation) in the scoping paper on criterion 2.2 of the EU listing exercise (Scoping Paper)[173]. The EU criterion has also provided the basis for the subsequent international standard endorsed by the Forum on Harmful Tax Practices (FHTP)[174]. All aforementioned third countries have introduced legislation reflecting the requirements set in the scoping paper and have therefore been considered compliant with the requirements of the EU list.

2. Summary of the requirements

The scoping paper requires the introduction of substance requirements for undertakings established in no or nominal tax jurisdiction that are engaged in specific business activities, which generate geographically mobile income. Such activities include banking, insurance, fund management, financing, leasing, headquarters, shipping and exploitation of intellectual property.

Relevant undertakings must report on whether or not they meet a set of requirements on an annual basis. Specifically, they must demonstrate that they undertake in the jurisdiction core income generating activities justifying the income that accrued to them in the relevant tax year. In this regard, they must demonstrate that they have in the specific jurisdiction adequate premises, adequate qualified employees and adequate expenditure to perform such activities. For any part of the core income generating activities that is outsourced, the undertakings must demonstrate that the service provider is performing the activities in the jurisdiction under the undertaking's supervision. In

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[173] Code of Conduct (Business Taxation) − Scoping paper on criterion 2.2 of the EU listing exercise9637/18 FISC 241 ECOFIN 555

[174] Inclusive Framework on BEPS: Action 5, Resumption of Application of Substantial Activities Factor to No or only Nominal Tax Jurisdictions (https://www.oecd.org/tax/beps/resumption-of-application-of-substantial-activities-factor.pdf)

addition, they must demonstrate that the relevant activities are actually directed and managed in the jurisdiction through strategic decisions taken there.

A distinction is made for intellectual property activities, where, under specific circumstances, a higher BEPS risk can be identified. This is the case in particular if the undertaking has not been involved in the development of the asset and is exploiting it through associated enterprises. In such scenarios, undertakings are presumed not to meet substance requirements and must provide detailed evidence on their business plans, their staff and decision-making processes to rebut such presumption.

A distinction is also made for purely equity holding undertakings, which only hold equity participations and only earn dividends, as well as for collective investment funds (CIVs). First, pure equity holdings have been considered to require a very low level of income generating activity and to raise a lower BEPS risk. As a result, such undertakings must only evidence compliance with corporate law requirements as well as that they dispose the premises and people necessary to hold and manage the equity. Second, CIVs are pools of money and as a result cannot be directly subject to substance requirements. Instead, the Code of Conduct Group developed an indirect approach focusing on whether the legislative and administrative framework of the jurisdiction can be considered robust enough to justify the location of a significant CIVs business sector.

In terms of procedure, the assessment of relevant undertakings' reporting lies, in principle, with the administration of the third country jurisdiction. However, the margin of discretion is limited in two ways. First, there is a stringent requirement for spontaneous exchange of information with the jurisdictions of residence of shareholders and beneficial owners. Second, third country jurisdictions are monitored on an annual basis on how they implement in practice the substance legislation. In this context, they must provide specific information on the data they have received from undertakings and their enforcement action, to be assessed by the Code of Conduct Group in coordination with the Forum on Harmful Tax Practices.

ANNEX 7: THE OPENLUX INVESTIGATION, SOME KEY FINDINGS

OpenLux is the name of a large media investigation led by a consortium of journalists, the Organized Crime and Corruption Reporting Project (OCCRP) associating 17 international medias – including Süddeutsche Zeitung, Le Soir, Le Monde and Woxx.

Unlike the "Panama Papers" or "LuxLeaks", OpenLux did not stem from a leak of private documents. This new type of reporting is based solely on the collection of public data gradually put in online accessible registers by Luxembourg.

After one year of investigations, approx. 3,3 million documents have been obtained from the two national registries (RCS and RBE) of Luxembourg, including 627 000 accounting documents, covering 260 000 companies (half of which no longer exist) over the period 2010-2020.

OpenLux sheds light on shell companies located in Luxembourg. Among other findings, OpenLux revealed that:

- 45% of the 140 000 companies currently registered in Luxembourg are pure holding companies with no other activity; they own 6,5 trillion EUR of assets, representing 85% of all the assets owned by companies in the country;
- 87% of businesses are owned by non-Luxembourgers (offshore);
- many of the companies do not have any employees or any physical office space at their registered address in Luxembourg;
- more than 25 000 firms are listed in just 40 addresses, while a total of 1 804 companies are registered to the same address.

Another key finding relates to transparency and availability of Beneficial Ownership (BO) information. OpenLux has shown that Luxembourg had not ensured availability of accurate and up-to-date information of beneficial owners of all of these companies.

Following the OpenLux revelations, Luxembourg rejected the claims made by investigative journalists. The government issued a statement pointing out, among others, that: "Luxembourg provides no favourable tax regime for multinational firms, nor digital companies, which have to abide by the same rules and legislation as any other company in Luxembourg." Moreover, the statement said that: "Luxembourg is fully compliant with and has implemented all applicable EU and international rules and standards with regards to tax transparency, the fight against tax abuse as well as AML – and even gone beyond these requirements".[175]

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[175] The statement by Luxembourg is online at: https://gouvernement.lu/en/actualites/toutes_actualites/communiques/2021/02-fevrier/08-declaration-openlux.html

ANNEX 8: HOW DO THE OPTIONS COMPARE? AN OVERVIEW TABLE

Options are compared against the following criteria:

1. Effectiveness in reducing the misuse of shell entities for tax purposes
2. Tax gains for public finances
3. Compliance costs:
    a. Cost of implementation for businesses
    b. Enforcement costs for tax authorities
4. Indirect benefits:
    a. Effect on the Single Market
    b. Effect on firm competition
    c. Effect on EU competitiveness
    d. Social impact
5. Coherence with other anti-tax avoidance and evasion initiatives

The symbol '0' represents no change compared to the baseline, the '+' symbol points to a better performance of the option compared to the baseline, and '++++' indicates the best performing among the options, whereas '-'indicates an additional cost and '----'the highest level of costs.

Table 12 Comparison of options

	Effectiveness in reducing the misuse of shell entities	Tax gains for public finances	Compliance costs		Indirect effects				Coherence
			Costs for businesses	Costs for tax administrations	On the Single Market	On competition among firms	On EU competitiveness	Social impacts	
(0) Baseline scenario – no action	0	0	0	0	0	0	0	0	0
(1) Soft law	0/+	0/+	0/-	0/-	0/-	0/+	0	-/+	0

(2) Common substance requirements	++	+	--	--	++	+	0/-	+	++
(3) Common substance requirements with AEOI	++++	+++	--	---	+++	++	-	++	++++
(4) Common substance requirements with AEOI and sanctions	+++++	++++	--	----	+++	+++	-	++	+++++

ANNEX 9: ADDITIONAL INFORMATION ON THE NECESSITY OF EU ACTION

It is basic principle of public policy intervention to steer away from introducing unnecessary measures. When putting forward a new initiative to tackle tax avoidance and tax evasion, an area where the Commission (as well as Member States) has been particularly active during the past decade, it is relevant to ask the question: why are existing measures not sufficient to tackle the problem? An answer to this question is provided in the main part of this impact assessment, in particular when the necessity of EU action is described in section 3. With this annex, the intention is to provide more details on the arguments supporting the case for intervention.

As mentioned in section 3, both jurisprudence by the European Court of Justice and current practice by the EU Code of Conduct Group are of relevance for this initiative, meant to tackle the use of shell entities for tax avoidance or tax evasion. Why are these measures deemed not enough to tackle the problem?

The Court has developed the notion of "wholly artificial arrangement" in order to evaluate if national anti-tax avoidance measures constitute a proportionate, and therefore legitimate, restriction to the fundamental freedoms. A wholly artificial arrangement is defined as an arrangement that "does not reflect economic reality", where there are "objective factors ascertainable by third parties with regard (…) to the extent to which (a company) exists in terms of premises, staff and equipment". The absence of actual economic activity must, in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has. [176]

The jurisprudence provides key guidance on how to construe substance requirements in the tax area but they do not exclude fragmentation in the internal market. On the one hand, jurisprudence has been developed on a case by case basis, allowing thus a significant margin of appreciation, where the circumstances differ. In addition, the substance test is construed within a limited framework, i.e. what can be proportionate and therefore, legitimate justification of a discriminatory treatment of a specific taxpayer in relation to specific domestic tax provision. This cannot be used as a self-standing rule of general application. As put by a Member State: "In order to fight harmful tax practices efficiently a certain degree of generality is needed."

[176] C-196/04 Cadburry Schweppes plc, and Cadburry Schweppes Overseas Ltd v. Commissioners of Inland Revenue [2006] ECHR I-7995, C-201/05 The Test Claimants in the CFC and Divided Group Litigation v Commissioners of Inland Revenue [2008] ECR I-2875.

Let's now turn to the Code of Conduct. According to the Group's guidance[177], a substantial economic presence should be assessed considering whether there is "an adequate number of employees with necessary qualifications and an adequate amount of operating expenditure with regard to the core income generating activities" of the entity. The character of the premises necessary for the specific activity should also be considered. However, the Code of Conduct criteria have a limited scope of application in the EU in relation to specific tax regimes. Equally, the instrument (as does the application of case-law) do not ensure timely identification of the cases of lack of substance and prompt communication of the information to all Member States that may be affected.

Overall, case law and implementation of the Code of Conduct do not appear sufficient to tackle the problem of the use of shell entities for tax avoidance or tax evasion. The same can be argued for existing EU measures in the area of administrative cooperation of against tax avoidance.

Namely, administrative cooperation through the DAC can only be of limited assistance in the absence of a common definition of what should be regarded as a shell entity or arrangement for tax purposes. The DAC allows Member States to exchange information spontaneously if they identify situations that can entail risk for the tax base of other Member States or automatically in pre-defined cases. At this stage there is no agreement to exchange information on shell entities and therefore automatic exchanges are precluded. While spontaneous exchange could take place, this would be ex post, i.e. after a tax audit, and subject to the discretion of the tax authorities.

Under ATAD, Member States can avail of the General anti avoidance rule (GAAR) in order to deny tax advantages obtained through abusive practices, including the use of shell entities. Yet, the GAAR should not be considered as a rule of primary application but rather as residual. It applies only in the absence of a specific anti-tax avoidance rule and aims to tackle abusive schemes that were not identified as yet, i.e. when the GAAR was construed. Once the legislator knows of a scheme that leads to tax avoidance and evasion, it is expected that the legislator acts to curb such scheme via targeted legislation and does not rely on the GAAR.

Finally, it is relevant to ask also whether existing instruments at an international level may be enough to tackle the problem. The OECD Base Erosion and Profit Shifting (BEPS) project has introduced substance criteria in the case of BEPS Actions 5 and 6. BEPS Action 5 seeks to ensure that Member States have significant economic activities linked to preferential tax regimes and their incentives, and substantial activities requirements for no or only nominal tax jurisdictions and provide guidance on the application of the requirement. BEPS Action 6 on Treaty Shopping seeks to prevent the

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[177] Code of Conduct (Business taxation), Guidance on the interpretation of the third criterion, 10419/18, Brussels 22 June 2018.

abuse of double taxation conventions by interposed shell entities including, for example, limitation-on-benefits rules or a principle purposes test (PPT). BEPS Actions 8-10 aim to align transfer pricing guidelines with value creation (intangibles) and risk allocation, including the use of DEMPE[178], to ensure that value creation is linked to substance requirements. Locating the intellectual property rights linked to intangibles in low tax jurisdictions while the value creation took place elsewhere is considered a major tax avoidance vehicle.

While these measures have been widely adopted and are considered essential tools in combatting abuse by shell entities, they do not contain specific objective criteria for determining whether an entity is missing substance. In addition, the OECD BEPS project addresses a series of recommendations to its members but these are not legally binding instruments and as such, the rules are not enforceable.

[178] Allocation of returns on intangibles depend on the functions, assets and risks related to the development, enhancement, maintenance, protection and exploitation of intangibles (DEMPE).

ANNEX 10: ADDITIONAL INFORMATION ON HANDLING OF PERSONAL DATA UNDER THE PREFERRED OPTION

This annex is meant to provide additional information on the processing of personal data under the preferred option. It shall clarify how the flow of information will function, which categories of personal data will be processed and why, how the information will be exchanged from an operational/technical perspective and, finally, to provide clarity concerning roles of the parties involved (data controllers and data processors).

This annex complements and expands section 5.2.3.3 Information exchange and personal data.

Overview of the preferred option

As explained in Chapter 8, the preferred option is a regulatory intervention, a Directive, which includes: common substance requirements that lead to the application of common tax consequences to entities that qualify as 'shell', automatic exchange of information provisions and a common sanctioning framework.

Automatic exchange of information: an amendment to the DAC

Automatic exchange of information (AEOI) will build upon the existing provisions of the Directive on Administrative Cooperation (DAC).[179] In practice, it means that the preferred option will include provisions to amend the DAC to introduce the mechanism for AEOI needed for the intervention to function effectively. The new AEOI mechanism introduced following the implementation of the preferred option will have to fully comply with the GDPR.

A closer look at the flows of information

In more details, under the preferred option, there would be two basic flows of information: a business to government flow, with a transmission of information from entities (referred to as "reporting entities") to the tax administration where they are resident for tax purposes; a government to government flow, with a transmission of information between tax administrations. This second flow will take the form of what is technically defined as an automatic exchange of information: the systematic communication of predefined information to another Member State, without prior request, at pre-established regular intervals.[180]

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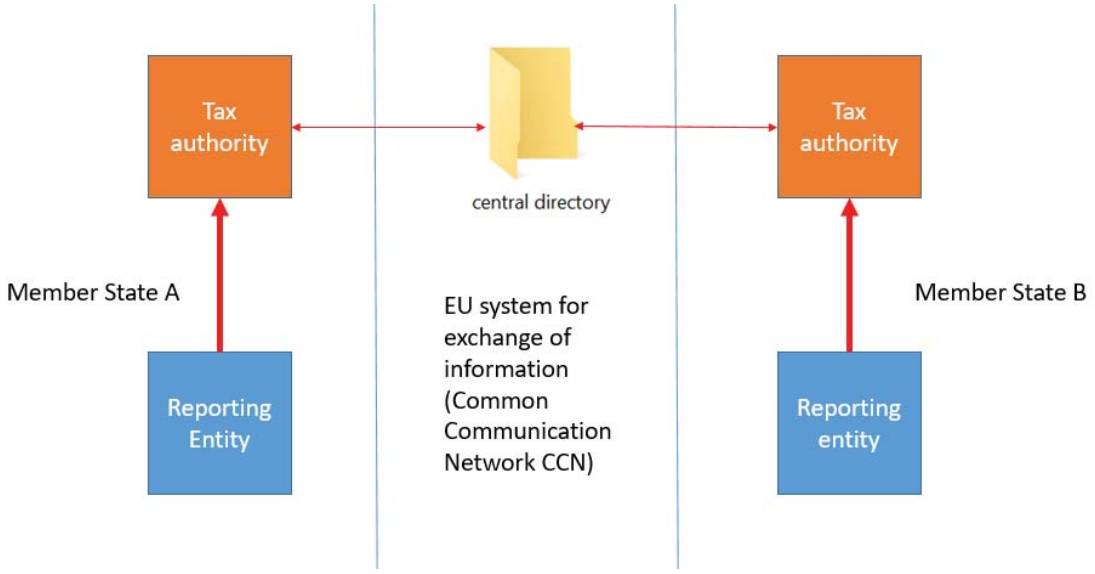
[179] Directive 2011/16/EU on Administrative Cooperation in Direct Taxation (DAC).
[180] DAC, article 3(9)a.



The picture is meant to illustrate the flows of information. The example shows only two fictional Member States but the same approach applies in all cases: a reporting entity provides information to the tax authority where the entity is resident for tax purposes. This is shown with a thick red arrow directed from the entity to the tax authority. This is a business to government flow of information which should comply with the GDPR. Then, there is a government to government flow of information, the AEOI between tax authorities. This is shown in the upper half of the picture. The arrows are not as thick as in the case of the previous flow. This shows that the amount of information to be automatically exchanged will be less than the information that tax authorities receive from reporting entity. In line with the principle of data minimisation and to ensure the efficiency of the system, only the most relevant information will be subject to automatic exchange of information. The information needs of tax administrations where entities are resident for tax purposes are different than those of other tax administrations potentially affected. This data flow shall also comply with the GDPR.

The central directory is a secure database where Member States can upload information. Once a Member State uploads information on the central directory, all other Member States can read this information. In practice, it works like a common, shared folder in a computer network. The computer network behind the central directory is called Common Communication Network (CCN), the secure network used by tax and customs authorities to exchange information.

Personal data concerned by the information exchange and rationale for their processing

The information exchange will be mainly about data and information concerning legal persons, i.e. the reporting entities. Personal data of natural persons that may be exchanged is the following:

- the identification of the entity's shareholder(s) and the beneficial owner(s)
- the identification of any person in the other Member States likely to be affected by the reporting of the entity

In practice, personal data exchanged will consist of names, surnames and dates of birth natural persons, assuming natural persons (and not legal entities) are the shareholder(s) and/or beneficial owner(s) of the reporting entity to ensure that data exchanged can be used for ensuring compliance with the intervention and for tax verification.

The requirement to exchange this personal data is due to the cross-border structures used for tax abuse purposes, in particular tax evasion. There is evidence of the use of complex cross-border structures to hide the identity of the beneficial owner of certain entities.[181] Such structures use techniques like layering or chaining to obscure the identity of the beneficial owner of an asset or funds. Layering or chaining involves interposing shell entities in multiple jurisdictions between the individual beneficial owners and the entity that holds legal title to certain assets or funds.[182]

Information on the legal and beneficial owners would ensure that the relevant Member State could ensure that its own tax laws can be enforced in relation to their own tax residents. Furthermore, Member States other than the Member State of residence should also be aware of the legal and beneficial owners of such entities.

The identification of any person in another Member States likely to be affected by the reporting of the entity relates to natural persons who would be considered as having the same role as an associated company of the entity. For example, when the natural person is not the legal or beneficial owner of the entity but has significant financial transactions with it, based on criteria laid down in tis Directive, then such information may be relevant to another Member State in calculating the tax liability of this natural person.

Technical means for automatic exchange of information

This information to be exchanged will be recorded by Member States in a Central Directory (CD). All Member States will be able to "read and write" on the CD. They will upload and retrieve information.

The CD will be developed and operated by the Commission. Information will be exchanged via the EU Common Communication Network (CCN), the secure IT network used by tax and customs administrations. The CD is hosted in the Commission Data Centre.

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[181] Commission study on Monitoring the amount of wealth hidden by individuals in international financial centres and the impact of recent internationally (Ecorys); ICF Consulting Services Ltd (2021), Commission Study on Letterbox Companies; Furthermore, data leaks including the recent Pandora leaks has confirmed the use of such complex structures for possible tax abuse purposes.

[182] Marquette Law Review: How Shell Entities and Lack of Ownership Transparency Facilitate Tax Evasion and Modern Policy Responses to These Problem.

The CD is already in used today for automatic exchange of information of tax rulings and of cross-border tax arrangements. Under the preferred option, the CD will be developed further, “expanded” to use a generic term, to be able to process the additional data to be exchanged under the intervention.

Data controllership

As with other systems for exchange of information based on the Directive on Administrative Cooperation (DAC), Member States will decide on the purpose and essential elements of the processing operation. The will keep control of the processing operation.

As assessed for all other DAC related information systems, the competent authorities of each Member State will be considered to be the data controllers for the purposes of the GDPR. Member States will maintain and keep the data up-to-date.

In line with what happens for all other DAC related information systems, the Commission will be a data processor. Member States decided that only their national competent authorities can have access to the system. The Commission will not have access to personal data. Its role will be limited to facilitate data processing. The Commission will support Member States by developing and operating the central directory for the automatic exchange of information. In other words, the Commission will ensure that information “flows” as expected.

Information processed will be retained in the CD and in Member States’ databases for 5 years and in any case for no longer than necessary to achieve the purposes of the intervention.