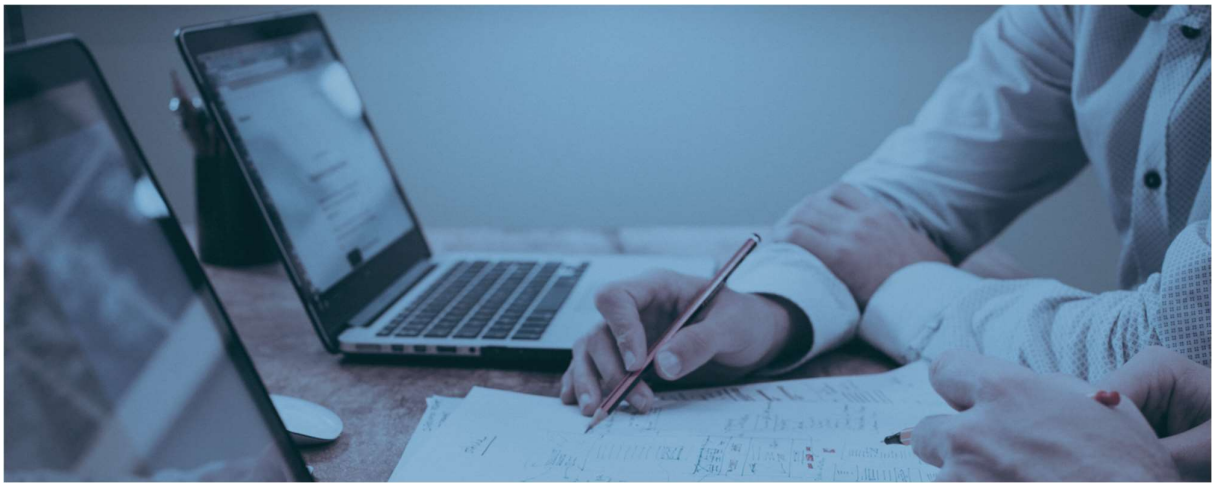
ATAD III: Preventing the use of EU-related shell companies



ATAD III – EU Unshell Initiative

On December 22, 2021, the EU Commission published a proposal for a directive to prevent the abusive use of shell companies for tax purposes. The aim of the proposed directive is to make shell companies that are perceived as harmful unattractive by introducing reporting requirements and tax disadvantages. The directive is to be introduced for shell companies domiciled within the EU. The planned entry into force of the directive is currently January 1, 2024, although a delay is likely as the EU member states have not yet approved the directive. In addition, a separate directive for shell companies domiciled outside the EU is also to be drafted.

Qualification as a shell company

Carve-outs

Companies listed on the stock exchange, regulated financial institutions, companies domiciled in the country of their parent company and companies with sufficient employees (at least 5 FTE) are exempt from the scope of the new directive.

Gateways

A company is considered a shell company if it generates cross-border mobile income and relies on external service providers for its own administration. Specifically, the cumulative fulfillment of the following three gateway criteria is examined:

1) *Revenues*

More than 75% of the income generated in the last two tax periods qualifies as relevant income. This is passive income such as interest, royalties, dividends, capital gains on shares, income from immovable assets or from crypto-assets.

This gateway test is also considered met if more than 75% of the assets consist of real estate or non-business assets such as art, yachts or private jets.

2) *Cross-border*

The cross-border criterion is considered to be met if at least 60% of the income is derived from cross-border transactions or if over 60% of the company's assets are located in another country.

3) *Outsourcing*

The criterion of outsourcing is considered to be met if the management of the day-to-day business and the decision-making in essential functions were outsourced to third parties in the past two tax periods.

Consequences for the shell company

1) *Reporting obligation*

In a first step, a shell company is subject to extensive reporting obligations. For example, the company must provide detailed information and evidence on substance indicators (own office premises, active bank account in an EU country, management staff residing near the company's registered office with appropriate qualifications and actual decision-making power, details on business activities and economic reasons for the structure). As an alternative to the substance indicators, the company can also prove that the chosen structure does not create a tax advantage.

Based on the documents provided, the competent tax authority decides whether a harmful shell company exists or not. If the structure is found not to be harmful, an exemption from the reporting obligation can be granted for up to 5 years.

2) *Tax consequences of a qualification as a harmful shell company*

The country of residence refuses to issue residence certificates (DTAs or EU directives) or issues them with a warning so that no treaty benefits can be obtained.

Tax advantages obtained, such as withholding tax refunds, are revoked or not granted to the company.

The EU-country in which the assets of the company are located taxes these assets as if they were held directly by the shareholders. In the country of residence of the shareholder of shell company, the shareholder is taxed (according to national law) as if he had earned the income of the company himself. This can result in significant double taxation. If the shareholder is not a resident of an EU member state, local withholding tax law applies in the member state of the source of income.

Information on shell companies is automatically exchanged with all EU member states.

Implications for companies with a nexus to the EU

Low-substance holding companies domiciled in the EU or acting as shareholders of EU subsidiaries should be avoided or replaced as part of a restructuring. Since the last two years are taken into account for the examination of the required substance, this restructuring should be implemented before the new directive comes into force.

For the asset management industry, it is recommended to structure investments in the EU area through regulated vehicles (such as UCITS and AIFs), if possible.

For real estate investments in the EU area, it is recommended to consider local country companies as investment vehicles.

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