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ATAD 3: EUROPEAN COMMISSION'S PROPOSAL TARGETING SHELL COMPANIES

INTRODUCTION

On 22 December 2021, the European Commission unveiled a Directive proposal aiming at promoting an efficient and fair business tax system for the European Union.

Following the anti-tax avoidance directive ("ATAD") and the directive on administrative cooperation ("DAC"), the European Commission is willing to propose a new directive to directly target legal entities with no minimal substance and economic activity. The results of such structures are to lower the taxpayer's global tax liability.

This proposed new directive also known as "ATAD 3" comes to reinforce the Base Erosion and Profit Shifting ("BEPS") initiative and bring more coherent EU approach against tax evasion and avoidance.

THE PROPOSAL

ATAD 3 will mainly target and capture all companies and structures that can be considered as resident of a Member State for tax purposes but, in reality, do not perform any economic activities. Their presence is only justified to allow certain tax advantages to their beneficial owner or to the group to which they belong. An example is provided in the Directive proposal in which: a financial holding may be set up to collect all payments from financial activities of other group companies in different EU Member States, taking advantage of the exemptions from withholding taxes of the Interest & Royalty Directive and then transfer this income to associated enterprise(s) in low tax third country jurisdictions with the aim of exploiting favourable tax treaties. ATAD 3 will, therefore, help Member States to identify companies that are effectively tax residents, engaged in economic activities but do not have substance or at least minimum substance in the country by applying a certain test. This test will be referred to as "substance test".

Companies failing to succeed in this "substance test" will be considered to have no substance in the country and will be deemed to "shell companies". However, the company will be granted the possibility to claim a rebuttal of a presumption of shell. The company will then have to produce concrete evidence of the performed activities and how.

The approach: the seven-step process

A seven-step process will have to be followed in order to determine whether or not a company has a minimal substance in a Member State:

- Step 1 – Qualifying entities: A clear split is made between companies with a high risk and low risk of lacking substance. High risk companies present a number of features usually identified as common for these kinds of companies. Three criteria (the so-called gateways) must be cumulatively met. For instance, at least 60% of the company's relevant income is earned or paid out via cross-border transactions, and in the preceding two tax years, the company outsourced the administration of day-to-day operations and the decision-making on significant functions.
- Step 2 - Reporting on substance: In this step, companies at risk will be requested to report specific information in their tax return.
- Step 3 – Minimum substance requirements: If the company provides sufficient and relevant elements of substance, it should be presumed not to be a "shell company". However, there is still a possibility for the tax administration to challenge these elements and consider the company as a "shell company", if for instance, the company is not the beneficial owner of any stream of income paid to it.
- Step 4 – Rebuttal rule: This step contains a right for the company considered as a "shell company" to prove that it has substance or that it is not misused for tax purposes. Evidence will have to produce information on commercial reasons or reasons for setting-up the company in this Member State. The Directive gives the possibility of extension of the validity of the "rebuttal" for a period of 5 years (6 years in total).
- Step 5 – Exemption of lack of tax motives: This step allows the company to request for an exemption of the reporting obligation under ATAD 3 if it can prove that the structure itself has been set up not for tax advantages (for itself or for the group) but for genuine business activities and commercial reasons. The company will have to produce elements allowing to compare the tax liability of the structure or the group to which it is part with and without its interposition. If the tax authorities are satisfied with these elements, an extension of the validity of the exemption for 5 years is possible (6 years in total). Of course, the legal and factual circumstances must not change over time.
- Step 6 – Tax consequences: If the company is considered as lacking substance and hence a "shell company", tax consequences must occur. The tax impact must be neutralised, cancelling tax advantages which have been obtained. Moreover, a Member State is permitted to not issue for a company, a tax residence certificate at all. However, this does not keep back all national rules of the member State regarding any tax obligations.
- Step 7 – Information exchange: Information regarding "shell companies" will be available for all Member States, at any time and without any need of request for information, through a Central Directory. This information will be available within 30 days from the time the information has been collected. Tax audits will also be possibly requested by other Member States to the Member States of the company if there's any suspicion of lacking substance.

PENALTIES

As soon as this reporting obligation (as stated above in Step 2) is transposed into the national legislation, penalties will be applied and will be set down by the Member States against the violation of this reporting obligations. As recommended by the European Commission, the penalties shall be effective, proportionate, and dissuasive. Moreover, an administrative pecuniary sanction of at least 5% of the turnover should be included in the financial penalty.

IMPLEMENTATION PLANS

It is aimed to first adopt this proposal as a Directive, and therefore transpose it into Member States' national law by 30 June 2023. This will come into effect as of 1st January 2024.

FURTHER ACTION NECESSARY?

It is clear that the draft Directive is an important change in the landscape of international taxation. Certain structures which were common in the past, do probably not meet in certain circumstances the requirements as included in the draft Directive. Additional taxation will be possible in that case. RSM Belgium can assist you in analysing the impact of the new rules for your companies.

If you have any questions regarding this topic, don't hesitate to contact our RSM Belgium | Tax team (tax@rsmbelgium.be).

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