Taxation: rules to prevent the misuse of shell entities for tax purposes

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The Committee on Economic and Monetary Affair adopted, under the consultation procedure, the report by Lídia PEREIRA (EPP, PT) on the proposal for a Council directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU.

Members recalled that the Pandora Papers' revelations reported on the creation of shell companies with the purpose of moving money between bank accounts, avoiding taxes and committing financial crimes, including money laundering, and circumventing Union sanctions on Russian oligarchs. They consider it essential that the directive sets **ambitious and proportionate standards** for defining common minimum substance requirements, for improving the exchange of information between national tax administrations and for deterring the use of shell companies promoted by certain intermediaries.

The committee responsible recommends that the European Parliament approve the Commission proposal subject to the following amendments:

Identification of companies that do not meet minimum substance indicators

According to Members, Member States should require undertakings meeting the following cumulative criteria to report to the competent authorities of Member States:

- more than **65%** (instead of 75%) of the revenues accruing to the undertaking in the preceding two tax years is relevant income of the company's revenue in the previous two tax years is relevant income;

- the undertaking is engaged in cross-border activity on any of the following grounds: (i) more than **55%** (instead of 60%) of the book value of the undertaking's assets that fall within the scope of Article 4, points (e) and (f), was located outside the Member State of the undertaking in the preceding two tax years; (ii) more than 55% (instead of 60%) of the undertaking's relevant income is earned or paid out via cross-border transactions;

- in the preceding two tax years, the undertaking outsourced the administration of day-to-day operations and the decision-making on significant functions to a **third** party.

Members deleted the derogation for undertakings with at least five own full-time equivalent employees or members of staff exclusively carrying out the activities generating the relevant income.

Indicators of minimum substance for tax purposes

Member States should require that undertakings meeting the criteria declare in their annual tax return, for each tax year, whether they meet the following indicators of minimum substance:

- the undertaking has own premises in the Member State, premises for its exclusive use or premises shared with entities of the same group;

- the undertaking has at least one own and active bank account or e-money account in the Union through which the relevant income is received;

- one or more directors of the undertaking are qualified and authorised to take decisions in relation to the activities that generate relevant income for the undertaking or in relation to the undertaking's assets;

- the majority of the full-time equivalent employees of the undertaking have their habitual residence as set out in Regulation (EC) No 593/2008 in the Member State of the undertaking, or are at no greater distance from that Member States insofar as such distance is compatible with the proper performance of their duties.

Undertakings should accompany their tax return declaration with documentary evidence including:

- an overview of the structure of the undertaking and associated enterprises and any significant outsourcing arrangements, including the rationale behind the structure, described in the context of a standardised format;

- a summary report of the documentary evidence submitted under this paragraph, containing in particular: (i) a brief description of the nature of the activities of the undertaking; (ii) the number of employees on a full-time equivalent basis; (iii) the amount of profit or loss before and after taxes.

Rebuttal of the presumption

Member States should take measures to enable undertakings that are presumed not to have minimum substance to rebut this presumption, without undue delay and excessive administrative costs, by providing any **additional supporting evidence** of the business activities which they perform to generate relevant income.

To this end, undertakings should provide the following additional evidence: (i) a document allowing to ascertain the business rationale behind the establishment of the undertaking in the Member State where the activity is performed; (ii) information on the profiles of full-time, part-time and freelance employees while ensuring high levels of data protection and privacy.

The Member State should consider a request for the rebuttal of the presumption within a period of **nine months** after the introduction of the request and it should be considered to be accepted in the absence of an answer from the Member State after the expiry of that nine-month period.

Tax consequences of not having minimum substance

Where an undertaking does not have minimum substance for tax purposes in the Member State where it is resident for tax purposes, that Member State should **deny any request for a certificate of tax residence** to the undertaking for use outside the jurisdiction of that Member State.

When denying a request for such certificate, the Member State should issue an **official statement** duly justifying such decision and prescribing that the undertaking is not entitled to the benefits of agreements and conventions that provide for the elimination of double taxation of income, and, where applicable, capital, or of international agreements with a similar purpose or effect.

Penalties

Penalties should include (i) an administrative pecuniary sanction of at least **2%** of the undertaking's revenue in the relevant tax year, if the undertaking that is required to report does not comply with such requirement for a tax year within the prescribed deadline and an administrative pecuniary sanction of at least **4%** of the undertaking's revenue if the undertaking that is required to report makes a false declaration in the tax return.

Review

No later than five years after the date of transposition of the Directive, the Commission should present a report on the implementation and operation of the Directive. Where appropriate, the report would be accompanied by a review with a view to increasing the effectiveness of the Directive and a legislative proposal to amend the Directive.

The report should assess:

- the impact of this Directive on tax revenues in Member States, on tax administration's capacities and in particular, whether there is a need to amend this Directive;

- whether it would be appropriate to add a substance indicator based on pre-tax profit per employee and to extend the obligation to report on indicators of minimum substance for tax purposes set out in that Article to regulated financial undertakings and, if necessary, review the exemption granted to them.