

## INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

<b>TITLE OF THE INITIATIVE</b>	<b>Fighting the use of shell entities and arrangements for tax purposes</b>
<b>LEAD DG (RESPONSIBLE UNIT)</b>	DG TAXUD. Responsible Unit: D2.
<b>LIKELY TYPE OF INITIATIVE</b>	<b>Council Directive</b>
<b>INDICATIVE PLANNING</b>	<b>Q4 2021</b>
<b>ADDITIONAL INFORMATION</b>	-

**The Inception Impact Assessment is provided for information purposes only. It does not prejudice the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception impact assessment, including its timing, are subject to change.**

### A. Context, Problem definition and Subsidiarity Check

#### Context

Several actions taken by the EU over recent years have provided new powerful instruments to tax administrations to tackle the use of abusive (often purely artificial) and aggressive tax structures by taxpayers operating cross-border to reduce their tax liability. However, even after these important developments, legal entities with no or only minimal substance, performing no or very little economic activity continue to pose a risk of being used in aggressive tax planning structures<sup>1</sup>. Such risks of misuse expand to legal arrangements. This is possible because, while substance of legal entities is addressed by the Code of Conduct Group on Business Taxation within the context of specific preferential tax regimes, there are no EU legislative measures which define substance requirements for tax purposes to be met by entities within the EU. Recent investigations conducted by a consortium of journalists<sup>2</sup> brought the issue again to the attention of the general public with a more pressing request to act at EU level to end this practice.

#### Problem the initiative aims to tackle

The issue at stake is the use of legal entities with no or minimum substance and no real economic activities, by taxpayers operating cross-border to reduce their tax liability.

While entities with no substance and no real economic activities can be used for different abusive purposes (including for criminal ones, e.g. money laundering, terrorist financing, etc.), this initiative would focus on situations where the ultimate objective is to minimise the overall taxation of a group or of a given structure.

The European Commission has received several complaints and requests for action from the European Parliament, from citizens, NGOs, journalists and the civil society in general.

<sup>1</sup> "Aggressive Tax Planning" is 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. Aggressive tax planning can take a multitude of forms. 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 exempt in the State of residence)."

<sup>2</sup> [https://www.lemonde.fr/les-decodeurs/article/2021/02/08/openlux-the-secrets-of-luxembourg-a-tax-haven-at-the-heart-of-europe\\_6069140\\_4355770.html](https://www.lemonde.fr/les-decodeurs/article/2021/02/08/openlux-the-secrets-of-luxembourg-a-tax-haven-at-the-heart-of-europe_6069140_4355770.html)

While the EU legal framework already provides for tools to fight tax avoidance and aggressive tax planning, there is a clear request to make sure that, within the EU, there is targeted scrutiny and action towards situations which involve the lack of substance of legal entities and arrangements. In this respect, the new criteria and processes developed in the context of the EU list of non-cooperative tax jurisdictions to measure the substantial presence and the performance of real economic activity in jurisdictions with no or very low corporate taxes could serve as a useful point of reference as they have proven to be effective in stepping up the fight against the use of shell entities and arrangements in third countries.

#### **Basis for EU intervention (legal basis and subsidiarity check)**

The legal basis for this initiative would be Article 115 of the Treaty on the Functioning of the European Union (TFEU) on the approximation of laws of the Member States, which directly affect the establishment or functioning of the internal market.

While general principles regarding substance requirements for tax purposes were established by the Court of Justice of the European Union<sup>3</sup> and by the Organisation for Economic Co-operation and Development (OECD) through the Base Erosion and Profit Shifting (BEPS) initiative (e.g. in the context of the work of the Forum on Harmful Tax Practices)<sup>4</sup> and while substance for legal entities is addressed in the context of preferential tax regimes under the Code of Conduct on Business Taxation, there are no EU legislative measures which define tax related substance requirements that can be enforceable at EU level. An action at EU level would ensure consistency across Member States on the definition of such substance requirements for tax purposes as well as on the countermeasures to be applied, thereby allowing tackling the issues at stake in a more efficient manner and minimising the risk of unfair tax competition amongst companies in different Member States<sup>5</sup>.

#### **B. Objectives and Policy options**

The **overall objectives** of this initiative are:

- 1) to preserve the integrity of the internal market by defining common tax related substance requirements to be met by legal entities and arrangements operating in the EU;
- 2) to combat tax abuse and aggressive tax planning<sup>6</sup> more effectively by equipping tax administrations with new targeted instruments to prevent, identify and penalise abusive practice of shell entities;
- 3) to preserve fair competition in the internal market by denying tax benefits to legal entities and arrangements which do not meet the tax related substance requirements. The denial of all tax benefits obtained by or thanks to the use of a shell entity will make their establishment and use less attractive, promote fairer taxation and more efficient resource allocation across the EU;
- 4) to ensure fair and effective taxation to support productive investment and entrepreneurship, while ensuring inclusive and sustainable social protection systems, preserving Europe's social market economy.

<sup>3</sup> See for example the judgment of the Court (Grand Chamber) of 12 September 2006 (Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue) for the concept of “wholly artificial arrangements” to be considered in the context of anti-abusive tax measures (i.e. to trigger their application against abusive structures for tax purposes).

<sup>4</sup> The OECD respective guidance has been elaborated in particular in the context of Base Erosion and Profit Shifting (BEPS) initiative (e.g. in the context of the work of the Forum on Harmful Tax Practices).

<sup>5</sup> For more information about unfair tax competition and the way it is tackled within the EU, you can consult the following link: [https://ec.europa.eu/taxation\\_customs/business/company-tax\\_en](https://ec.europa.eu/taxation_customs/business/company-tax_en)

**Policy options** that will be analysed in detail should include, but are not necessarily limited to, the following:

- 1) The baseline scenario used as benchmark will consider the current national practices and legislation (where existing) providing for anti-tax avoidance rules, including those deriving from the transposition of existing EU rules (e.g. the Anti-Tax Avoidance Directive – ATAD).
- 2) The Commission will consider as well to what extent the existing (e.g. the Code of Conduct on Business Taxation) or new soft-law instruments may eventually achieve the objectives.
- 3) Another option would be a new legislative initiative to define new tax related substance requirements and new mechanisms, including enhanced cooperation and monitoring of the existing legislation in the field of taxation, for legal entities and arrangements operating in the EU. As regards a possible legislative initiative, several options would have to be considered to design the best legislative policy package. At this stage, these options would include a discussion of possible new substance requirements and indicators of “real economic activity” for the purpose of taxation rules.
- 4) Options for enhanced cooperation, monitoring and enforcement of the new rules will equally be explored.

### **C. Preliminary Assessment of Expected Impacts**

#### **Likely economic impacts**

The initiative should have two main economic impacts, namely on Member States’ tax revenues and on EU competitiveness. Minimum standards on tax related substance that this initiative envisages should serve to decide whether entities in a Member State are deemed shell entities and, if so, to deny them tax advantages in the Member State. An intended economic impact would be to make tax evasion and avoidance more difficult and less economically attractive, thus overall increasing tax revenues and eventually improving tax fairness within the EU. Less tax avoidance and evasion opportunities could reduce the attractiveness of the EU as a single market for incorporation of shell entities, in turn potentially decreasing the investment in the EU market. The possible impact on third countries through the anticipated relocation of shell entities in response to the proposed measures would also be considered. However, it could be expected that the overall benefits generated by this proposal in terms of additional tax revenues for the Member States, a better level playing field among firms operating within the Internal Market, especially SMEs, and reduction of wealth distribution inequalities in the EU would offset such a negative impact. A standardised common assessment of substance for tax purposes within the EU for entities could be, subject to further assessment, an important tool for tackling the erosion of the tax base of the Member States by tax avoidance and evasion.

Depending on the preferred option finally chosen, the compliance costs of this initiative are in any case expected to be limited, both for the taxpayers (i.e. legal entities and arrangements) and for the tax administrations. For the taxpayers, the compliance costs might encompass gathering, self-assessing and eventually providing the relevant data to the tax administrations; but the data requested should be readily available to them, thus limiting the costs. An EU wide tax initiative against shell entities used for tax purposes operating in the single market based on simple and commonly agreed criteria for tax related substance should ensure a common and simple approach across the entire EU and subsequently also keep the compliance costs and burdens for the entities targeted by the initiative to a manageable level. For the tax administrations, the administrative burden will encompass monitoring and assessing data provided by the entities. However, these administrative costs are expected to be limited given the limited scope of the proposal and should be considered as part of the duties of the tax administrations to ensure shell companies are not used for tax avoidance purposes. In addition, criteria to be used by tax administrations during their controls should be easy to assess, possibly in an automated way, thus limiting the additional costs associated. Here again, the expected increase in tax revenues, the improved level playing field between companies and the fairer tax system (less prone to abuse) should outweigh

the necessary compliance costs to enforce it.
<b>Likely social impacts</b>
Fairer taxation is expected to have a positive social impact. A well-functioning tax system, where everyone and every company pays its share, should have a stronger distributive role to convert the public revenues into public services and social protection for the benefit of all citizens, thus contributing to reduce wealth distribution inequality. The impact assessment will analyse this aspect of social justice and equity further. Moreover, a fairer tax system could improve tax compliance, strengthen trust in national authorities and tax systems and enhance public perceptions towards multinational companies across the society, often perceived as being unfairly favoured in tax matters.
<b>Likely environmental impacts</b>
The initiative is not expected to have any significant environmental impacts.
<b>Likely impacts on fundamental rights</b>
The protection of fundamental rights (in particular, equality and solidarity) will be duly considered, as well as EU freedoms, such as the freedom of establishment and free movement of capital. Also, the impact assessment will discuss the extent to which options are proportionate and do not go beyond what is needed to achieve the objectives.
<b>Likely impacts on simplification and/or administrative burden</b>
The impact assessment will endeavour to establish whether an EU harmonised framework may result in a lower level of regulatory costs (administrative burden and compliance costs) for both tax administrations and businesses – especially compared to the economic impacts the measure could achieve. Currently, rules, administrative approaches and practice related to dealing with anti-tax avoidance measures vary a lot among Member States, which is likely to generate situations of uncertainty for businesses operating cross-border.
<b>D. Evidence Base, Data collection and Better Regulation Instruments</b>
<b>Impact assessment</b>
An impact assessment will support the preparation of this initiative and inform the Commission's decision. The work on data collection and the economic analysis has already started.
<b>Evidence base and data collection</b>
<p>As in all tax abuse domains, there is a lack of precise evidence pointing to the scale of abuse through shell entities, and their numbers, both in the EU and at international level. Moreover, the elements necessary to provide evidence for this possible new initiative (e.g. the information to be used for a definition of shell entity and the identification of the relevant target population) will likely be not publicly available due to their sensitivity. In addition, the lack of a common definition of “shell entity” at this stage does not allow a precise quantification of the target population. Nevertheless, the use of shell entities for tax abuse purposes, and other issues like money-laundering, is well documented.</p> <p>A study conducted by the European Parliamentary Research Service on shell companies in the European Union<sup>7</sup> pointed to the use of different type of entities created for tax purposes established in Member States with high levels of foreign direct investment (FDI) compared to gross domestic product (GDP). Its findings will also be taken into account in the impact assessment.</p> <p>Recently, the so-called Open-Lux investigations, have raised the attention on the use of entities for certain activities (mainly holding companies dealing with passive income) where the existence of substance and the real ownership structures are put into question. A number of further studies and research carried out at national level should provide additional useful input.<sup>8</sup></p>

<sup>7</sup> [https://www.europarl.europa.eu/cmsdata/155724/EPRS\\_STUD\\_627129\\_Shell%20companies%20in%20the%20EU.pdf](https://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf)

<sup>8</sup> Other studies and initiatives will be taken into account as well, such as: -Tilburg University's study on Dutch shell companies (<https://research.tilburguniversity.edu/en/publications/dutch-shell-companies-and-international-tax-planning>)

<p>Other past initiatives aimed at fighting tax avoidance and evasion, notably the Anti-Tax Avoidance Directives, could help inform on the reduction of the potential erosion of attractiveness of the EU resulting from fewer tax abuse opportunities.</p> <p>Furthermore, two Commission's studies, one on monitoring of offshore financial wealth and the other one on shell companies<sup>9</sup>, will try to assess the role that shell companies have in tax evasion and tax avoidance.</p>
<p><b>Consultation of citizens and stakeholders</b></p>
<p>The Commission will run targeted consultations of Member States' relevant authorities to obtain a more comprehensive and balanced picture of the magnitude and evolution of the problem in the different Member States and the status quo in terms of existing tax legislation, specific provisions, enforcement and monitoring. Information on regulatory costs (administrative burdens and compliance costs), benefits and savings of the initiative at stake will also be gathered during this consultation. The Commission will also run targeted consultations of representatives of the relevant businesses potentially impacted by the new initiative would equally be consulted.</p> <p>In addition, a public consultation will be launched in June 2021 with a questionnaire available in all the 23 EU official languages. The public consultation will be accessible via the Commission's central <a href="#">public consultations page</a>.</p>
<p><b>Will an Implementation plan be established?</b></p>
<p>An Implementation Plan is not foreseen, since the proposal at stake would not cover a framework directive or a directive aimed at the full harmonisation of a policy area or a directive having a significant impact on or amending various branches of the national legal order.</p>

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- Cyprus' Central Bank: <https://www.uniwide.biz/latest-news/central-bank-of-cyprus-has-prohibited-service-of-shell-companies/>

- Recent Dutch law on substance requirements for "Service companies":

<sup>9</sup> Both expected to be published in 2021.