

Tax Updates

8 February 2023



Consistent with our commitment to provide updated information on current tax issues, we set down below a brief overview of the Proposed Council Directive laying down rules to prevent the misuse of shell entities in the EU for tax purposes (Unshell Directive or ATAD III)

On 17 January 2023, the European Parliament approved the proposal of the European Commission for issuance of a Council Directive laying down rules to prevent the misuse of shell entities in the EU for tax purposes. In its current version, the proposed text of the Directive (referred to as ATAD III or Unshell Directive) states the 30th June 2023 as the expected date of its adoption by the Member States and the 1st January 2024 as the expected date of its application. Delays, however, in its application seem possible due to the fact that the 27 Member States are expected to carry out intense negotiations in order to produce the final text of the Directive (expected to be published sometime later in 2023).

Our analysis below is based on the text of the proposed Directive as currently published.

Aim of the Directive

In general, "shell" entities are considered legal entities with no minimum substance and economic activity, which are being used for improper tax purposes, such as tax evasion or tax avoidance. The provisions of the proposed Directive aim to enable the tax authorities of Member States to detect shell entities by laying down common rules for the determination of minimum substance (minimum substance indicators) and introduce tax consequences in case such shell entities are being used.

Scope of the Directive

- The Directive applies to all enterprises established in the EU, irrespective of their legal form or size (including legal entities with no legal personality, partnerships etc.).
- Certain categories of enterprises are exempt from the obligations imposed by the Directive. Indicatively such exempt enterprises include listed companies, regulated financial enterprises (e.g. credit institutions, insurance and reinsurance companies, AIFMs, UCITS, AIFs, pension institutions, etc.), enterprises with no or minimal cross-border activities, enterprises with at least five full-time employees etc.

The Seven Steps of the Directive

In order to prevent the misuse of shell entities in the EU, the Directive introduces a seven-step procedure, as follows:

Step One: Identification

The enterprise identifies (by self-assessment) whether it falls within the scope of the Directive, i.e. whether it meets the following three criteria ("Gateways") that are used for identification of whether it is "at risk" to be deemed a shell entity:

- *Passive Income* in the previous two tax years,
- *Cross-border activities* through which the passive income was derived,
- *Outsourcing of day-to-day management* and significant decision making to external partners in the previous two tax years.

Step Two: Declaration of minimum substance

If all three gateways above are met, and if the enterprise does not belong to one of the exempted entities, then the enterprise is required to declare through its annual tax return whether it meets all the below minimum substance indicators (and provide the necessary documentation as evidence):

- Premises owned by the enterprise or made available for the exclusive use of the enterprise in the enterprise's Member State
- Bank account: At least one active bank account in the name of the enterprise in the European Union
- Directors or employees tax resident in the Member State of the enterprise, having appropriate qualifications and authorities.

Step Three: Possibility of exemption from the obligations under this Directive

An enterprise may request to be exempt from its obligations under the Directive (i.e. minimum substance declaration and submission of information through its annual tax return) if it can prove that its interposition does not result in a tax benefit for its beneficial owners or for the group as a whole, as the case may be.

Step Four: Presumption of minimum substance

An enterprise that declares to meet all the indicators of minimum substance is presumed to have minimum substance for the tax year in question, whereas if it declares not to meet one or more of these indicators (or does not provide satisfactory supporting documentation) it is presumed not to have minimum substance for the tax year in question.

Step Five: Rebuttal of the presumption

Enterprises may rebut the presumption of not having minimum substance by providing additional supporting evidence regarding the business activities which they perform to generate their income.

Step Six: Tax Consequences

The main aim of the tax consequences is to restrict the shell entity from taking advantage of the tax benefits provided by the DTTs or by the EU Directives 2011/96/EE (Parent – Subsidiary Directive) and 2003/49/EK (Interest – Royalties Directive).

For the shareholders: The Member State of the shell entity's shareholder shall tax the relevant income of the shell entity in accordance with its national law as if it had been directly accrued to the shell entity's shareholder(s) and deduct any tax paid on such income at the Member State of the shell entity.

For the shell entity: The Member State of the shell entity shall deny the shell entity's request for issuance of a tax residence certificate for use outside the jurisdiction of this Member State, or shall grant a special tax residence certificate which states that the entity is not entitled to the benefits of any DTT or of the EU Directives 2011/96/EU and 2003/49/EC. Notwithstanding the above, the Member State of the shell entity may continue to consider the shell entity to be resident for tax purposes in its territory and to tax the income flows of that entity and its assets in accordance with its national law.

Step Seven: Exchange of Information

Information collected on all enterprises that meet the gateways for inclusion in the provisions of the Directive and do not fall under the exemptions shall be communicated to the tax authorities of other Member States through automatic exchange of information and entered into a secure central EU directory.

Penalties and Tax Audits

In case an enterprise does not comply with the provisions of the Directive (non submission of information, submission of false information etc.), an administrative monetary

penalty of at least 5% of the enterprise's turnover in the relevant tax year shall be imposed.

Finally, when the tax authorities of one Member State have reason to believe that an enterprise established in another Member State has not fulfilled its obligations under the Directive, they may request from the tax authorities of this other Member State to carry out a tax audit of such enterprise.

Comments

In the current version of the Directive, it seems that information of the previous two tax years shall be taken into consideration for the identification of an enterprise as shell entity and its inclusion under the obligations of the Directive. As a result, enterprises and groups of companies, which may be affected by the provisions of the Directive, should examine as soon as possible all issues relevant to their minimum substance and the sufficient documentary evidence thereof, and proceed without delay to the necessary actions in order to comply with the new legislative regime that is expected to come soon into force.

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This Newsletter aims to provide the reader with general information of the above-mentioned matters. No action should be taken without first obtaining professional advice specifically relating to the factual circumstances of each case.