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EU Unshell Directive Proposal

March 2024

What is Unshell?

- On December 22, 2021, the European Commission issued a proposal for a Directive aimed at fighting the misuse of 'shell entities' for tax purposes (the Unshell Directive).
- Unanimity in the Council of the EU is required for adoption.

Why has this been proposed?

- The proposed measures aim to enable tax authorities to detect entities lacking minimum economic substance and that are misused for the purpose of obtaining tax advantages.
- The intention is to disallow such entities the benefits of certain withholding tax reliefs, unless they are able to successfully challenge the presumption that they qualify as shells or benefit from tax advantages.

Who is affected?

- **All EU undertakings**, irrespective of legal form or size.
- **Exclusions:**
  - Companies listed on a regulated stock exchange
  - Regulated financial undertakings
  - Holding companies with no / limited cross-border elements
  - Entities with at least five full-time employees.

How would the proposed rules operate?

The proposal outlines a **seven-step** process.

1. Entities in scope self-assess against three gateway criteria that examine the type of income, volume of cross-border activity and level of outsourcing.
2. Entities crossing **all three gateways** are deemed to be at high-risk of lacking substance and would be required to **report** on substance through their annual tax return.
3. Reporting entities that fail to meet **three substance indicators** related to own infrastructure (premises and bank account) and nexus (employees and/ or directors), are deemed to be '**shell entities**'.
4. The shell presumption can be **rebutted** by bringing evidence of commercial reasons and nexus.
5. Entities can also request an upfront exemption by substantiating a **lack of tax motives** test.
6. Tax consequences include **denial of certain tax benefits**.
7. Data on shell entities would be **automatically exchanged** between Member States.

What are the consequences of being a shell?

- **'Shell entity'**: no certificate, or qualified certificate of tax residence and denial of Parent-Subsidiary and Interest and Royalties Directives benefits.
- **EU shareholder**: tax the payments received by the 'shell entity' as if received directly.

What is the status of the Unshell proposal?

- The text of the Directive has been subject to lengthy discussions in the Council of the EU working groups. Several compromise texts were proposed, yet Member States have not yet reached agreement.
- Based on the December 8, 2023, ECOFIN report, a compromise text was proposed by the Spanish presidency outlining a two-stage approach, i.e., i) first step: automatic exchange of information based on a set of agreed hallmarks and domestic tax consequences where appropriate, and ii) second step: exchange and evaluation of best practices on applying tax consequences.
- Following concerns raised by some Member States, an alternative text, incorporating a minimum standard and a toolbox of consequences, was drafted in November but did not receive unanimous agreement.
- Discussions are set to continue in 2024, with the file having been included in the work program of the Belgian Presidency (first half of 2024), albeit not prioritized specifically.

When would Unshell be implemented and when would it become applicable?

- The initial aim was adoption in 2023 and application of the rules from January 1, 2024. However, due to the delays in the negotiation process, the final text and date of application remaining uncertain.
- It can be inferred from the progress report published by the ECOFIN that the final text will very likely differ from the initial proposal, possibly substantially.

How can KPMG help?

The network of EU tax specialists based in KPMG firms can help you assess how the new rules may impact your business, as well as understand current anti-abuse trends across the European Union.

If you would like to receive more information, feel free to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG contact.

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