OPINION STATEMENT

Opinion Statement FC 2/2022 on the EU Commission Proposal for a Directive on the Use of Shell Entities in the EU ("Unshell or ATAD3")

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CFE Tax Advisers Europe is the European umbrella association of tax advisers. Founded in 1959, CFE brings together 33 national tax institutes, associations and tax advisers' chambers from 24 European countries. CFE was the initiator of the Global Tax Advisers Platform through which it is associated with more than 600,000 tax advisers worldwide. CFE is part of the EU Transparency Register no. 3543183647-05.

We would be pleased to answer any questions you may have concerning our Opinion Statement. For further information, please contact Bruno Gouthière, Chair of the CFE Fiscal Committee or Aleksandar Ivanovski, Director of Tax Policy at info@taxadviserseurope.org. For further information regarding CFE Tax Advisers Europe please visit our web page http://www.taxadviserseurope.org/

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1. Introduction

CFE Tax Advisers Europe welcomes the work of the European Commission in seeking to reduce tax evasion throughout the EU, the aim of which CFE has always fully supported.

In seeking to support the Commission in this objective, CFE wishes to highlight the potential issues in practice raised by the proposed Directive, noting that the application of the existing anti-avoidance measures within the EU has become very complex in recent years. While CFE embraces the objectives expressed by the unshell proposal, it has concerns about the manner in which this draft directive intends to achieve these objectives and doubts whether these objectives will actually be achieved. This opinion statement elaborates these concerns and proposes alternative solutions that would, in the view of CFE, be more proportionate and suitable to achieve ATAD3's objectives and ensure compliance with primary EU law.

The proposed Directive seems to ignore the fact that transfer pricing and CFC rules already deal with the very issues that it is purporting to address. Indeed, the past few years have seen the implementation of a trove of EU and broader international measures designed to counteract certain perceived abusive practices. These include the Multi-Lateral Instrument ('MLI'), limiting access to treaty benefits (PPT), EU Mandatory Reporting (via DAC 6), as well as two EU anti-tax avoidance directives ('ATAD'), comprising rules on CFCs, interest deductibility, anti-hybrid arrangements, exit taxes and general anti-avoidance. The effectiveness of these rules is yet to be fully seen. In the opinion of CFE, the proposed directive seems to assume that abusive situations persist, without having allowed these measures sufficient time to prove their relevance.

CFE suggest a different approach in respect of addressing the outstanding issues raised by shell entities:

- Introduce another iteration of the DAC directive by way of enhancing transparency between member states and taxpayers, limiting the proposed directive to exchange of information (i.e. by removing the proposed articles 11 and 12);
- Create a list of Member states that have introduced the Principle Purpose Test (PPT) in their respective double tax treaties;
- Invite the European Commission to use the powers conferred on it by Article 258 of the Treaty on the Functioning of the EU to enforce the compliance by Member States with their obligation to prevent the avoidance of EU legislation (i.e. ATAD) and to do so in a manner that is compliant with primary EU law and settled ECJ case-law.

2. Potential Issues Concerning Compatibility with Primary EU Law

ATAD3 makes a distinction between domestic and cross-border situations and imposes a general presumption of abuse based on certain standardised criteria. Now, it seems resulting from case law by the Court of Justice of the European Union ("ECJ") that such general presumptions of abuse are not allowed.[1] While two older ECJ judgments *Cadbury Schweppes* and *Thin Cap*[2] suggested that general abuse presumptions are permitted, provided that the taxpayer is provided the opportunity to rebut such presumption, the ECJ seems to take slightly modified approach in its more recent case law.[3] This recent case-law complements the judgments in *Cadbury Schweppes* and *Thin Cap* as concerns the burden of proof allocation.

As such, the ECJ places the burden of proving abuse with the tax administration. It is also clear from ECJ case law that tax administrations *"may not confine themselves to applying predetermined general criteria, but must carry out an individual examination of the whole operation at issue"*.[4] The fact that articles 6 and 7 of ATAD3 provide general criteria leading to a presumption of abuse might therefore be seen as incompatible with ECJ case law regarding the freedom of establishment and/or the free movement of capital, regardless of the rebuttal provisions included in ATAD3.[5]

Compliance with the EU fundamental freedoms (treaty provisions), as well as general principles of EU law, not only applies with respect to national measures, but also with respect to secondary EU law (directives) and other measures adopted by the European institutions.[6] The European Commission has rightfully acknowledged the need to ensure compliance of secondary with primary EU law in the draft proposal to implement the Pillar II measures in EU law[7], by supplementing the original OECD blueprint with rules for a 'large scale domestic group', since that directive might otherwise have amounted to a breach of the fundamental EU freedoms.

By creating a presumption of guilt on undertakings, irrespective of whether there are objective and verifiable elements making it possible to identify the existence of a wholly artificial arrangement entered into solely for tax reasons, the proposed directive ignores the case law from the CJEU which has determined the circumstances in which tax laws may impose restrictions on fundamental

[1] See inter alia ECJ, 17 July 1997, C-28/95 (*Leur Bloem*), para. 41; ECJ, 5 July 2012 C-318/10 (*SIAT*), cons 55 and 56; ECJ, 8 March, 2017, C-14/16 (*Euro Park Service*), para. 55; ECJ 7 September 2017, C-6/16 (*Eqiom*), para. 32 and the joined cases ECJ 20 December 2017, C-504/16 (*Deister Holding*) and C-504/16 (*Juhler Holding*), para. 74.
[2] ECJ, 12 September, 2006, C-196/04 (*Cadbury Schweppes*), para. 70; ECJ, 13 March, 2007, C-524/04 (*Thin Cap*), para. 82
[3] The only exception being ECJ, 20 January, 2021, C-484/19 (*Lexel*), para. 50, although this exception may have resulted from the ECJ's reliance on its prior approach taken in *Thin Cap* (see previous footnote) whereas the abuse presumption (burden of proof) was not the main topic in *Lexel* (unlike the cases mentioned in footnote 1).
[4] *Eqiom* (footnote 1), para. 32
[5] For a more detailed discussion on the evolution of the ECJ's case law on the allocation of the burden of proof in relation to the existence of abuse see A.W. Ravelli & F. Franconi, *Numerous EU Member States are in Breach of EU Law by Requiring Taxpayers to Demonstrate Absence of Abuse* (Vol. 61 Eur. Taxn. no. 10, Journals & Opinion Pieces IBFD)
[6] ECJ, 8 december 2020, C-620/18 (*Hungary v Parliament & Council*), para. 104 to 117 and ECJ, 26 October 2010, C-97/09 (*Schmelz*) para. 50, see also Opinion A-G Kokott, ECJ, 14-10-2021, nr. C-556/20, para. 36 and 37
[7] Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, SWD(2001) 580 final

freedoms. In this regard, the TFEU in Articles 49 and 63 (previously 43 and 56 respectively) allows Member States to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation, or to take measures which are justified on grounds of public policy or public security. However, the Treaty also affirms that such measures and procedures cannot constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments.

The Court cases on this topic have established that any such tax rules must not go beyond what is necessary (e.g., FII Group Litigation, Thin Cap Group Litigation v Commissioners of Inland Revenue, National Grid Indus, and the EU Commission vs. the UK). These cases make it clear that to justify the introduction of tax laws that would impose restrictions on freedom of establishment or the free movement of capital, there is a pre-requisite that the issue that needs to be dealt with is one which involves the existence of a wholly artificial arrangement entered into for tax reasons alone. In such circumstances, the restriction must provide the taxpayer with the opportunity 'without subjecting him to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that transaction.'[8]

In addition, any anti-abuse legislation may not be *"manifestly inappropriate with regard to the objective pursued"* [9], requires that *"any burden falling upon economic operators to be minimised and commensurate with the objective to be achieved"*[10] and must be compatible with primary EU law (in particular the general principles of EU law)[11].

Proportionality as a general principle of EU law takes precedence over secondary EU law and directives need to be compatible with it.[12] To that extent, the proposal must ensure proportionality when imposing denial of directive or treaty benefits. In compliance with the principle of proportionality as a general principle of EU law, the directive should not go beyond denying tax (law or treaty) benefits that were incorrectly obtained. For example, if a payment by a company of a source Member State ("SMS") to a shell is (without ATAD3) exempt from withholding taxes under a directive and would have been subject to a withholding tax rate of 10% under the treaty of the SMS with the jurisdiction of the ultimate recipient of such payments, it should be stated in the proposed Directive that the withholding tax rate cannot exceed 10%, regardless of the domestic rates in the SMS. Similar proportionality issues would arise if a company of a SMS makes payments to a shell and the shell on-pays such amounts to two or more different recipients, not all of whom are (equally) reducing their tax liability via the shell. In the views of CFE, those principles are missing and there is no real proportionate application of anti-tax avoidance measures in the draft at present despite the clear primary EU law requirement to counter abuse in accordance with the principle of proportionality.[13]

[8] See Case *SGI*
[9] ECJ, 3 December 2019, C-482/17 (*Czech Republic v Parliament & Council*), para. 119
[10] See *Czech Republic v Parliament & Council* (footnote 8), para. 79
[11] See *Fedessa* – Case 331/88, paras 19 - 21
[12] Idem.
[13] ECJ, 20 January, 2021, C-484/19 (*Lexel*), para. 51

In this respect, from CFE's perspective an issue that was touched upon in the Danish Beneficial Ownership cases merits further clarification. If a company pays income to a shell entity fully controlled by that company, it would be entitled to a reduced rate of withholding tax. The question remains why disregard all treaty benefits and not allow application of the treaty regarding the source country and the country of residence, in situations when the income is received directly.

3. Fundamental practical concerns with ATAD3

The explanatory memorandum with ATAD3 acknowledges that the anti-abuse rules across member states are fragmented and expresses a fear that such could be replicated and possibly worsened, were Member States to take action individually. In this regard, the explanatory memorandum with ATAD3 states that ATAD3 apparently complies with the principle of subsidiarity since *"a common approach towards shell entities would <u>ensure legal certainty and reduce compliance costs for businesses operating within the EU</u>."* CFE is however concerned that ATAD3 may possibly achieve the opposite of these objectives, which we will explain hereafter.

- ATAD3 explicitly states that Member States may still apply their domestic rules and/or the EU anti-abuse concept as developed by the ECJ and as laid down in article 6 of ATAD1[14]. Therefore, ATAD3 would only increase the number of different rules that would apply in parallel and that multinational companies and tax administrations need to comply with and administer. Furthermore, many rules/concepts in ATAD3 are unclear and ATAD3 is lacking effective statutes of limitation (see paragraph 4 hereafter in more detail). As far as it concerns legal certainty, ATAD3 therefore achieves the opposite of its stated objectives and its subsidiarity justification is therefore arguable.

- For the same reasons, ATAD3 also significantly increases the administrative burden and therefore compliance costs for both companies and tax administrations. This would apply even more strongly for companies and tax administrations in Member States that do not currently apply anti-abuse presumptions with respect to shell companies. Such companies and and tax administrations would henceforth be required to provide and validate statements and evidence, file and deal with requests for certainty about the rebuttal provisions and exemption requests.

Another issue with ATAD3 is that the presumptions of abuse do not take into account modern business models and how businesses and their employees work nowadays. In fact, even before the proposal at stake, it has been suggested that the abuse presumptions were generally outdated regarding physical presence that are not valid in a digitalised and post-Covid era. The substance indicators in the proposed

[14] Council Directive (EU) 2016/1164

ATAD3 seem to impose unrealistic and outdated requirements on many companies by presupposing that all businesses and their employees require a continued physical presence at one fixed location. This requirement seems to disincentivise modern and tech-savy business models.

If the Covid pandemic has taught us anything in this respect, it is that genuine business can be conducted without physical presence of directors or employees via online communication (although this of course differs per type of business). Twenty years ago, not having one fixed place to conduct a business might for many businesses have been an appropriate indicator of artificiality, but this is no longer the case in 2022.

If even in purely domestic situations many businesses and their employees no longer require a fixed office or frequent physical presence at a certain location in order to properly fulfil their tasks, it would be hard to understand why such requirements should be imposed to businesses in cross border situations.[15] Oddly enough, while in recent years, businesses, technology and society as a whole have become less attached to one specific physical location, the European Commission's views on abuse and the presence of economic activities seem to have moved in the opposite direction as is apparent if one compares the design of ATAD3 with the following statement from 2014: *"As the Commission stated in response to a question from the bench, it is not required that the economic activities take effect in the EEA State of establishment. It suffices that they take effect in the EEA."*[16]

4. Possible alternatives

CFE proposes to limit the scope of the proposed amendments to provisions that would enhance transparency between Member States and taxpayers, thus removing the proposed articles 11 and 12 of the current draft.

In the view of CFE, the existing anti-abuse concept as developed in ECJ case law, the domestic rules that are in force in the various Member States (that must not contain over- or underkill compared to the EU anti-abuse concept), the GAAR that is contained in ATAD1[17] already provide a legislative framework to effectively counter aggressive tax planning through shell companies. CFE acknowledges the divergence in domestic anti-abuse rules between the various Member States, as is also identified in the explanatory memorandum of ATAD3. This divergence can however also be addressed differently, without increasing the legal uncertainty and the administrative burdens for companies and tax administrations, while also remaining within the boundaries of existing ECJ case law that disallow overkill and underkill.

[15] Naturally, many companies will already consider tax treaty concepts such as "place of effective management" and "permanent establishment" in determining where they are physically present.
[16] EFTA Court, 9 July 2014, Joined Cases E-3/13 and E-20/13 (*Fred Olsen*)
[17] Article 6 of Council Directive (EU) 2016/1164

To begin with, the European Commission could use the powers conferred on it by article 258 of the Treaty on the Functioning of the EU to enforce the compliance by Member Stateswith their obligation to prevent the avoidance of EU legislation and to do so in a manner that is compliant with the rules set out by the ECJ.

In addition, it could be considered to develop extensive and detailed guidelines including a large number of examples in order to make the application of the EU abuse principle (as developed by the ECJ) more concrete. The OECD transfer pricing guidelines and the commentary with the OECD model tax convention have proven useful tools to clarify and harmonize certain abstract concepts (e.g. at arm's length, permanent establishment, beneficial owner etc.). The same could be achieved for an abstract concept as "abuse". The OECD has also proven that states, taxpayers, NGOs and other stakeholders can successfully work together to create high quality guidelines that are effective for tax administrations and workable in practice for taxpayers. While such guidelines will likely not achieve an absolute clarity and harmonization (neither does ATAD3 in its current form however), they would - in CFE's view - be more successful in achieving the objectives identified in ATAD3 than the current language of ATAD3.

With or without the foregoing, the existing blueprint of ATAD3 could still be useful to enhance the transparency between member states and taxpayers if its consequences would be limited to the exchange of information (i.e. by removing the proposed articles 11 and 12). This way, member states will be provided with the information necessary to enforce their domestic rules in accordance with the existing EU anti-abuse principle. This would still result in an increased administrative burden for both taxpayers and tax authorities, but would remove the most pressing concerns regarding legal certainty.

Considering that the case law by the ECJ[18] rejects rules providing for "overkill" (general presumptions of abuse) and "underkill" (as follows from the *Danish cases*[19]), CFE does not believe that setting fixed criteria to determine a presumption of abuse or safe harbors regarding the absence of abuse is the right way forward. Not only ECJ case law, but also the abovementioned fundamental practical issues advocate against such an approach, at least in the manner in which ATAD3 is currently designed.

5. Issues with specific rules in ATAD3

As stated above, CFE sees several fundamental EU law and practical issues with the current ATAD3 proposal. If it would ultimately be decided to proceed with a form of implementation of ATAD3 which is essentially based on its current design, the specific rules included in ATAD3 however also raise a

[18] As mentioned in paragraph 1 of this opinion statement.
[19] ECJ, 26 February, 2019, C 115/16, C 118/16, C 119/16, C 299/16 (*Danish cases*),

myriad of other concerns and questions that should be addressed. Without striving to be exhaustive, below we have included some of these concerns and questions that have been identified in ATAD3.

1. Many rules and concepts in ATAD3 are unclear. For example, what is "outsourcing", when is a director considered "qualified" or "authorized"? What is a distance "compatible with the proper performance of their duties"? What is "satisfactory supporting documentary evidence". When are assets "held for private purposes"? Should article 4, paragraph f consider only income from *single* assets with a book value of EUR 1 million or also from *multiple* assets with an aggregate value of EUR 1 million? Does article 6 apply if the criteria mentioned therein are met in the previous 2 years for i) only one brief moment, ii) the majority of the time, iii) all of the time, iv) other options such as at the closing of the financial year? Is it intended that article 6, paragraph 1(d) applies if one of the shareholders resides in the same jurisdiction as the undertaking? Without further detail regarding the rules of ATAD3, it can thus be expected that ATAD3 will result in significant divergence in the interpretation between different Member States (as we already see in relation to the DAC6 rules) and between tax administrations and taxpayers, leading to lengthy disputes and legal uncertainty. It is therefore of paramount importance to supplement ATAD3 with a detailed technical memorandum detailing the application of each provision in ATAD3.

2. It might be considered that an exemption should be provided for entities that are part of a group that has at least one other entity in the same jurisdiction that satisfies one of the exemptions of article 6, paragraph 2, article 9 or article 10, considering that in such situations the presence of the group (as a whole) in the respective jurisdiction may not be considered an artificial arrangement with the main purpose of avoiding taxation.

3. Article 6, paragraph 2(e) does not require the employees to be working in the jurisdiction where the undertaking is considered a tax resident. Is this intended?

4. Articles 9 and 10 only allow for a limited type of rebuttal arguments, which may be regarded as not fully compliant with ECJ case law.[20] The determination of abuse should in all cases require an evaluation of all relevant facts and circumstances. Such facts and circumstances could for example also include:
    a. Predominant non-tax motives for establishing an entity with limited substance, such as (without limitation) asset protection via access to a BIT network, estate planning, establishing a joint venture vehicle in a jurisdiction with a predictable and developed company law, access to a developed financial infrastructure, preferences by banks, other creditors, investors or other stakeholders for a special purpose vehicle in a certain jurisdiction etc.;

[20] As explained in paragraph 1 of this opinion statement, abuse presumptions (and required rebuttal by a taxpayer) are already in breach of primary EU law. The limited scope for rebuttal only further highlights the incompatibility of ATAD3 with primary EU law.

   b. The absence of tax motives when a structure was created, for example if a certain tax benefit was not foreseeable when the structure was created (e.g. if such benefit arises due to an unforeseeable change in or entry into force of a law, a tax treaty or a directive or a jurisdiction becoming a party to such treaty or directive).

5. The interaction between ATAD3, the CFC rules of ATAD1 and the Pillar II draft Directive should be clarified. As long as the income is taxable in the hands of the shareholders with application of CFC charge or ATAD1/2, there should be no issue.

6. The minimum penalty of 5% of the undertaking's turnover is certainly excessive. For example this could be the case in situations where no tax is avoided but an entity fails to report that it meets the requirements of article 6. It follows from settled EU case law that disproportionate penalties which do not take into account the specific facts of a case are incompatible with EU law, particularly if such penalties do not apply in a sufficiently similar domestic situation. This was most recently confirmed in the case *Commission v Spain* which involved a Spanish rule requiring an information statement (form 720) on assets held abroad.[21] It may be noted in passing that the European Commission considered the Spanish rule in question to be incompatible with EU law (which was confirmed by the ECJ), while at the same time proposing a penalty measure (in ATAD3) that has the same fundamental flaws as the Spanish rule.

7. As previously stated, fact that ATAD3 safeguards legal certainty is arguable for instance as regards the statute of limitation. Instead of leaving that issue to domestic law, the proposed Directive should in the opinion of CFE include a precise rule in this respect so that taxpayers would not potentially suffer indefinite uncertainty regarding the validity of the documentation provided in application of article 7 of the draft. Therefore, to preserve even a minimum degree of legal certainty, article 8 should be supplemented with a statute of limitations equal to the ordinary statute of limitations of tax assessments. If a taxpayer goes to great lengths to provide a tax administration with detailed information and evidence that it meets the requirements of ATAD3, such taxpayer should not be left with indefinite uncertainty regarding whether a tax administration may find the evidence submitted unsatisfactory and could thus give rise to penalties.

8. To prevent double taxation, attention should be given to the application of tax treaties between the jurisdiction of a shareholder and a source state (and the application of tax credits between such treaties) if ATAD3 is applied in relation to an intermediate shell entity. For example, article 23b of the OECD Model Tax Convention only provides for a credit *"Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State <u>in accordance with the provisions of this Convention</u>."* It is however not "this Convention" (i.e. the tax treaty between the shareholder state and the source state) which provides for a

[21] Inter alia ECJ 27 January 2022, C-788/19 (*Commission v Spain*)

source state taxing right, but the tax treaty between the source state and the state of the shell entity. This is why in the views of CFE, the proposed directive should provide that the shareholder that is taxable on the income received by the shell entity should be granted a tax credit in its country of residence in accordance with the tax treaty concluded between its country of residence and the source state.

9. The explanatory memorandum does not express any intended retroactive effect. However, it should be noted that article 6 (depending on how it should be interpreted) may already effectively have entered into force on January 1, 2022 as a result of the 2 year look-back period and the official entry into force per January 1, 2024. This retroactive effect would mean that taxpayers meeting the criteria of article 6 before 2024 (possibly only briefly) should still comply with the other requirements of ATAD3, even if they no longer meet the criteria of article 6 as from January 1, 2024. ATAD3 would then have entered into effect ten days after ATAD3's first publication as a proposal. CFE agrees that such consequence is apparently not intended, but believes that it should precisely be clarified that it may not materialize in order to avoid future potential difficulties.

10. With respect to article 10 it should be clarified which taxes are included in the term *"tax liability of its beneficial owner(s) or of the group, as a whole"*. For example, if VAT is avoided, such avoidance may potentially result in the denial of VAT benefits under the applicable VAT anti-avoidance principles, but should not result in other tax disadvantages. In addition (and also in connection with the foregoing), article 10 should be amended to limit the application of articles 11 and 12 of ATAD3 only to the amount of tax that is avoided (see paragraph 1 of this opinion statement in more detail).

11. The use of the terminology "economic activity" should be reconsidered as this could result in a strange and unintended interaction with the EU VAT rules. As "economic activity" is a term of community (tax) law, one would expect the use of this term to be aligned. The use of this terminology in ATAD3, and possible definitions given tot his term in relation to ATAD3, could therefore also have effects in relation to the EU VAT rules. Regardless of the foregoing, the use of the term "economic activity" in the definition of "undertaking" (article 3, paragraph 1) suggests that a classic shell entity which only holds shares does not qualify as an "undertaking" (as such entity may not carry out an "economic activity", certainly not according to the VAT definition). Such shell entities would therefore (potentially) fall outside the scope of ATAD3. This does not appear in line with the intentions of ATAD3.

12. Article 11(1) applies where an undertaking passes the gateways and has not rebutted its position (under Article 9 – rebuttal). However, it does not seem to take account of any exemption granted under Article 10. Article 10 exempts the undertaking itself from the consequences of the proposed Directive, but not its shareholders or a person paying to the undertaking – both of whom are affected by Article 11. A similar issue arises for Article 11(2)

and (3): also treated as shareholders are those with an indirect shareholding / participation through one or more of undertakings which themselves are shell entities (though it is not clear if only EU tax resident undertakings can be shell entities for this purpose). Consequently, it is not enough to only establish if the undertaking itself is a shell entity, but one must also establish the status of each direct and indirect shareholder / participator.

13. There is no proportionality provided for in the Directive in terms of ownership or the imposition of tax. For example, it would appear that any direct or indirect shareholder in a shell company who is subject to the terms of the proposed Directive (i.e., is an EU resident) is obliged to tax their share of the underlying profits. For example, this could in principle capture an EU taxpayer holding a single share in a large EU group. The taxpayer would need to know whether there were any EU based shell companies within the corporate structure to which the rules might apply. It would seem exceedingly difficult for them to know this. Even if they did, how would they obtain the relevant information to tax the underlying share of profits? There needs to be some degree of proportionality in relation to the application of these rules. This could be significant in respect of investments in listed groups but also in joint venture structures and in fund structures (particularly where there are multiple tiers of funds, such as a fund of funds structure).

14. Clarity is required in relation as to how tax will be applied to a shareholder where they are an indirect shareholder in a chain of shell companies. The Directive as proposed does not clearly state that tax can only apply at the level of one EU shareholder. Thus, on the face of it, a shareholder would have to impose tax on the income of all shell companies in the chain meaning the same income could be taxed many times and, in many countries. Even the upper shell companies could be obliged to tax the profits of the lower tier companies, while their own income is taxed at the ultimate shareholder level.

15. The tax consequences imposed by the proposed Directive on the shareholder entity do not allow for credit or reduction of taxation in respect of taxes that would be paid by the shareholder on the actual receipt of income from the shell company.

16. In relation to indirect ownership (which looks to a chain of ownership where no entities in the chain meet the substance requirements), it is not clear how one deals with non-EU companies in the chain. Do they have to be assessed against substance criteria? If so, how is that to be read against the various criteria e.g., a bank account in the EU?

17. While the draft Directive permits an EU shareholder to take credit for taxes paid by the EU shell company against any tax imposed in the Directive, it does not apply an equivalent relief in respect of third country taxes suffered by the subsidiary company. For example, the EU shell company may pay less tax in its own country due to credits available with respect to the amounts received from the third county. These may reduce the amount of tax paid by the shell

company and, consequently, the amount of credit available to the EU shareholder per the Directive. However, if the EU shareholder is taxed as if it received the income from the third country directly, it is not clear that those same credits can be claimed in the EU shareholder country.

18. The draft Directive requires an EU shareholder to be taxed on the income of the shell entity as if it received it directly. No consideration is given to the fact that the shell company might use some of that money to fund its expenses. For example, a holding company might fund an investment in another company with third-party debt which it services with dividends (and perhaps interest) it receives. The EU shareholder will receive no deduction for these genuine costs.

19. The presumption that where the subsidiary company is an EU Member State and treaties between the shareholder jurisdiction and that Member State can be ignored, appears to be highly problematic. Apart from the question of conflicts of national law with those of the treaty, it needs to be borne in mind that the shareholder jurisdiction can be both a direct and indirect shareholder jurisdiction. It is presumed that there would be a cascading effect whereby one would start with the nearest shareholder to the shell company and work upwards until one reached an EU entity if one so existed. If there are intermediaries in non-EU jurisdictions, the treaties between those jurisdictions and the EU shell company may have precedence. In these circumstances, it would seem highly problematic to override the treaties between a third country and the shell company jurisdiction.

20. It would appear that an assessment of these rules is required irrespective of whether any treaty benefits are being sought. This would seem to place an undue burden on entities to conduct these assessments when there is no particular benefit to them doing so, notwithstanding, that existing CFC rules should pick up much of the taxes that would otherwise be imposed by this Directive.

21. Denial of a request for a tax residence certificate generally on a shell company may well contravene tax treaties with third jurisdictions.

22. Irrespective of whether it is contravention of the relevant treaty, it is not clear why a tax residency certificate should be denied with respect to an entity which has multiple different activities, where only one such activity is giving rise to shell company status.

23. It is not clear why benefits under the Parent-Subsidiary and the Interest & Royalties Directives need to be removed given there are anti-avoidance provisions in these Directives already.

24. Where the shell entity's shareholders are not resident for tax purposes in the EU but the person paying the relevant income to the shell entity is EU resident, it must apply withholding tax on those payments (in accordance with its local law) subject to any double taxation agreement

that EU Member State and the jurisdiction of the shell entity's shareholders. This applies even to third parties, thereby assuming that they will know the status of the recipient itself and the residency status of all shareholders (which may be direct or indirect depending on whether there are other shell entities in the ownership chain). This will be impossible in practice.

25. In a situation where all three parties are resident in the EU, there may be increased levels of taxes compared to a scenario where the EU subsidiary company pays directly to the EU shareholder. There may be withholding taxes imposed at both the level of the subsidiary and the shell company in addition to taxes paid at the EU shell company level and taxes paid at the shareholder level. This would seem to be more than double taxation.

6. Conclusion

The Directive seems to ignore the fact that transfer pricing and CFC rules already deal with the very issues that it is purporting to address. Therefore, there is a real possibility for a taxpayer to be caught by these rules as well as by the Unshell Directive. Indeed, the past few years have seen the implementation of a trove of EU and broader international measures designed to counteract certain perceived abusive practices. These include the Multi-Lateral Instrument ('MLI'), limiting access to treaty benefits (PPT), EU Mandatory Reporting (via DAC 6), as well as two EU anti-tax avoidance directives ('ATAD'), comprising rules on CFCs, interest deductibility, anti-hybrid arrangements, exit taxes and general anti-avoidance. The effectiveness of these rules is yet to be fully seen. In the views of CFE, the proposed Directive presumes problems persist while this is may not be correct in light of the numerous anti-abuse measures already taken at EU level.

TThe directive as proposed by the Commission may not even achieve its stated objectives in particular regarding legal certainty and a reduction of compliance costs. The current design of ATAD3 contains some ambiguous and disproportionate rules that will likely give rise to differences in interpretation and numerous lengthy disputes.

CFE therefore urges the Commission to consider the alternatives described in this opinion statement via which the Commission could further harmonize the anti-abuse measures, the application thereof and transparency across the various Member States, without the adverse consequences that would result from ATAD3. If instead it is decided to proceed with ATAD3 based on its current design, we recommend taking into account the suggestions as set out above. CFE stands ready to support the Commission in addressing the issues identified in the above.