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OPINION STATEMENT

Opinion Statement FC 5/2021 on the European Commission Public Consultation on Fighting the Use of Shell Entities for Tax Purposes

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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 is pleased to contribute to the EU Commission public consultation on tackling the use of shell entities for tax evasion and aggressive tax avoidance purposes.[1]

CFE considers the present EU anti-avoidance framework (based primarily on ATAD and the ECJ case law) to be robust and sufficient to tackle serious issues pertaining to aggressive tax avoidance, by empowering national tax administrations with the necessary tools to identify and address structures that appear to be abusive and aggressive, or contrary to the established EU law standards. CFE sees accordingly no need for further action in this respect.

2. Existing EU Measures

From the CFE's perspective, the challenges to successfully designing balanced measures at EU level are three-fold:

1. How to meaningfully scope shell entities and provide definitions that are sufficiently clear to exclude entities engaged in legitimate holding, estate planning, financial, insurance/reinsurance and/or commercial activities, even if they do not need staff and equipment to achieve such purposes;

2. How to choose a policy solution that is fit for purpose in the context of the existing measures aimed at targeting abusive/illicit use of shell entities.

3. How to avoid complex legislation which includes hallmarks, such as those used in DAC 6, instead of clear legal definitions. Discussions that the CFE has had with relevant stakeholders, suggest that many taxpayers, their advisers and tax administrations are still struggling to understand the scope of those hallmarks.

The European Commission evaluation of the problem, as indicated in the inception impact assessment of June 2021, is that despite the robust anti-avoidance framework currently in place, some opportunities still remain for abusive use for tax avoidance and tax evasion purposes by entities with no substance or with minimum substance, which do not engage in genuine commercial activity. There is indeed evidence that shell companies might be used in the context of criminal activity to conceal funds, and move assets without authorities being able to identify those asset movements.[2]

1 https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12999-Tax-avoidance-fighting-the-use-of-shell-entities-and-arrangements-for-tax-purposes/public-consultation_en

2. Stolen Asset Recovery Initiative, joint project of the World Bank and the UN, estimates that only a fraction of the value of stollen assets through such entities is being seized and recovered, World Bank. "Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities and Action Plan." (Accessed 14 July 2021)

Shell entities could be used to avoid the anti-money laundering obligations by allowing assets to be moved quickly, from simple wire transactions to complex mechanisms that rely on such entities. Many fringe activities, without any legitimate commercial or economic purpose, are relying on shell entities to engage in illicit movement of assets to further criminal causes.[3] Prior to the enactment of the Common Reporting Standard (CRS), a typical shell company from a tax haven held through nominee shareholders would constitute an example. According to the World Bank, the nominee shareholders and directors ensure that all official paperwork does not include the beneficial owner's details and assets can be moved at a moments' notice to another jurisdiction by the nominees should the need arise. A tax haven company set up in such a way allows anonymous banking and asset ownership and, in some jurisdictions, legal protection from foreign government court orders. Such companies could also be used to avoid sanctions and taxation.[4] The UN also confirmed that large-scale corruption typically involves use of shell entities to conceal ownership, enable tax evasion, and move around the world proceeds of corruption, according to a study conducted by the World Bank and the United Nations.[5]

To address such situations, CFE's view is that new anti-avoidance initiatives are not necessary at present, given that there are plethora of existing rules and practices enshrined in EU law which would be suitable to address the concerns outlined in the EU initiative to tackle abusive use of shell entities for tax avoidance purposes. This baseline scenario would be most suitable at present, from a policy, practical and administrative compliance perspective. Prior to any potential EU action, the Commission, in cooperation with Member states should assess Member States' practices and legislation (where existing) to address use of shell entities for tax avoidance and evasion purposes.

In addition, it is important to bear in mind that corporate law entities can be used legitimately and be structured in a way that genuinely reflects where commercial activity takes place and where assets are being held. The flow of technology, goods, services, and private capital requires structures allowed by present day company law, which also involve various corporate vehicles. As such, these entities constitute the foundation of entrepreneurial activities in market-based economies and have contributed to globalisation, the benefits of which we all enjoy today. We recognise, however, that these entities might be used for abusive purposes, including laundering proceeds of criminal activity, corruption, and bribe, defrauding creditors

3. Pacini, Carl, Jerry W. Lin, and Gary Patterson. "Using Shell Entities for Money Laundering: Methods, Consequences, and Policy Implications." Journal of Forensic and Investigative Accounting 13.1 (2021).

4. According to Transparency International (Australia), a company registered in Samoa and the Seychelles was alleged in the Panama Papers to have been used by the Syrian regime of Bashar Al Asad to avoid US sanctions on aviation petroleum products. Similarly, tax haven companies have alleged to have been used by North Korea and Iran to avoid sanctions. See http://time.com/4281652/panama-papers-companies-blacklisted-us-sanctions/

5. De Willebois, Emile van der Does, et al. The puppet masters: How the corrupt use legal structures to hide stolen assets and what to do about it. World Bank Publications, 2011.

as well as tax evasion and tax avoidance. Finally, with the enactment of mandatory disclosure rules (CRS, FATCA and DAC6) to a lesser extent these vehicles could be used to avoid any disclosure requirements, mandated by national, EU or international law.[6]

In an EU-law context the situation is very specific. The EU has soft-law instruments at its disposal including the Code of Conduct on Business Taxation, which does prescribe 'substance requirements' for legal entities in the context of evaluation of preferential tax regimes (for third countries).[7] In addition, for internal situations, secondary EU law already provides for effective tools to tackle structures where tax advantage is the sole reason for interposing a corporate vehicle (GAAR - Article 6 ATAD). The CFC rules provided by ATAD also provide tools to address the 'unintended consequences' of setting up a particular (shell) entity without any commercial justification.

Finally, the European Court of Justice has provided significant clarification as to what constitutes a 'wholly artificial arrangement', allowing Member states to disallow EU law benefits in purely abusive structures interposed solely for tax purposes and without any commercial justification whatsoever.[8]

3. Potential New EU Measures

If the decision is taken to draft a directive, assessment of exiting measures to tackle shell entities at Member states' level must be conducted prior to embarking on a legislative activity. The substance requirements would need to be carefully considered to reflect what would ordinarily constitute a genuine commercial activity. Any new rules should be proportionate to the issue at stake, and only target abusive structures, as overly broad rules might hinder genuine economic activity. Any such new rules must clearly avoid putting undue burden on taxpayers and business activity in the Single Market.

The driving principle in the matter should be, in our views, that a foreign entity may never be required to have more "substance" than a domestic one. For instance, if a multinational group established in a given EU country is not challenged for having set up holding companies with no personnel and equipment in the same country, why should it be criticised for having set up similar holding companies in another EU country? It is not admissible to require that foreign holding companies should systematically have personnel and equipment while domestic ones should not.

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6. OECD Report: Behind the corporate veil - using corporate entities for illicit purposes (IBFD): Corporate vehicles, such as corporations, trusts, foundations, and partnerships, are often used together to obscure ownership by maximising anonymity.

7. Code of Conduct for Business Taxation (EU), Criterion 3: "When assessing whether such measures are harmful, account should be taken of, inter alia: whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages"

8. Judgment of the Court of Justice of the EU (Grand Chamber) of 12 September 2006: Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue

Furthermore, we would advise caution in enacting EU law instruments that lack clear definitions. If the balance is not right in such a policy choice, the compliance costs of implementing another directive that includes hallmarks will be substantial for taxpayers and for tax administrations alike. Especially for tax administrations, the red-tape burden will involve monitoring, analysing, exchanging, and assessing a large amount of data. We envisage significant issues with the practical implementation of such actions.

4. Conclusion

Considering all of the above, it appears that there is no need for further legislative action regarding shell companies and that benefits from keeping the baseline scenario would outweigh the potential risks at present, by giving time for evaluation and full implementation of existing anti-avoidance measures, before adopting new legislative ones.