An Overview of the European Directive on Shell Companies

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Les sociétés écrans sont des entités légalement constituées qui restent inactives jusqu'à ce qu'elles soient utilisées par leurs propriétaires. Bien qu'elles n'aient rien d'illégal en soi, elles peuvent donner lieu à des abus, en particulier dans le domaine de l'évasion fiscale. La Commission européenne a proposé une directive sur ce sujet qui entrera en vigueur en 2024 et se réfère à 2022-2023 comme point de référence.

Las empresas pantalla son entidades legalmente constituidas que permanecen inactivas hasta que son utilizadas por sus propietarios. Aunque no hay nada intrínsecamente ilícito en ellas, existe la posibilidad de abusos, sobre todo en el ámbito de la evasión fiscal. La Comisión Europea propuso una Directiva para abordar esta cuestión que entrará en vigor a partir de 2024 y se refiere a 2022-2023 como referencia.

A 2018 European Parliamentary Research Service study noted three types of shell companies: (1) anonymous companies, (2) "letterbox" companies that register in one member State, but the company's economic activity occurs in another State to take advantage of differences in labor regulations and social security contributions, and (3) "special purpose entities," which are essentially holding companies. The new Directive is an attempt to regulate this, with the goal of implementing the EU's "Green Deal" and effective taxation, particularly where "interposed" companies are inserted in the chain of ownership[1]. The new Directive will enter into force in 2024 but refers to 2022-2023 as a benchmark.

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Mandatory Exchange of Data and Possible Request for Tax Audits Among Member States

The final approval is on the way for the European Directive on Shell Companies to fight interposed companies, the so-called intermediate companies, which are not engaged in any genuine economic activity. The EU Council, having acquired the favorable opinions of Parliament and the European Economic and Social Committee, is preparing to vote on the proposal COM (2021) 565, which contains a clampdown to prevent the exploitation of tax benefits provided by the conventions and Directives 2003/49 (on "interest and royalties") and 2011/96 (the so-called "parent-subsidiary Directive").[2]

Multinational corporations often set up companies without economic substance or meaningful activity to transfer profits to it from the high-tax Member States in which they operate. They do so by interposing a conduit company, which receives dividends, interests, royalties, and other passive income, enjoying the benefits of withholding taxes on outbound flows paid, subject to the issuance of a certificate of tax residence in an EU State, then re-transferring the gross profits (untaxed or minimally taxed) to the reference shareholder or group, usually residing in non-EU States.

The new Directive was implemented by 30 June 2023, for it to take effect in 2024, with an impact on the latter period subject to a tax return to be submitted in 2025.[3] But in reality, there is little time to reorganize. The "company at risk" of qualifying as a shell company, regardless of its legal form and amount of revenue, must carry out a substantive test based on the entry criteria – that is the "gateway" – which already occurred in 2022-2023. Otherwise, the absence of minimum economic substance results in the disapplication of all concessions provided by the conventions and directives (Article 6).

1. See generally *"Unshell" – Rules to Prevenet the Misuse of Shell Entities for Tax Purposes"*, found at https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/733648/EPRS_BRI(2022)733648_EN.pdf.

2. See in Europa.eu https://eur-lex.europa.eu/legal-content/IT/ALL/?uri=celex:32003L0049.

3. Assonime, [i.e., Association of Italian Joint-Stock Companies] Consultations n° 6, 7 April 2022.

Only EU companies with at least five employees and regulated financial companies are excluded. All others must carry out a self-assessment to verify the cumulative presence of three alerts in the 2022-2023 observation periods:

(1) achieving passive income for over 75% of revenues, a threshold that Parliament advocates should be reduced,

(2) exercising a cross-border business, and

(3) outsourcing the decision-making process of significant functions.

In the event of a positive outcome, the company shall report at least three "indicators of substance" in its tax return: the availability of premises, its bank account, and the directors' real powers and on-site residence.

Additional exculpatory documents and evidence are allowed, such as location and type of premises, qualifications and functions of directors, outsourced activities and nature of revenues and costs, as well as activities carried out to generate passive income (Article 7).

If the administrative audit reveals that the company lacks economic substance, the company can rebut the presumption that it is a shell company by providing additional evidence of the *commercial rationale* pursued and the *decision-making process* of the activities exercised, to demonstrate its control and bearing of risks (Articles 8 and 9).

Therefore, it was necessary for companies to reorganize as early as FY2022, both to avoid the negative fiscal effects – full withholding taxes, transparency taxation for the shareholders, denial of the certificate of residence, or issuance of a certificate that inhibits treaty benefits – and also to avoid the penalty of 5% of the turnover or, as suggested by Parliament, to be parameterized based on the assets owned, for the hypothesis of declaratory infidelity.

It is desirable to take immediate action also because the directive provides for the mandatory automatic exchange of information and the request for tax audits among Member States. Of course, reorganization of the company must be legitimate and it must have facts that justify the rationales and representations expressed.

The reorganization may involve the rationalization of holdings and the strengthening of governance, with corrections to the activities carried out, including those outsourced, implementing resources, employees, and functions of the director.

Alternatively, it is possible to opt *ex ante* for the exemption procedure by providing suitable evidence to demonstrate that the interposition does not provide any tax advantage either to its shareholders or beneficial owners or to the group (Article 10).

As such, the intent of the proposed Directive is evident: once it enters into force, the company with absent minimal "indicators of substance" could experience significant tax consequences, including dismissal of the tax benefits deriving both from the tax treaties and "interest and royalties directive," as well as "parent-subsidiary directive," resulting in a situation where the relevant jurisdiction will be unable to issue the residence certificate that represents the "*conditio sine qua non*" required for the attainment of these benefits (Articles 11 and 12).

The new regime will result in a higher effectiveness, also due to the automatic and "wide-ranging" exchange of information which will make it possible to share all relevant information among the Member States in a central register and facilitate tax audits (Article 13).

Conclusion

Companies are under increasing pressure to enhance their gatekeeping functions. The new EU Directive is a step towards codifying such obligations.

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