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Additional comments to the EBIT response to the European Commission's questionnaire as part of its public consultation on fighting the use of shell entities and arrangements for tax purposes

Brussels, 6 August 2021

Dear Mr Gentiloni,

EBIT's Members[1] thank the European Commission for the opportunity to provide additional comments to its questionnaire as part of its public consultation on fighting the use of shell entities and arrangements for tax purposes.

Below you will find additional comments that are intended to help put EBIT's responses to the questionnaire into perspective. The main points addressed here relate to issues regarding definitions, proliferation of measures, creating certainty for and trust between taxpayers and tax administrations, avoidance of double taxation, transparency and recognition of genuine transactions.

The European Commission announced its intention to fight the use of shell companies in its Communication of 18 May 2021 by stating objectives to step up further the fight against the abusive use of shell companies – i.e., using the Commission's terms companies with no or minimal substantial presence and real economic activity – through a new legislative initiative to neutralise the misuse of shell entities for tax purposes. EBIT's Members believe that the fight against tax avoidance and aggressive tax planning, as well as misuse of business structures, plays an important role in modernizing the international tax system, and, in particular, for safeguarding Europe's Single Market. EBIT Members also believe that it is necessary that genuine business structures and business models are not hampered in the way they genuinely generate value for those businesses and the Single Market.

Although the European Commission recognises that valid reasons for the use of shell companies may exist, the Communication puts the emphasis rather on their negative use. Whilst we agree that tax avoidance and aggressive tax planning are a legitimate concern, we wish to stress that the tools to be developed must be proportionate to and focused on the problem. This requires a clear understanding and a clear assessment of the problem at stake, against clearly defined parameters and based on objective and reliable data (which currently

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[1] EBIT's Members include Airbus Group, BP, Caterpillar, Diageo, GSK, Huawei, International Paper, Johnson and Johnson, JTI, Naspers, PepsiCo, Pfizer, P&G, Raytheon Technologies, RELX, Schroders and SHV Group. For more information on EBIT see: www.ebit-businesstax.com

seem lacking, as indicated in the 2018 Study referenced in the Inception Impact Assessment). The proposed approach by the European Commission in our view will not only impact artificial arrangements and harmful tax planning but also risks impacting acceptable tax planning, for example through mismatches in implementation of genuine business structures.

Definition of shell entities

EBIT's Members feel that the questionnaire is vague on the definitional issues of shell companies. In the first instance, entities with minimal or no substance or economic activity would be in scope of the project. However, the scope is not clear, since reference is also made to company service providers involved in the creation, participation, management of corporate vehicles, such as legal or accounting professionals (see questions 2.16 – 2.18).

Also, further reference is made to shareholders' activities. The list of activities mentioned in question 3.9 seems to suggest that these activities are typical of shell companies and hence would not create substance or economic activity. EBIT's Members wish to stress that these activities represent genuine economic activities within an MNE.

Whether an entity would be considered a shell company can only be determined on the basis of a factual, legal and economic analysis and should not be determined based on a shortlist – or longlist - of activities that are allegedly allocated to abusive shell companies.

Rather than focus on an entity by entity basis, for an MNE, the whole presence in a particular territory should be considered e.g. often activities are divided within separate entities within the same country for commercial, legal, historic or other reasons. The consideration should not be to analyse each entity within a country on a stand-alone basis but rather to look at the substance/activities in that country as a whole by an MNE. This is more appropriate for large groups. This approach based on the presence of a group in a territory instead of an entity by entity approach is also in line with the jurisdictional blending approach under Pillar II of the OECD / G20 project on the taxation of the digitalisation of the economy.[2] Nevertheless, such a test would only serve the purpose of demonstrating the total presence and activities of an MNE in a certain jurisdiction. The income of the distinct group enterprises would of course be determined on the basis of the separate entity approach and the arm's length principle.

To give a real-world example provided by one of EBIT's Members[3]:

Investment funds, particularly those investing in illiquid asset classes such as commercial property, housing, infrastructure assets, or unlisted debt and equity, asset holding companies are used for a variety of reasons. They may be used as a pooling vehicle allowing different investors to participate, either as investors in a widely marketed fund, or a joint venture, to share in the returns from assets.

A key benefit of an asset holding company is to limit the liability of the fund and its investors due to the limited liability that corporate form provides. This allows ring fencing of liability across different assets by holding them in separate legal entities, encouraging investment.

[2] See also the Inclusive Framework Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy of 1 July 2021

[3] NB: not all EBIT Members are asset management businesses: EBIT spans 16 different business sectors, more information is available on: https://www.ebit-businesstax.com/programme.aspx

Banks and other entities providing financing for investments typically require under the terms of a covenant for the assets to be held in a separate legal entity to facilitate clear delineation of the security and priority of payment. This may require multiple entities to be stacked within a structure to accommodate multiple finance providers with different levels of priority. This significantly reduces the administrative complexity of such tiered financing by clearly delineating which loans are enforceable against each entity.

Asset holding companies are critical in allowing certain investments to be made as a joint venture between a small group of investors, or between a fund and one or more investors (so allowing a fund to participate in an investment that is too large for it to invest alone). Asset holding companies facilitate decision making by giving authority to the directors of the company to make day-to-day decisions, such as making investments and disposing of them, rather than requiring all of the decisions to be made by the body of investors collectively and in a cumbersome manner. When selling illiquid assets, it is frequently beneficial to sell the shares in the asset holding company rather than the asset directly. While there may be tax benefits in doing so (if transfer taxes on shares are less than on the underlying assets) there are other benefits such as simplified conveyancing, no need to novate or re-establish service contracts relating to the asset, and retaining the ring-fencing of liability. A holding entity may be used to aggregate several asset holding companies together. This may provide multiple benefits such as allowing sub-consolidated accounts, simplification of contracting arrangements, ease of sale etc.

Investment funds are subject to a rigorous regulatory framework, and unregulated or less regulated funds are generally available only to institutional investors, which are often tax exempt in their home territory (e.g. pension schemes). While for the reasons given above, there are many reasons why funds and other investment vehicles are necessary to a structure, it is important that the investment structure is tax neutral so far as possible. This is achieved when the tax outcome for investors is similar to that which would be obtained if they held the asset directly. Accordingly, it is important that the asset holding companies in the structure do not add significantly to the tax burden, compared with a direct investment in the underlying asset. Such additional tax burdens would significantly deter investment. As such, a typical real estate fund would be structured in a way that it pays a fair amount of tax in the jurisdiction where the real estate is located on rental income and gains (according to local law and applying arm's length principles in respect of any financing). Intermediate holding entities are then structured in a way that minimises the tax burden for themselves and also for the investors. This then replicates the position of an investor holding the real estate directly.

While the same tax outcome could in theory be achieved by use of tax transparent entities (such as contractual funds and partnerships), these create significant complexities. Tax transparency is not universally recognized across all investment jurisdictions leading to adverse outcomes. The ability for investors to access their rights under double taxation treaties is significantly reduced where investment is held via transparent structures, particularly if multiple layers are involved, since it is difficult to trace ownership through the structure. Multiple filings for treaty benefits would be required creating a significant administrative burden for funds and investors – the cost of which may exceed the treaty reliefs being claimed. Holdings via an asset holding company in the context of a fund facilitates treaty claims by ensuring that only one claim is required. While acknowledging that this might allow claiming of treaty benefits greater than those the investors themselves were entitled to, the majority of investors in such funds are typically institutions which are treaty eligible. Any EU regime targeting asset holding companies should be specifically targeted at abusive arrangements – rules which are too broad are likely to deter a significant amount of investment.

MNEs may choose to incorporate shell companies for commercial purposes with no tax advantage, for example, as local holding companies for entities carrying on regulated/restricted activities, to facilitate corporate transactions such as demergers. Groups may also hold shell companies that historically had more extensive activities which declined/ceased and which cannot easily be eliminated for commercial reasons.

Existing measures for fighting tax avoidance and/or aggressive tax planning

During the last five years, a myriad of anti-tax avoidance measures has already been taken, mostly as a result of the publication of the G20/OECD BEPS reports in October 2015. The following list includes examples of anti-tax avoidance measures at international level that have seen the light since then:

- BEPS action 6 and the Multilateral Instrument (MLI): limitation of benefit clauses and / or principal purpose test with an impact on numerous double tax treaties;
- ATAD: introduction of and transposition in the domestic legislation of the Member States of
    - Interest limitation rules (Article 4);
    - Exit taxation (Article 5);
    - Controlled Foreign Companies (CFC) rule (Article 7);
    - Main purpose test (general anti-abuse rule) (Article 6); and
    - Anti-hybrid rules (Article 9).

Importantly, these measures are also used (or can also be used) to address tax avoidance through the abusive use of shell entities.

Further, several measures are still under construction, for example, introducing a minimum tax under Pillar II of the OECD / G20 project on the taxation of the digitalisation of the economy. The Income Inclusion Rule (IIR) operates as a sort of CFC rule. This measure can be used against shell entities. In its Communication of 18 May 2021, the European Commission indicated already that Pillar II would be implemented through a Directive.[4] The European Commission also noted that changes may be needed to the CFC rules and the Interest and Royalty Directive in order to bring them in line with Pillar II. Further news bulletins[5] indicated that the European Commission wants to act swiftly once an agreement on the Two-Pillar solution is reached at the international level. The impact of the Two-Pillar measures is likely to be significant. The OECD Secretariat recently stated that the cumulative impact of these initiatives means that the "tax haven" as people think of them would no longer exist.[6] The measures further support the jurisdictional approach as highlighted above. The OECD Secretariat expects that those jurisdictions that offer international financial services may continue to find a market for their services, particularly where they add value for their customers in providing advice and support for commercial transactions that are not tax-driven.[7] The recent statement by the Inclusive Framework on a Two-Pillar Solution has now been agreed by 132 member jurisdictions and has been subsequently endorsed by the G20 Finance Ministers. It would be good if the impact of these developments would be taken on-

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[4] See section 2.2 of the Communication from the Commission to the European Parliament and the Council - Business Taxation for the 21st Century

[5] Commission mulls minimum tax rate rollout early next year - by Matei Rosca - June 30, 2021 – available at https://pro.politico.eu/news/eu-commission-mulls-first-time-use-of-anti-distortion-provisions-on-tax-policy

[6] OECD Highlights brochure: Addressing the tax challenges arising from the digitalisation of the economy, July 2021. https://www.oecd.org/tax/beps/brochure-addressing-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf

[7] OECD Highlights brochure: page 15.

board and evaluated, given the potential overlay with the topic at hand ("fighting the use of shell entities and arrangements for tax purposes").

The EU's ATAD Directive provided for two options for introducing CFC rules, namely:

- Option A on passive income: income derived from interest or any other income generated by financial assets, royalties, dividends, disposal of shares, income from financial leasing, income from insurance, banking and other financial activities, income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little economic value; or

- Option B on non-genuine income: non distributed income of the entity or permanent establishment arising from non-genuine arrangements in a low taxed jurisdiction which have been put in place for the essential purpose of obtaining a tax advantage and lack substance.

Any contemplated EU shell entity Directive should not be construed in such a manner that it would disallow the choice of the Member States for either Option A or Option B.

EBIT's Members welcome and appreciate the European Commission's hard work on measures fighting tax avoidance. Because there are multiple measures that have been implemented recently or that are in the course of being developed and will be implemented soon that will also tackle abusive shell entities, we are surprised that the European Commission is now working on a proposal for another EU Directive that likely will duplicate certain measures that are elaborated on in a global context.

In the 2018 study commissioned by the European Parliament titled: "An overview of shell companies in the European Union"[8], the authors indicate that it is too early to assess how the recent pieces of legislation (reference is made to the ATAD and BEPS measures) will perform on their own, and in combination with other related pieces of legislation. The authors of the study recommend to the European Parliament a fitness check that could lead to a more comprehensive picture of how the legislative and policy interventions have performed within the EU. Although this recommendation was written in 2018, EBIT's Members believe this is still valid today. EBIT's Members consider that such a thorough assessment of the existing measures and their application (including how EU Member States have implemented these in their audit activity and how much additional tax revenues have been or are being collected as a result of this) and interaction should take place before any new – likely overlapping – legislative measure is put forward. If existing measures are demonstrated to not be fully effective, EBIT's Members believe that consideration should be given in the first instance to ways in which the relevant measures or their implementation / application may be adapted (ensuring consistency in the implementation and application of the relevant rules: see below). Any additional legislative measure that is still considered necessary thereafter should only target clearly identified remaining areas of concern.

Next to the work at the international level, EU Member States have introduced in their domestic legislation also anti-abuse measures to counter tax avoidance and aggressive tax planning, for example under the format of general anti-avoidance rules or specific anti-avoidance rules. Another element which should not be underestimated is the evolution of new insights through (EU- or national-level) court rulings and doctrine. One example is the Danish court rulings on beneficial ownership.

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[8] Ivana Kiendl Krišto and Elodie Thirion - Study: An overview of shell companies in the European Union - ISBN: 978-92-846-3377-7

Creating certainty for and trust between taxpayers and tax administrations

As indicated above, a multitude of measures addressing tax avoidance and aggressive tax planning have already been taken and may need to be adapted considering the ongoing work in the international tax arena. A possible separate EU Directive specifically addressing shell entities would come on top of those measures. A proliferation of measures leads to multiple layers of legislation, and an increase of uncertainty for taxpayers and tax administrations alike because of:

- Conflicting provisions in the different measures, for example different scope and application conditions;
- Absence of streamlining between the countries' unilateral measures;
- Different or conflicting interpretations of the different instruments.

These elements create uncertainty for both taxpayers and tax administrations, which in turn leads to more controversy and disputes.

A specific element to which EBIT's Members want to draw attention is the potential different interpretation by EU Member States with regard to scope and effective application of the measures, creating uncertainty and leading to mismatches in their application, resulting in double (multiple) taxation, or in some (less likely) cases potentially even less than single taxation, and more disputes and controversy. As an example, the approaches that EU Member States consider on the basis of the Danish beneficial ownership cases give rise to uncertainty (and lead to double taxation and controversy). What is needed in the first place in EBIT's Members' view is to bring consistency to the different rules.

EBIT's Members believe that the announced measure on shell entities is unlikely to help restore the trust relationship between the taxpayers and tax administrations. Indeed, the intended measures seem to indicate that any use of a shell entity is abusive, without even having performed an in-depth examination of the surrounding legal and economic facts and circumstances: moreover, shell companies that have been predominantly set up for economic and legal (protection) reasons while no tax advantage prevails, should not be affected.

Avoidance of double taxation / ensuring single taxation

One effect of the multitude of measures mentioned above is the potential for creating double or multiple taxation. The two goals of avoiding double taxation on the one hand are best served by an integrated and consistent set of measures, based on an in-depth knowledge of the workings of the MNE and the actual business models that are used. EBIT's Members acknowledge the rationale of single taxation at investors' level. As already indicated, a shortlist - or longlist - of activities that could potentially lead to aggressive tax planning may not be the solution. The solution should rather be found in an analysis of whether the transaction or arrangement is genuine and economically sound and not wholly artificial.

Transparency

The questionnaire refers to promoting transparency on shell entities across the EU (see possible options under question 3.23). EBIT's Members would like to draw attention to the several transparency measures that have been taken – or will likely be taken shortly – with respect to enhanced transparency[9]:

[9] Private and voluntary initiatives on transparency are not considered here.

- OECD/G20 standards on Exchange of Information on Request (EoIR) and Automatic Exchange of Information (AEoI);
- DAC3 - compulsory spontaneous exchange of information on tax rulings and APAs (resulting from BEPS Action 5);
- DAC 4 - Country-by-country reporting (resulting from BEPS action 13);
- DAC5 – tax administrations access to beneficial ownership information;
- DAC6 – reporting of potentially harmful arrangements by tax intermediaries;
- DAC7 – reporting of certain elements by platform operators, and perhaps more importantly the creation of a framework for joint audit;
- EU public country-by-country reporting.

EBIT's Members are convinced that the above measures – alongside the right of tax authorities to ask for additional information within the framework of exchange of information and/or a tax audit – allow tax authorities to retrieve the right kind of information to make an informed decision on whether or not specific scrutiny is required to tackle specific constructions or transactions. As mentioned above, EBIT's Members believe a thorough assessment of the effectiveness of existing measures should include an assessment of how EU Member States have implemented existing measures in their audit activity and how much additional tax revenues have been or are being collected as a result of this.

Recognition of genuine transactions versus artificial constructions

EBIT's Members have already drawn attention to the distinction between genuine business structures and artificial constructions. It is indeed important that genuine business structures are not negatively impacted, also given the potential spill-over effects this could have for the single market as a whole. This is also in line with settled case law of the European Court of Justice – and as reflected in the EU's Directives i.e. any additional measure should specifically relate to wholly artificial arrangements aimed solely at escaping tax normally due on domestic profits and should not go beyond what is necessary to achieve that purpose. EBIT's Members are convinced that the existing framework is both fit for purpose and adequate to tackle any remaining issues, including artificial constructions.

EBIT Members trust that the above additional comments are helpful and are taken into account. EBIT Members are always open to engage in further discussions and consultations on this important subject.

Yours sincerely,

European Business Initiative on Taxation – August 2021

For further information on EBIT, please contact EBIT's Secretariat via Bob van der Made, Telephone: + 31 6 130 96 296; Email: bob.vandermade@pwc.com).

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