The announced Unshell Directive and SAFE initiative and the EU's impact in non-EU countries

Chair: Sigrid Hemels | Dutch Council of State and Erasmus University Rotterdam

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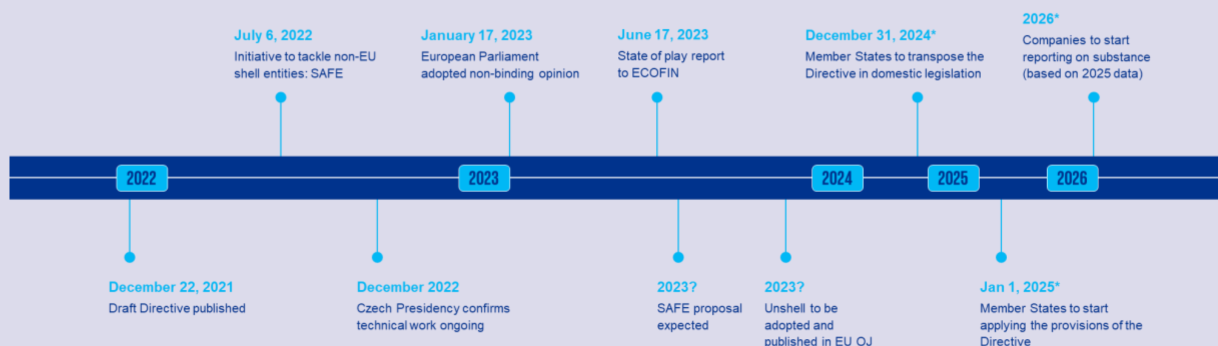
The second session that took place in the morning of Thursday, the 6th of July, concerned the announced Unshell Directive and SAFE initiative. Hemels emphasizes in her opening remarks that the Member States are still discussing the Unshell directive and that changes to the proposed proposal are expected. With regards to the SAFE initiative Hemels stated that there is not even a proposed directive. This panel, therefore, focused on moving targets. Both directives have an impact on third countries.

After Hemels introduced the panel members, Enache discussed the proposed Unshell directive.

Presentation 1: Unshell, Raluca Enache (head of KPMG's EU Tax Centre)
Enache started with a timeline:



She discussed the seven-step process that can be derived from the Unshell directive. This process starts with determining if the (shell) entity needs to report on economic substance (gateway test and substance test) and, if so, is followed by the rebuttal option (a tax motive test). If the entity is a tax motivated shell entity, this may have tax consequences, and information will be exchanged on an automatic basis. As a result of the discussion between the Member States, the separate gateway test and substance test that are part of the draft directive will most likely be merged into one test.

The directive contains several carve outs. These include listed companies or regulated financial undertakings and holding companies with no or limited cross-border elements. Currently, the draft directive also includes a carve out for undertakings with at least 5 full time equivalent employees (fte's) or members of staff exclusively carrying out the activity's generating the relevant income. Based on the current discussion, it seems that the 5 fte carve out will be removed.

Enache discussed the gateway test, reporting obligations, the minimal substance indicators, and the rebuttal option. In addition, she analyzed the tax consequences for both the shareholder of the shell entity, the shell

entity itself and the entity paying to the shell entity. She emphasized that the current proposal implies that the shell entity will not receive a tax residence certificate at all or get one with a warning that the entity is a shell entity.

Enache concluded with some practical considerations, one being that significant compliance and administration is required, for example the reasons for including a shell entity in the group structure. This could be problematic since in existing structures this might not be administrated sufficiently. Furthermore, she referred to the impact on tax treaties with non-EU countries, the impact on existing commercial agreements and the interaction with Pillar two. She concluded with stipulating that the directive is still a draft under discussion.

Hemels concluded this part of the panel by agreeing with Enache that it is of the utmost importance to not see the Unshell directive as standalone legislation but to take into account the interaction it has with other instruments that are already in place or that might be introduced in the future. With this remark, she made the bridge to Ivanovski's presentation.

Presentation 2: Securing the Activity Framework of Enables (SAFE), Aleksander Ivanovski (Director of tax policy at CFE Tax advisers Europe)

Ivanovski had, according to Hemels, the big challenge to discuss an initiative for which not even a draft has been proposed. Ivanovski stressed that the SAFE initiative is based on ethics. SAFE is not so much about the legality of an arrangement but addresses more the acceptability. Ivanovski referred in this context to several existing ethical codes for professional advisers in some Member States.

The goal of the SAFE initiative is to prevent *enablers* from setting up complex structures in *non-EU countries*, with the objective of eroding the tax base of Member States through tax evasion and aggressive tax planning. On the first day of the IFA conference one panel member working for the European Commission (EC) stated that the draft SAFE directive will be published after the Unshell directive has been adopted. Progress is expected during the Spanish EU Presidency. Ivanovski noted that European Commissioner Paolo Gentiloni confirmed that DG TAXUD already completed the technical work on the draft directive.

Ivanovski discussed that the initiative interacts with existing initiatives to combat tax evasion and aggressive tax planning, such as DAC6. The aim of DAC6 is to provide tax administrations with information on potential aggressive tax arrangements so that they can react to harmful tax practices and close loopholes by enacting legislation or by carrying out risk assessments.

According to Ivanovski, the EC considered three policy options. The first option was that the enabler (the tax advisor) would be required to carry out dedicated due diligence procedures. These procedures would entail that all enablers would need to carry out a test to check whether the arrangement or scheme they are facilitating leads to tax evasion or aggressive tax planning. The second option would be a prohibition to facilitate tax evasion and aggressive tax planning in combination with due diligence procedures and a requirement for enablers to register in the EU. Only registered enablers would be allowed to provide advice or services of a tax nature to EU taxpayers or residents. In cases of non-compliance, enablers could be removed from the registry. The third option was a code of conduct, but this option is the least likely to be included.

Ivanovski stated that to combat tax planning it is very important to have clear definitions in the possible SAFE directive for enablers to know what is allowed and what is not allowed. Such clear definitions are missing in the DAC6 directive with regards to the hallmarks. Ivanovski suggested the UK-DOTAS regime for inspiration. He stated that enabling aggressive tax planning is far removed from what one would expect from competent and ethical professionals.

Ivanovski referred to the CFE Discussion Paper *Ethical Bar for All Advisors – 'If It Is Legal, Is It Acceptable?'*. This paper proposes an ethics quality bar for tax advisors based on five key questions to achieve an appropriate balance between the rights and obligations of taxpayers and avoiding abusive tax planning. The paper is also directed at tax policymakers and tax administrations in the hope that they will embrace the promotion of an ethics quality bar to ensure that high professional standards are not undermined within the market.

The five key questions being presented in the CFE paper are:
1. Is there a genuine economic purpose for the tax planning apart from achieving a tax benefit, either now or in the future?
2. Are the arrangements artificial or manipulated in a form-over-substance approach to achieve a tax benefit?
3. Is the tax planning based on interpretations of applicable international and national tax law which are likely to be considered credible by the courts and informed stakeholders?
4. Would the arrangement be implemented if the relevant tax authority had a full overview of every aspect of the planning?
5. Are there any other potential reasons why the tax planning could be perceived by policymakers and the general public as abusive?

Presentation 3: EU's impact in non-EU countries, The Swiss perspective, René Matteotti (professor of law, chair in Swiss, European and International Tax Law, university of Zürich and tax attorney at Tax Partner in Zürich)
Matteotti presented a third country perspective (Switzerland). He discussed the Swiss substance requirements for foreign intermediate companies to claim benefits under the tax treaty between Switzerland and the state of residence of the intermediate company.

Swiss law requires three types of substance:
- Personnel substance
- Functional substance
- Financial substance

Personnel substance can also be met if another group entity based in Switzerland has the required number of employees. Financial substance is met if there is at least a 30% equity capital ratio. Financial substance suffices to meet the substance test if the direct or indirect shareholder is:
- listed on a stock exchange, or
- is an operating company in a Double Tax Convention/Double Tax Treaty (DTC) country, or
- is a holding company resident in a DTC country with an operating company resident in the same DTC country.

In these DTC situations the personnel substance and functional substance of the intermediate company in its residence country are irrelevant. This is a relaxation of the normal substance requirements Switzerland requires outside of the DTC context.

However, there is also a more formal requirement: the intermediate company must have a tax residence certificate. Without a tax residence certificate, Switzerland does not provide tax treaty benefits. Therefore, for Switzerland it is very important what will be included in the Unshell directive with respect to the tax residence certificates.

Matteotti discussed several cases. The first scenario is a Swiss intermediate company with an EU Debtor. The Unshell directive will according to Matteotti have no impact on the intermediate Swiss Company, since it is based in a third country. Matteotti raised the question how the Unshell directive will affect the application of the PPT. In his opinion it would be tempting for EU member states to rely on the substance criteria included in the Unshell directive and therefore on their own EU set of rules. A set of rules Switzerland may not agree with.

The second scenario was an EU intermediate company with Swiss shareholders. According to Matteotti, the shareholders in Switzerland are eligible for treaty benefits since the Unshell directive does not have extra territorial affect. The EU country of the intermediate company may levy a withholding tax according to the Unshell directive. This withholding tax will not be credited by Switzerland at the level of the shareholders. This will make Switzerland less attractive and therefore the Unshell directive has indirect impact on Switzerland.

The third scenario involves a Swiss debtor owned by an intermediate company based in the Netherlands with US shareholders. This is a common structure because the tax treaty between the Netherlands and the US leads to a 0% withholding tax instead of a 5% withholding tax in case the tax treaty between Switzerland and the US would apply (which would be the case without the Dutch intermediate company). Without the Unshell directive, Switzerland would just look at the tax certificate of the Dutch intermediate company, the financial substance (30% equity ratio) and the shareholders in the US.

Under the Unshell directive, the Netherlands would probably give a certificate of residence with a shell notice. Matteotti assumes that Switzerland will not change its practice and will still apply its 30% equity requirement which is quite favorable for US investors. If the Unshell directive would not allow member states to issue a tax certificate, Switzerland would not be able to grant benefits according to its domestic procedural law. It is therefore very important whether the certificate will be given or not.

Panel discussion
Matteotti ended his presentation with a question to Ivanovski: what impact would SAFE have on US and Swiss tax advisors involved in setting up structures such as in the third scenario (an intermediate company in the Netherlands)? Ivanovski thinks that those tax advisors will be obliged to report about this structure, but this is it not clear. Matteotti hopes that there will not be an exterritorial effect for Swiss tax advisors and that Swiss tax advisors will not be required to register in the EU when advising EU clients. This could lead to problems because Swiss criminal law prohibits Swiss citizens to exchange information with other countries if they have no nexus in the other country.

Matteotti asked Enache to reflect on the tax certificate issue that might arise. Enache pointed out that the Unshell directive only looks at the substance of the intermediate company and not at the substance/characteristics of the shareholder or of companies that are also based in the resident country of the intermediate. The Unshell directive takes a very individual approach. With respect to the tax certificates, Enache reckons that Member States will not agree on having the EU set rules about tax residence certificates. Matteotti agrees and adds that it would be a breach of the double tax treaties if Member States would not provide tax residence certificates.

Boei raised the question whether an (EU) General Anti Abuse Regulation (GAAR) could apply if an entity would not be regarded a shell under the Unshell directive, either because the substance requirements are met or because the rebuttal possibility that the intermediate is interposed for commercial reasons is met. Boei was of the opinion it would be wrong to disallow treaty or EU directive benefit in such cases. If a specific situation falls under specific legislation, it should not be possible to apply a GAAR. Enache replied that from an Unshell perspective Member States still want to have the possibility to apply the EU GAAR or their local GAAR. So, meeting the Unshell directive requirements is not the end. This challenges the legal certainty that companies need. Furthermore, the EU does not regard the Unshell directive as an anti-abuse regulation.

Matteotti asked Enache how the Unshell directive will affect the application of the PPT. Enache replied that it is most uncertain what the impact will be. Tax authorities already apply substance requirements similar to the ones in the Unshell directive.

Hemels asked Enache how multinational enterprises (MNE's) can prepare for Unshell. Enache pointed out that with or without Unshell, we are moving towards a more substance-based environment. She advised tax advisors/MNE's to map their structure for example based on the substance requirements from the Unshell directive or the rules that follow from the Danish beneficial ownership cases. Companies should be aware of risks. Enache advised to always consider what the (commercial) reasons are when setting up a structure or arrangement and keep a record of these reasons.

Hemels asked Ivanovski how tax advisors can prepare for what is coming. Ivanovski points out that CFE is already making tax advisors aware of tax ethics since this will be of increased relevance. Hemels ends the panel with some final words thanking the panel and the audience.

Panel members:

- Sigrid Hemels (Chair) | Dutch Council of State and Erasmus University Rotterdam
- Raluca Enache | KPMG
- Aleksandar Ivanovski | CFE Tax Advisers Europe
- René Matteotti | University of Zurich and Tax Partner Zurich
- Willem Boei (Secretary) | Erasmus University Rotterdam