

Anti-Tax Avoidance Directive 3 (ATAD 3)

EU Proposal on Shell Companies



The Dublin based treasury services company



The ATAD 3 proposal, if adopted as an EU directive, is due to be effective from 1 January 2024. Here Justin Callaghan, CEO of FTI Treasury, provides an overview of the proposal and some of the considerations for corporates to evaluate now.

What is ATAD3?

On the 22 December 2021 the EU published its proposal for a council directive to establish a single set of pan EU rules to prevent the misuse of shell entities for tax purposes. The proposal for the Anti-Tax Avoidance Directive 3 (ATAD3) follows the OECD BEPS project and several other EU directives targeting tax-based structures.

The proposal's goal is to introduce a range of standardised minimum substance criterion aimed at identifying entities with 'relevant income' which may have limited economic activity, known as risk cases. It then outlines a step-by-step process to be followed by any of these identified risk cases, including reporting requirements on entity substance, rebuttal and exemption processes, and the potential tax consequences for risk cases.

How is relevant income defined?

Relevant income is defined as income falling under any of the following categories:

- Interest or any other income generated from financial assets, including crypto assets
- Royalties or any other income generated from intellectual or intangible property or tradable permits
- Dividends and income from the disposal of shares
- Income from financial leasing
- Income from immovable property
- Income from movable property, other than cash, shares or securities, held for private purposes and with a book value of more than one million euro

- Income from insurance, banking and other financial activities
- Income from services which the undertaking has outsourced to other associated enterprises

Which entities are in scope?

The proposal is broad in its scope and aims to identify and obtain the relevant reporting information from all non-exempt entities which meet the 'gateway' criteria. Exempt entities listed under Article 7 of the proposal are detailed as follows:

- Companies listed on a regulated market or multilateral trading facility as defined under Directive 2014/65/EU of the European Parliament and of the Council
- Regulated financial undertakings
- Undertakings that have the main activity of holding shares in operational businesses in the same Member State while their beneficial owners are also resident for tax purposes in the same Member State
- Undertakings with holding activities that are resident for tax purposes in the same Member State as the undertaking's shareholder(s) or the ultimate parent entity

Key Dates

- 22 Dec 2021 - Proposal Issued
- 30 Jun 2023 - Transposed to Member States national law
- 1 Jan 2024 - Effective

Importantly there is a 2 year look back clause within the proposal which means there is potential for the proposal to be relevant from 1 January 2022.

- Undertakings with at least five own full-time equivalent employees or members of staff exclusively carrying out the activities generating the relevant income

If an entity does not qualify for an exemption under any of the listed categories, they must assess if they breach the gateway for 'risk cases'.

What is the 'gateway'?

Risk cases which must report substance details under ATAD 3 are entities which simultaneously present several criteria. These are referred to as gateway criteria. Entities that present none or only some of the gateway criteria are referred to as 'low risk cases' and are irrelevant for the purposes of the Directive.

The gateway criteria which must be considered for the preceding two tax years, are:

- More than 75% of the revenue accruing to the entity is relevant income
- The undertaking is engaged in cross-border activity on any of the following grounds:
 - more than 60% of the book value of the entity's assets are located outside the member state jurisdiction of the entity
 - at least 60% of the entity's relevant income is earned via cross-border transactions
- The undertaking outsourced the administration of day-to-day operations and the decision-making on significant functions

An entity which presents all these characteristics will fall into the risk case category.

What are reporting requirements for risk cases?

Risk cases will be required to report their position in respect of 'indicators of minimum substance' in the annual tax return. These indicators are:

- Does the entity have its own premises/office space for its exclusive use
- Does the entity have at least one active bank account in the EU
- One of the following:
 - One or more directors of the entity:
 - is resident for tax purposes in the same jurisdiction as the entity;
 - is qualified and authorised to make decisions in relation to the activities that generate relevant income;
 - is actively and independently exercising this authorisation regularly;
 - is not an employee of a non-associated company and does not act as director of any other non-associated company.
 - The majority of full time employees of the entity are resident in or the

ATAD3 Process Steps:

1. Is entity in exempt category?
2. Does entity pass all gateway criteria for risk cases?
3. Report on substance
4. Assessment of reporting by tax authorities
5. Claim rebuttal of assessment.
6. Claim exemption.

live closeby the jurisdiction of the entity and are qualified to undertake the activities which generate the relevant income

Documentary evidence will need to be provided for each of these indicators, including:

- address of premises;
- amount and type of gross revenue;
- amount and type of business expenses;
- details of business activities performed to generate the relevant income;
- number of directors, their qualifications, authorisations and place of residence for tax purposes *or* the number of full-time equivalent employees performing the business activities that generate the relevant income, their qualifications and their place of residence for tax purposes;
- details of outsourced activities;
- bank account number and any mandates granted to access the bank account.

Assessment by tax authorities

Information reported by risk case entities will be assessed by the tax authorities and where all indicators are met, and satisfactory evidence is supplied the entity will be presumed to have met the minimum substance requirements for the tax year. Where either all indicators are not met or evidence of such is not satisfactory to the tax authorities, the entity will be presumed to not have met the minimum substance requirements for the tax year.

Rebuttal of substance presumption

The proposal allows for an entity to rebut the presumption of not meeting minimum substance levels by providing additional information to the tax authorities.

The additional information required is to include:

- Details of the commercial rationale for establishing the entity
- Employee details including role and position in the organisation and decision making powers
- Evidence that decision making in respect of the activities generating relevant income is taking place in the jurisdiction of the entity

If the entity is successful in the rebuttal of the presumption then, as long as the factual and legal circumstances of the entity remain unchanged, this rebuttal will stand for the tax year in question plus an additional 5 years.

Exemption from consequences

An entity can obtain an exemption from the consequences of not meeting the minimum substance requirements if an organisation can show the existence of the entity does not reduce the overall tax liability of the shareholder or group of the entity. To obtain an exemption evidence will need to be provided allowing for a comparison of the group's overall tax liability without the relevant entity versus with the relevant entity showing no tax benefit. If the entity is successful in obtaining an exemption this will stand for the tax year in question plus an additional 5 years.

Tax consequences

The tax consequences of not meeting the minimum substance requirements and thus being defined as a shell company include:

- Other EU states will disregard any double taxation agreements and conventions which may be in place with entity's jurisdiction
- If the shareholder of the entity is tax resident in an EU state then relevant

income of the entity will be taxed in accordance with the national laws of its shareholder's jurisdiction.

- If the entity's shareholder is not resident in an EU state then the payer of relevant income will apply withholding tax as if the income was being paid directly to the jurisdiction of the shareholder.
- The entity may be denied a tax certificate or issued with a tax certificate which states that the entity has shell company status and is not entitled to the benefits of certain double taxation agreements.

The specific consequences will vary on a case-by-case basis depending on the overall group structure of an individual organisation.

Exchange of information, penalties and audit

The proposal lays out a requirement for the exchange of detailed information for all reporting entities. This will result in an EU-wide database of reporting entities.

Entities which fail to report the necessary information or provide inaccurate reporting could face a financial penalty of up to 5% of the entity's turnover in the relevant tax year.

If an EU state has reason to believe that an entity tax resident in another EU state has not met its obligations under the Directive they can request the tax authorities of the state where the entity is resident to undertake a tax audit. This audit will need to be started within one month of the request.

What can be done now?

Whilst the Directive is still at the proposal stage and there are likely to be numerous changes it would still be prudent to undertake a review of corporate structures and evaluate the potential impact.

Practical steps could include:

- Evaluate entities for exemption
- Assessment of structure for potential reporting entities
- Assess substance indicators within identified risk cases
- Evaluate rebuttal prospects
- Evaluate exemption prospects
- Develop a plan to limit impact of Directive implementation

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