

TAX

EU DIRECTIVE PROPOSAL TO PREVENT THE MISUSE OF SHELL ENTITIES FOR TAX PURPOSES

VdA EXPERTISE



February 2022

On December 22, 2021, the European Union ("EU") Commission released the proposal for a Directive to prevent the misuse of shell entities for tax purposes and amending the Directive on Administrative Cooperation in the field of taxation ("DAC").

The proposal for a Directive – commonly designated as "Unshell Directive" or the "ATAD 3" – follows recent efforts to strengthen the international legal framework against tax avoidance, by setting criteria helping Member States to identify entities with no economic substance established in the EU and preventing such entities to accede to benefits under EU law.

The ATAD 3 will be applicable to any entity, regardless of its legal form, that is a **tax resident and eligible to receive a tax residency certificate in a Member State**, irrespective of profitability or turnover volume.

Entities that, due to the nature of their activity, do not pose a risk of lack of substance for tax purposes are **excluded**. These include, among others, listed companies, regulated financial entities and holding companies that are resident for tax purposes in the same Member State as their shareholders or the ultimate parent entity.

Only entities that are deemed to have a high risk of having low economic substance are subject to the reporting obligations and subsequent scrutiny by the Tax Authorities in the relevant jurisdiction.

An undertaking is considered a **high risk entity** if all the following requirements are met:

- In the preceding 2 tax years, more than 75% of the income is derived from interest or other income generated from financial assets (including crypto assets), royalties, dividends, income from financial leasing, immovable property, income from services outsourced to associated enterprises, insurance, banking and other financial activities (also referred to as "**Relevant Income**");
- It is predominantly engaged in cross-border transactions, meaning that a majority of the aforementioned income is received or passed to another jurisdiction; and
- In the preceding 2 tax years, the day-to-day management and the decision-making on significant functions of the entity is wholly or partially outsourced.

Entities that are considered to have a low risk of low economic substance are not subject to the reporting obligations.

High risk entities will be **required to disclose additional information in their tax returns each year**, including:

- Address and type of premises;
- Amount and sort of gross revenue and business expenses;
- Nature of business activities performed that generate relevant income;
- The number of directors, 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, qualifications and place of residence for tax purposes;
- Outsourced business activities; and
- Bank account number, mandates granted to access the bank account and to use or issue payment instructions, and evidence of the account's activity.

Entities that are required to report the abovementioned information will be considered as having economic substance if all the following criteria are met:

- The entity has its own premises or premises for its exclusive use in the Member State;
- The entity has at least one active bank account in the EU;
- The entity has qualified directors or full-time employees who are resident for tax purposes in the same Member State as the entity or within commuting distance.

Entities that are deemed not to have minimum substance for tax purposes will be denied a request for a certificate of tax residence for use outside of their residence Member State, as well as access to any agreements, conventions and other instruments that eliminate double taxation.

The ATAD 3 is expected to be applicable as from 1 January 2024, with implementation beginning in 2023.

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