



# **The Good, the Bad and the Ugly: DAC6, “Unshell” and European Anti-Treaty-Shopping Rules**

**STEP Israel Conference**

**September 20, 2022**

## **Panelists**

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# Agenda:

- Introduction
- DAC6 - Directive of Administrative Cooperation – Tax Transparency
- “Unshell” Directive – Proposal for an EU Directive to prevent the Use of Shell Entities
- What could be the Future of Taxation?

# What is DAC6?

- **Mandatory reporting regime:**
  - “cross border arrangements”
  - Implicating one or more “hallmarks”
  - By “intermediaries (and, in some cases, taxpayers)”
  
- **To EU tax authorities, subject to automatic exchange of information**



## Considerations and study cases on EU DAC6 and “Unshell”

20 september 2022 | *Luigi Belluzzo, TEP*

**STEP Israel 2022**

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**A. DAC 6**

- ❖ **Directive (EU) 2018/822**, the so-called DAC 6, aims at the protection of national tax bases. The Directive, in fact, belongs to the instruments of the 'transparency package', drawn up by the European Commission in connection with the BEPS Project, and, in particular, it refers to Action 12, called '**Mandatory disclosure rules**'.
- ❖ The DAC 6, in particular, introduces a disclosure obligation for intermediaries, with respect to **cross-border mechanisms**, which they themselves have developed or marketed or with respect to which they have provided assistance or advice, in the event that the **hallmarks** identified by the Directive are met.
- ❖ In such cases, therefore, the intermediary (and in some cases the relevant taxpayer) will be obliged to communicate to the competent Administration the information relating to this mechanism. The information will then be subject to **automatic exchange** with the relevant European Administrations.

- ❖ It should be noted that the distinguishing features mentioned are identified in [Annex IV](#) of the Directive and are characteristic of a given arrangement and symptomatic of a 'potential risk of tax avoidance'.
- ❖ More in detail, they are divided into the following categories:
  - A. Generic hallmarks linked to the [main benefit test](#);
  - B. Specific hallmarks linked to the [main benefit test](#);
  - C. Specific hallmarks related to [cross-border transactions](#);
  - D. Specific hallmarks concerning [automatic exchange of information \(D.1\)](#) and [beneficial ownership \(D.2\)](#);**
  - E. Specific hallmarks concerning [transfer pricing](#).

The 'hallmark D' relates to [behaviour](#) designed to thwart the exchange of information or to make the identification of beneficial owners more difficult. In detail, this hallmark is aimed at intercepting (i) mechanisms designed to circumvent automatic exchange of information obligations on financial accounts; (ii) mechanisms using an opaque offshore structure

- ❖ An **arrangement** which may have the effect of undermining the reporting obligation under the laws implementing Union legislation or any equivalent agreements on the automatic exchange of Financial Account information, **including agreements with third countries**, or which takes advantage of the absence of such legislation or agreements. Such arrangements include at least the following:
- (a) the use of an account, product or investment that is not, or purports not to be, a Financial Account, but has features that are substantially similar to those of a Financial Account;
  - (b) the transfer of Financial Accounts or assets to, or the use of jurisdictions that are not bound by the automatic exchange of Financial Account information with the State of residence of the relevant taxpayer;
  - (c) the reclassification of income and capital into products or payments that are not subject to the automatic exchange of Financial Account information;



- (d) the transfer or conversion of a Financial Institution or a Financial Account or the assets therein into a Financial Institution or a Financial Account or assets not subject to reporting under the automatic exchange of Financial Account information;
- (e) the use of legal entities, arrangements or structures that eliminate or purport to eliminate reporting of one or more Account Holders or Controlling Persons under the automatic exchange of Financial Account information;
- (f) arrangements that undermine, or exploit weaknesses in, the due diligence procedures used by Financial Institutions to comply with their obligations to report Financial Account information, including the use of jurisdictions with inadequate or weak regimes of enforcement of anti-money-laundering legislation or with weak transparency requirements for legal persons or legal arrangements.

- ❖ **An arrangement involving a non-transparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures:**
  - (a) that do not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises; and
  - (b) that are incorporated, managed, resident, controlled or established in any jurisdiction other than the jurisdiction of residence of one or more of the beneficial owners of the assets held by such persons, legal arrangements or structures; and
  - (c) where the beneficial owners of such persons, legal arrangements or structures, as defined in Directive (EU) 2015/849, are made unidentifiable.



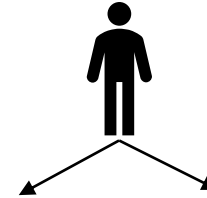
## **A.1 STUDY CASE**

**Individual transfer of residence from Israel to Italy**

# «AS IS» SITUATION



TAX  
RES  
ISRAEL



Israel



*Participations*



*Financial Assets*

off-shore



*Participations*



*Financial Assets*

## «AS IS» SITUATION



Individual meets the conditions to benefit from the New Tax Resident Italian Flat Tax regime (€100k), which provides an optional tax regime allowing new residents to pay, for all income produced outside the Italian territory, an annual flat-rate amount of **€100,000**.

In addition

- Not subject to tax monitoring obligations
- No wealth tax on foreign assets
- No inheritance and gift tax
- No remittance issues



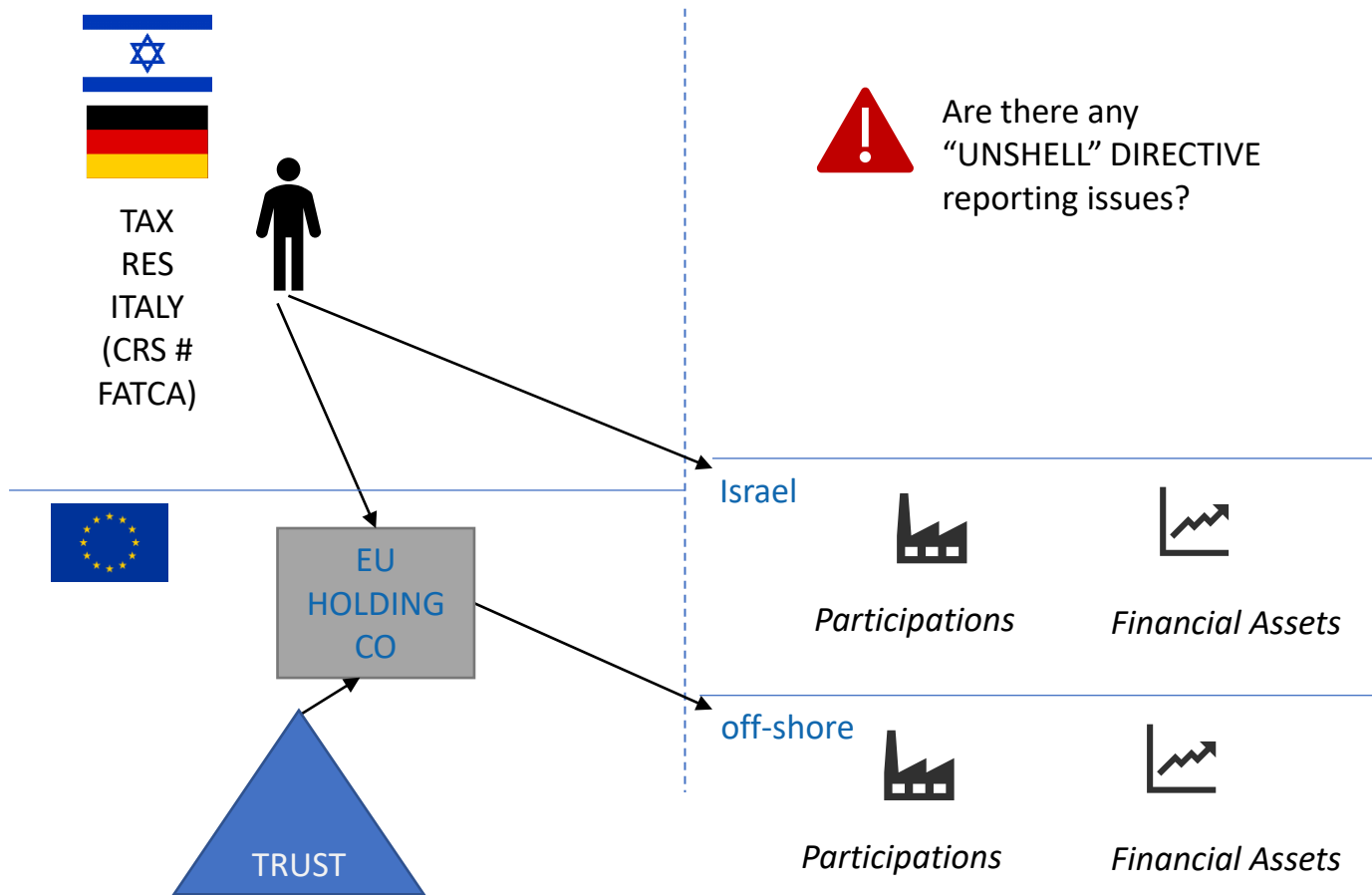
The result of the process is that individual:

- 1) Become Tax Res in Italy
- 2) Leave Tax Res in Israel



Are there any reporting obligations related to the DAC 6?

# «AS IS» SITUATION





**GLI STUDI LEGALI DELL'ANNO 2022**





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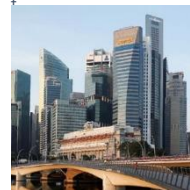
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# What is the Proposed “Unshell” Directive?

- **New Substance Test for EU Undertakings**
- **Tax Consequences**
- **If specific “gateways” fulfilled, reporting obligation subject to automatic exchange of information**
- **Penalty and Audit**



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STEP Israel Conference 20-21 September 2022

Gerd Kostrzewa TEP, Heuking Kühn Lüer Wojtek, Düsseldorf, Germany



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LAWYERS AND TAX ADVISORS

## Presentation outline

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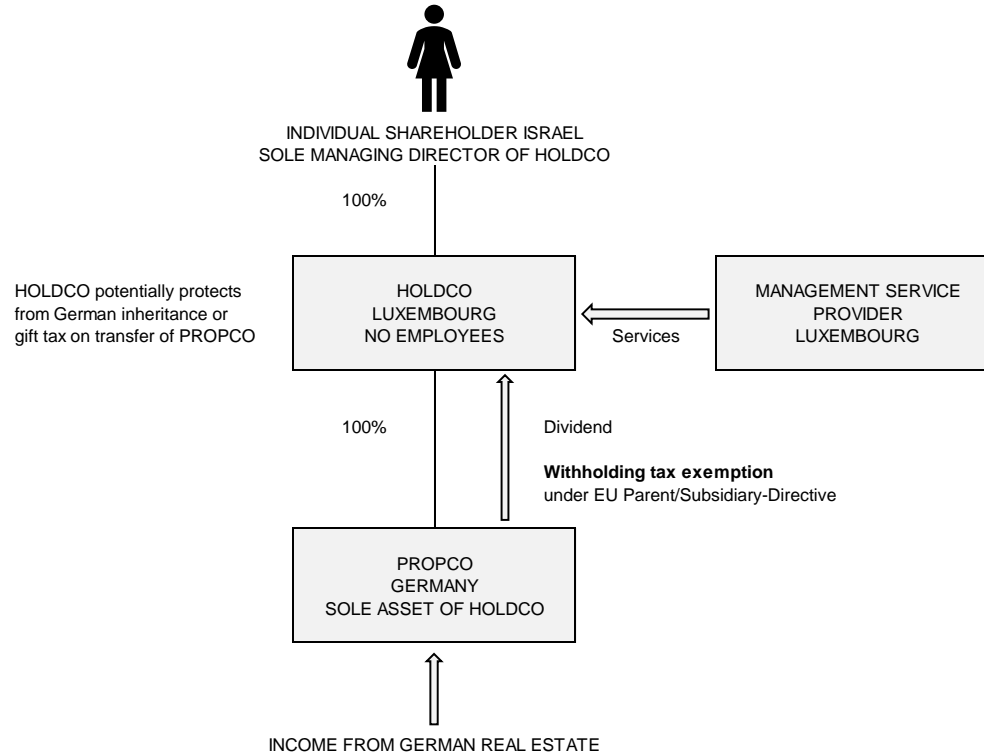
1. A brief history of EU anti abuse rules
2. Typical holding structure
3. The proposal for the „Unshell“ Directive
4. Impact of “Unshell” on typical holding structure
5. German anti-abuse rules
6. German anti-treaty shopping rule

## A brief history of EU anti abuse rules

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- October 5, 2015 – OECD report on Base Erosion and Profit Shifting (BEPS), 15 “Action Points”
- July 12, 2016 - EU Anti Tax Avoidance Directive (ATAD 1)
  - Limitation of deductibility of interest
  - Exit taxation
  - General anti avoidance rules (GAAR)
  - Controlled foreign company rules (CFC)
  - Transfer pricing rules
  - Hybrid entities
- May 29, 2017 – Amendment of EU Anti Tax Avoidance Directive (ATAD 2)
- June 7, 2017 – Signing of the Multilateral Instrument (MLI) by 68 countries, simplified procedure to amend Tax Treaties according to BEPS Action Points
- May 25, 2018 - 6<sup>th</sup> Directive on Administrative Cooperation in the field of taxation (DAC6), obligation of intermediaries to report certain tax-relevant cross-border arrangements
- **December 22, 2021 – Proposal for Directive to prevent the misuse of shell entities (ATAD 3 - “Unshell”)**
- July 6, 2022 – EU Commission starts public consultation on planned measures (e.g. registration and due diligence requirements, penalties) to prohibit enablers to assist in the creation of tax arrangements in non-EU countries that lead to tax evasion or aggressive tax planning

## Typical holding structure



## Proposal for “Unshell” Directive (1)

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- Introduction of an EU-wide “substance test” and related reporting obligations for EU (“undertakings”)
- An “undertaking” can be any entity engaged in an economic activity; **also foundations or trusts**
- Member States to transpose Directive by June 30, 2023 to become effective as of January 1, 2024
- Directive provides for a 7-step approach:
  - Step 1: Definition of entities that are at risk to be qualified as shell and are obliged to report on their substance
  - Step 2: Entity reports on substance criteria if obliged to report
  - Step 3: Entity presumed or not presumed to have sufficient substance based on reporting
  - Step 4: Entity can rebut presumption as shell company with insufficient substance by substantiating that it conducts a genuine economic activity
  - Step 5: In case rebuttal under Step 4 is not possible, entity will not be regarded as shell company if it can substantiate that it does not create a tax benefit
  - Step 6: In case a rebuttal under Step 4 and 5 is not possible, “look-through” approach will be applied; entity will be denied tax-resident status as well as benefits under Tax Treaties and relevant EU Directives (e.g. withholding tax reduction)
  - Step 7: Information exchange among all EU Member States on entity falling under Step 1, even if entity does not fall within the scope of the other steps

## Proposal for “Unshell” Directive (2)

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### Step 1: Is the entity considered a risk and subject to reporting obligations?

- Substance-related reporting obligations apply to entities that are tax-resident in the EU and meet all of the following criteria (“gateways”):
  - Gateway 1: The entity has generated more than 75% passive income such as interest, income from crypto assets, royalties, dividends, income from leasing, insurance and immovable property in the last two tax years.
  - Gateway 2: The entity is engaged in cross-border activities on any of the following grounds
    - more than 60% of the entity’s immovable assets or movable assets other than cash, shares or securities are located outside the EU country in which the entity was tax-resident in the last two years, or
    - at least 60% of the entity’s income is earned via cross-border transactions.
  - **Gateway 3: The entity has outsourced the administration of day-to-day operations and the decision-making relating to significant function in the last two years.**
- Exemption from reporting obligations for
  - Listed entities and specific financial entities
  - Holding entities holding shares of businesses in the same EU Member State with beneficial owners tax-resident also in the same Member State
  - Entities with at least **five full-time employees** carrying out the activities generating the relevant income

## Proposal for “Unshell” Directive (3)

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**Step 1 - Gateway 3: Has the entity outsourced the administration of day-to-day operations and the decision-making relating to significant functions?**

- Outsourcing of significant functions to third parties is always harmful (administration service providers)
- Wording of Proposal suggests that outsourcing to related companies will also be harmful
- Outsourcing of minor support functions permissible (e.g. bookkeeping)

**Gateway 3 is problematic:**

Does the outsourcing relate to day-to-day operations?

Does the outsourcing relate to significant functions?

**Broad application of Gateway 3 by tax authorities to be expected**



## Proposal for “Unshell” Directive (4)

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### Steps 2 & 3: Reporting requirements and substance test

#### Risk entity is obliged to declare in its annual tax return if

- the entity has own premises in the respective Member State, or premises for its exclusive use;
- the entity has at least one EU bank account;
- the entity meets one of the following indicators:
  - One or more of the directors of the entity:
    - reside in the Member State of the entity or near enough to that Member State to properly perform their duties;
    - are qualified and authorized to make decisions relating to the underlying income;
    - actively and independently use their respective authority on a regular basis;
    - are not employees of an unrelated entity and are not directors of such unrelated entity;
  - The majority of the full-time equivalent employees of the entity reside in the Member State of the entity or near enough to that Member State to properly perform their duties and are qualified to carry out the activities that generate the relevant income of the entity.

**Entity is obliged to submit documentary evidence on these criteria (gross revenue, type of income, information on directors and their qualification, outsourced functions etc.).**

**If the entity meets the requirements listed above, it will be presumed to have sufficient substance.**

## Proposal for “Unshell” Directive (5)

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### Step 4: Rebuttal of the presumption of insufficient substance

- The entity can substantiate that it conducts a genuine economic activity by providing the following evidence:
  - A document showing the commercial rationale behind the establishment of the entity;
  - Information about the employee profiles, including
    - the level of their experience,
    - their decision-making power in the overall organization,
    - their role and position in the organization chart,
    - the type of their employment contract,
    - their qualification and duration of employment;
  - Concrete evidence that the decision-making concerning the activity generating the relevant income is taking place in the Member State of the entity.
- Presumption of insufficient substance is rebutted if the documentation shows that the entity has performed and continuously had control over, and borne the risks of, the business activities that generate the relevant income.
- Rebuttal is valid for a period of up to five years, subject to unchanged circumstances

## Proposal for “Unshell” Directive (6)

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### Step 5: Exemption if no tax benefit

- The respective Member State may grant the entity an exemption from the obligations under the Directive if the entity provides sufficient and objective evidence that its interposition does not lead to **any** tax benefit for its beneficial owners or the group as a whole.
  - Evidence shall include information about the structure of the group and its activities
  - Evidence shall allow a comparison between the overall tax due by the beneficial owners or the group as a whole in case of a interposition of the entity and without the interposition of the entity.
- Exemption may be granted for a period of up to five years, subject to unchanged circumstances

**The Proposal does not provide for a de minimis exemption with respect to the amount of the tax difference.**

## Proposal for “Unshell” Directive (7)

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### Step 6: Consequences of insufficient substance if rebuttal or exemption does not apply

- Member States other than the Member State of the entity will apply look-through approach; entity will be denied tax-resident status as well as benefits under Tax Treaties and relevant EU Directives (e.g. withholding tax reduction)
- The Member State of the entity's shareholders will tax the relevant income of the entity at the level of the shareholders and grant a deduction of the tax paid by the entity on such income
- If shareholder is not resident in EU, the Member State of payer of income shall apply withholding tax according to its national rules
- The Member State of the entity will deny request for a certificate of tax residence to the entity

### Step 7: Exchange of information

- Member State of the entity will automatically exchange information within 30 days of receiving this information among all EU Member States on entity falling under Step 1, even if entity does not fall within the scope of the other steps
- Information on rebuttals and exemption (Steps 4 & 5) will also be exchanged

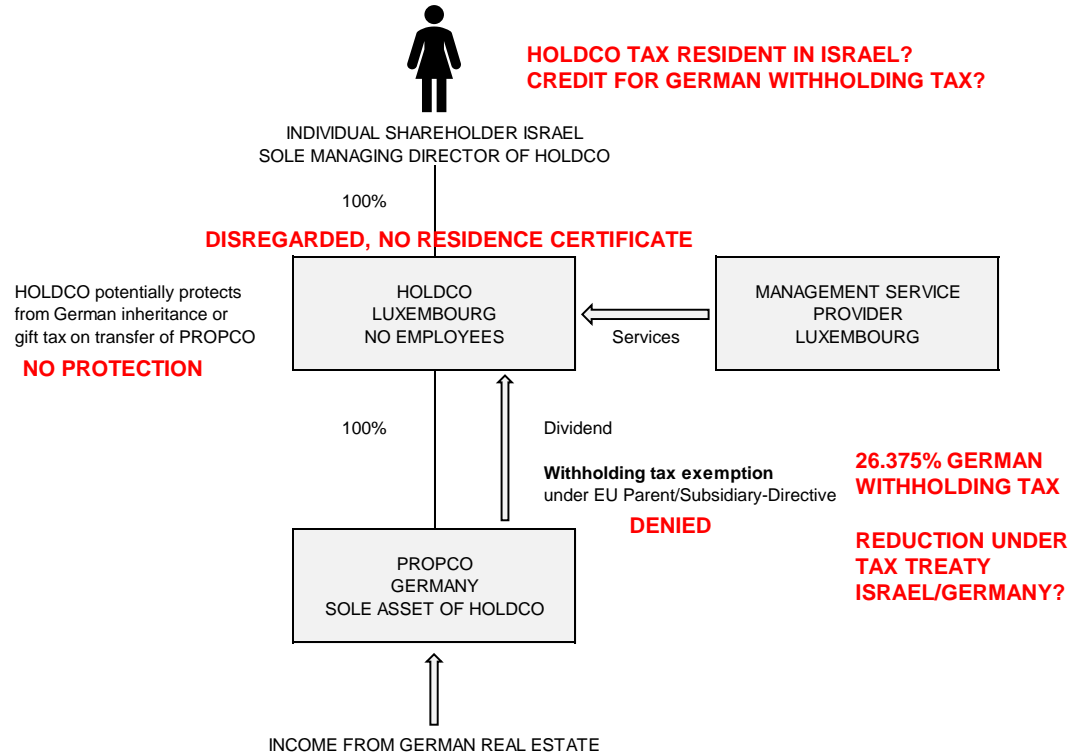
## Proposal for “Unshell” Directive (8)

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### Sanctions

- Member States to provide for penalties for false or late declarations pertaining to entity's obligations under the Directive
- Member States shall ensure that penalties include an administrative pecuniary sanction of **at least 5%** of the entity's turnover in the relevant tax year

## Impact of “Unshell” on typical holding structure



## German anti-abuse rules

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### We have them all ...

- General anti-abuse rule (GAAR): Abusive “inappropriate” legal structures are disregarded for tax purposes (sec. 42 Fiscal Code)
- CFC rules: Passive income of corporate entities located in low-tax jurisdictions is taxed at level of German shareholders (sec. 7-13 Foreign Transactions Tax Act)
- **National anti-treaty shopping rule: No withholding tax reduction under Tax Treaties or EU Directives for foreign holding companies with insufficient substance (sec. 50d para. 3 ITA)**
- National subject-to tax and switch-over rules leading to non-application of Tax Treaty benefits (sec. 50d para. 8 & 9 ITA)
- National treaty-override rule relating to attribution of trust/foundation income (sec. 20 para. 1 Foreign Transactions Tax Act)
- Exit taxation rules (sec. 6 Foreign Transactions Tax Act)
- Transfer pricing documentation rules
- Strict tax residence rules: Any German living place will lead to German income taxation on worldwide income and inheritance/gift taxation on transfer of worldwide assets (no day-count)
- Almost 100,000 tax authority employees; every return is reviewed, frequent field audits, extensive application of tax fraud rules; CRS, FATCA, AML, transparency register

## German anti-treaty shopping rule (sec. 50d para. 3 ITA)

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**Holding company, association of persons, trust/foundation is not granted relief from German withholding tax under Tax Treaty provisions or EU Directives if**

- Shareholder (or UBO of trust/foundation) would not be entitled to relief under **the same Tax Treaty or Directive** if they directly received the respective income

**and**

- The source of income has no material connection with a genuine economic activity of the holding company, association, trust/foundation;
  - mere passive holding activity is not regarded as an “economic activity”
  - **active management of at least two subsidiaries may qualify as genuine economic activity**
- Holding company, association, trust/foundation can rebut the presumption of treaty abuse if it can prove that that it was interposed for sufficient non-tax reasons by providing documentation explaining
  - all tax and non-tax reasons for its interposition
  - all tax effects under German and foreign tax law
- Exemption from anti-treaty shopping rule for listed companies



Thank you very much for your attention



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# Shell entities (the Unshell proposal for a Directive)

## Entities at « risk »

### EU entities for which:

- (i) Either >75% of relevant income: i.e., dividends, interest, royalties, capital gains, income from financial leasing, from immovable property, from movable property held for private purposes (if book value > €1M), from financial activities, from services outsourced to associated enterprises (in N-2 and N-1) Or >75% of the book value of the assets is composed of immovable property and/or movable property held for private purposes (if book value > €1M) Or >75% of the book value of the assets is composed of shares
- (ii) >60% of the book value of the assets or relevant income comes from or is paid outside the EU State of the entity
- (iii) In N-2 and N-1, the entity outsourced the administration of day-to-day operations and the

### EXCEPT

Listed entities, regulated financial undertakings, entities holding operating businesses in the same EU State while having beneficial owners in the same State, holding companies resident in the same State as their shareholders or as their ultimate parent entity, entities having ≥5 full-time employees engaged in relevant income-generating activities

## Annual reporting requirements

### Minimum substance indicators to be reported for year N:

- Existence of own premises (A)
- Holding one own and active EU bank (B) account
- Directors / employees: (C)
  - That is ≥1 director that is a resident of the EU State of the entity (or a cross-border director), qualified, making decisions, actively and independently, on a regular basis, and neither an employee nor a director of other non-associated enterprises or
  - That is >50% of full-time employees that are resident of the EU State of the entity (or cross-border employees)

### Supporting documents to be produced annually in support of

### EXEMPTION

if the entity proves that the interposition does not lead to a tax benefit for its beneficial owner(s) or the group

## Shell entity presumption applies if

Either one of the minimum substance indicators is not met  
Or if supporting documents are not satisfactory

### Rebuttal of presumption by providing:

- Commercial (i) rationale
- Employee (ii) information
- Evidence of a local (iii) making

### CONSEQUENCES OF SHELL ENTITY QUALIFICATION

#### → Entity tax transparency

- Immediate taxation of shareholders in their EU State on the income received by the entity (potential tax credit)
- Application by EU States of tax treaties and EU directives without taking account of the interposition of the shell entity
- Difficulties to be foreseen for the obtaining of tax treaty advantages on the part of non-EU States in the event of the interposition of shell entities



Double taxation risks

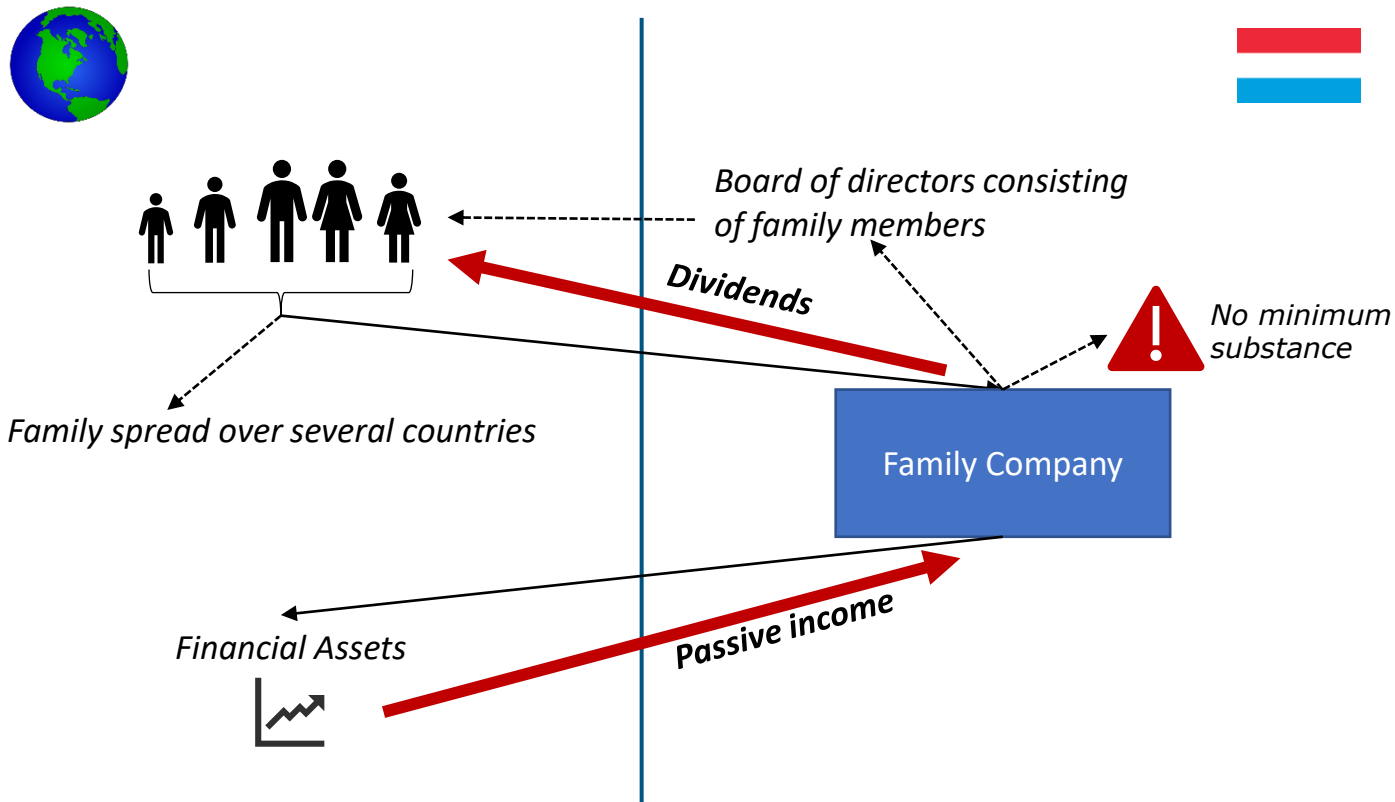
#### → Automatic exchange of information between EU States

#### → Penalty floor of 5% of the entity's turnover in the event of non-compliance with reporting obligations

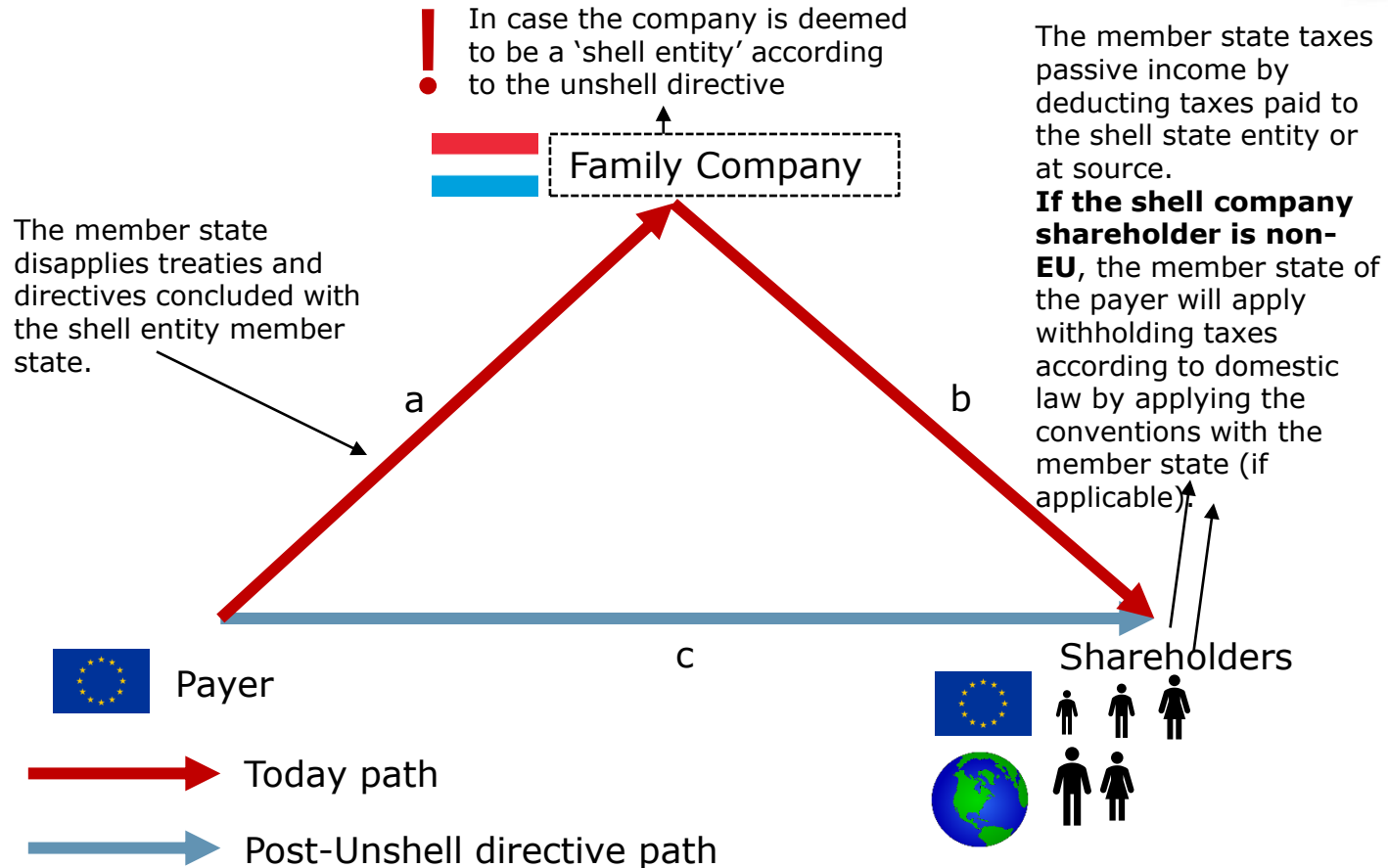


## **B.1 STUDY CASE - A Family company tax resident abroad**

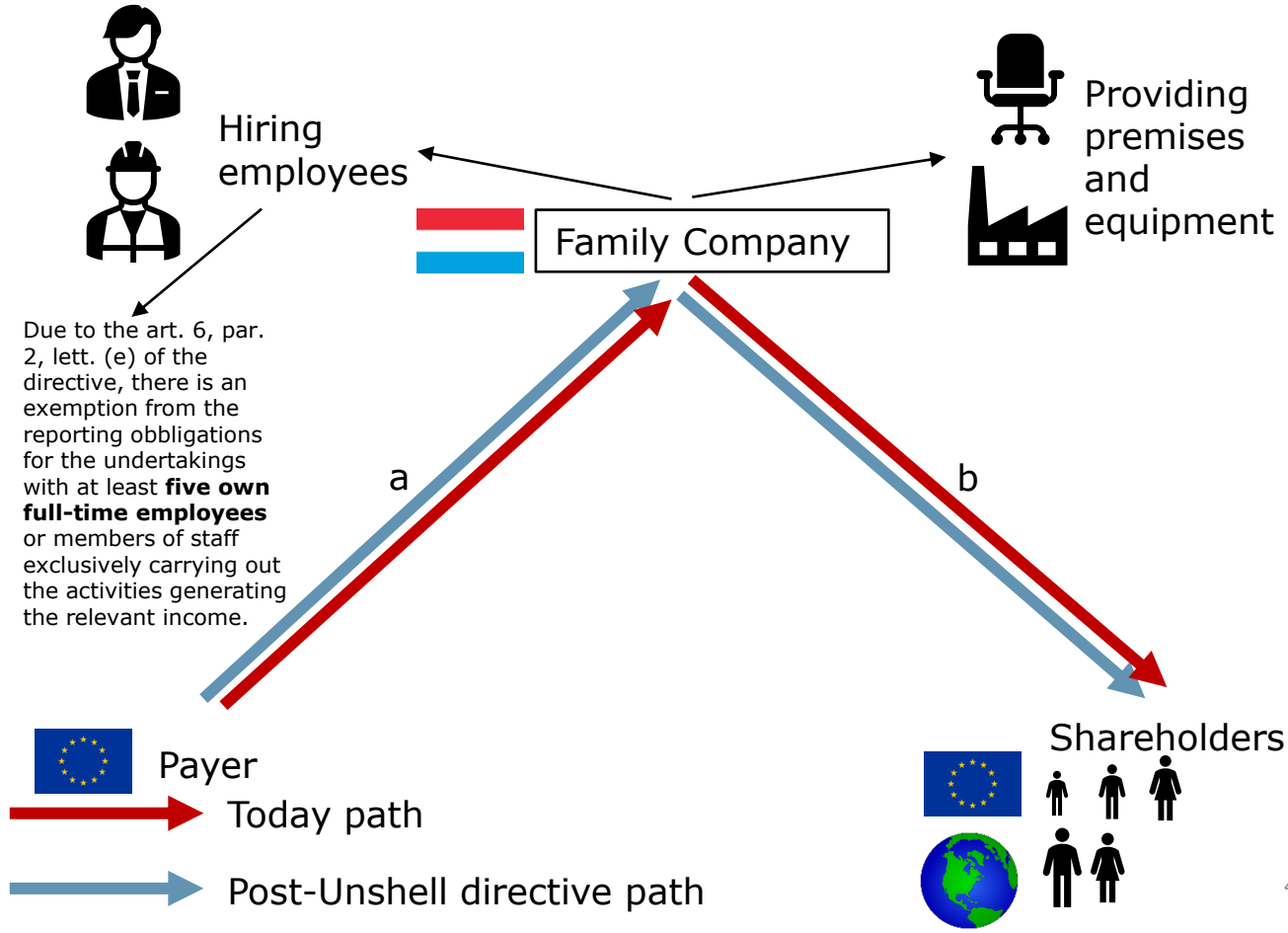
# «AS IS» INTERNATIONAL FAMILY



# POST-UNSHELL DIRECTIVE

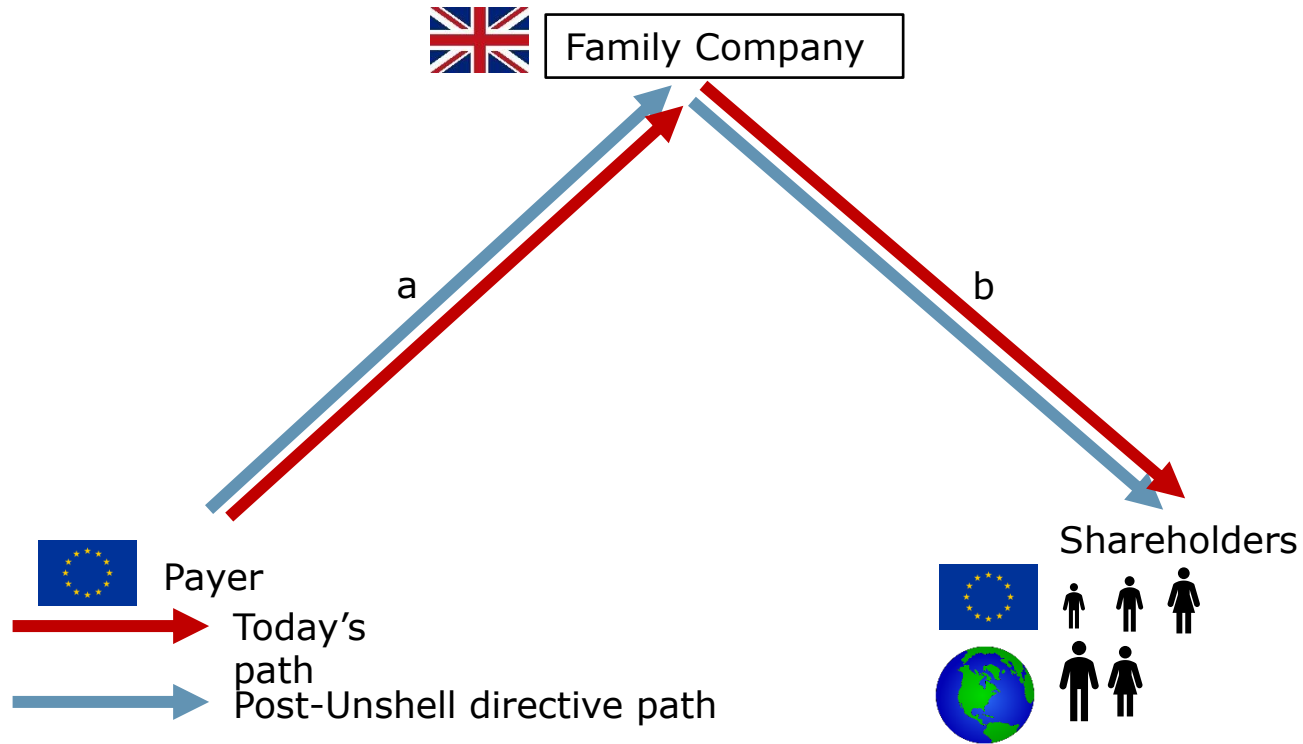


# ALTERNATIVE 1 – HOLDING COMPANY WITH ECONOMIC SUBSTANCE





## ALTERNATIVE 2 – NON-EU HOLDING COMPANY



# What could be the Future of Taxation?

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