27th August 2021

IFSP - MBB comments for the European Commission's Consultation on Fighting the use of shell entities and arrangements for tax purposes

The Malta Business Bureau (MBB) and the Institute of Financial Services Practitioners (IFSP) are pleased to provide feedback in the consultation process on a proposed Directive to combat the use of legal entities with no or minimum substance and no real economic activities by taxpayers operating cross-border to reduce their tax liability.

Principal Considerations

We note that the purpose of the proposed Directive, based on the approximation of laws which directly affect the functioning of the internal market, is to harmonise corporate substance requirements across EU Member States. The current corporate direct tax landscape throughout the EU is already largely based on jurisprudence of the Court of Justice of the EU, the decisions of which are tantamount to EU law and which have given rise to a number of Directives, most notably in this respect the Anti-Tax Avoidance Directive as part of the Anti-Tax Avoidance Package.

The introduction of further legislation in this vein must be assessed against over-regulation and be sensitive to the delineation between healthy and harmful competition. An assessment should primarily be conducted to determine whether guidelines, which would be easier to develop and adapt, would better achieve the intended objective of the proposal at hand.

The alleged risk posed by legal entities with no or minimal substance or that perform no or little economic activity and which are used in aggressive tax planning structures is already addressed through the above-mentioned Anti-Tax Avoidance Directive and in particular the Controlled Foreign Companies Rule and the General Anti-Avoidance Rule which neutralize tax benefits where there are no genuine economic activities. These provisions are in turn buttressed by mandatory disclosure on cross-border tax arrangements under the Directive on Administrative Cooperation in the field of taxation (DAC6).

Experience shows that harmonisation is effective only insofar as it does not result in a restrictive one-size-fits-all approach which attempts to treat unequal matters equally. A standardised common assessment of substance for tax purposes would be difficult to implement across sectors, particularly taking into consideration the scenarios being targeted by the proposed Directive. It is likely that such an attempt would inadvertently make

implementation of the Directive fragmented and ineffective. Creating standard triggers to activate further assessments translates into the requirement of significant Revenue resources to evaluate each legal entity that meets a hallmark. Such a practice should be supported by carve-outs to avoid the requirement to persistently assess genuine economic activities to separate the wheat from the chaff.

We submit that the introduction of synchronised substance benchmarks across 27 Member States runs the risk of inconsistent application to the detriment of the taxpayer. Moreover, the term 'shell companies' refers to more than one set of facts. Attempting to identify hallmarks generally deemed to suggest aggressive tax planning may give rise to a framework whereby tax abuse is presumed until proven otherwise, with the onus being on the taxpayer. This direction of travel is not consistent with the development of the Court's rationale, which in turn implies that the purported harmonisation has the effect of increasing preliminary references and potential investigations.

Measuring substance and the performance of real economic activity in jurisdictions with no or very low corporate taxes through the lens of the Code of Conduct on Business Taxation's work in the context of the list of non-cooperative tax jurisdictions is effectively an extension of the assessment to Member States which already adhere to EU law and international transparency standards. Further, the stated intention of the proposed Directive to equip Member States with new targeted instruments to prevent, identify and penalise the deemed abusive practice of shell entities by, for example, denying tax benefits, in addition to the current checks and balances in place against aggressive tax planning, goes against the objective of simplifying and incentivizing compliance as a positive approach to reducing tax abuse and increasing revenues.

For the above reasons, rather than rush to a self-imposed 2021 cut-off date (particularly in the midst of the Pillar 1 and Pillar 2 consensus discussions) on the basis of self-acknowledged lack of evidence, it would be wiser to effectively clarify whether such harmonized rules are still required, what the targeted personal scope is (to apply only as is necessary and proportionate to the objective being achieved) and the extent of defensive measures to be imposed by Revenues. Only then could the Commission assess the actual impact of any introduced rules, whether unanimously or by way of enhanced cooperation. We do not believe that the questionnaire to which this Paper is attached suffices as base for this exercise.

It is naïve to imply that the introduction of companies for the purpose of a sole transaction or to conduct limited activities is tantamount to aggressive tax planning. In assessing whether a company has the necessary substance to carry out its intended function, said substance need only be commensurate to that function and not to a benchmark set of characteristics that should necessarily be universally applicable. Requiring special purpose vehicles to systematically have employees, an extent of assets and risks, to have own financing arrangements and so forth does not tally with commercial reality. Moreover, seeking to indirectly impose so-called substance requirements may jar with actual commercial or financing prerequisites.

Concluding Remarks

Aggressive tax planning should be tackled head on, and the tools to do so are already provided for and in place. More time is needed to assess the impact (and improvement, where appropriate) of current anti-tax abuse and transparency regulations prior to introducing yet another ad hoc measure, particularly one with a debateable basis.

Recurrently increasing burdens on legitimate business and Revenue resources hamper innovation and business activity, as well as the effectiveness of said resources in applying and enforcing current measures. Moreover, denying and questioning the commercial viability of corporate structures on the basis of a standardised presumption of tax abuse is neither warranted nor desired in a progressively competitive world, where the EU would do well to focus on thriving as a region.

The EU, particularly in a post-Covid era, should be doing its utmost to remain an attractive avenue for business.

We trust that you find our above inputs useful.

Yours faithfully,

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