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THE ONGOING FIGHT AGAINST TAX AVOIDANCE IN THE PERSPECTIVE OF THE EU LEGAL SYSTEM: FROM ATAD I TO THE PROPOSAL FOR AN *UNSHELL DIRECTIVE*

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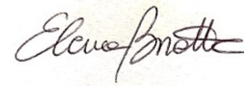
Firma (signature) 

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INTRODUCTION

It is widely known that EU, for a long time now, is trying to tackle the widespread problems of tax evasion and tax avoidance which characterize its Member States. Tax evasion is about illegal arrangements put in place to voluntarily hide in part or fully the liabilities due to tax administration, also through the submission of fake documentation. On the other hand, tax avoidance appears to be a more sophisticated practice since the line between legal and illegal is so much blurred and sometimes very difficult to define. This practice is accepted by the law, as a tool to limit the amount of liabilities due. The problem arises when the tax planning became aggressive, aimed at reducing completely the tax burden, exploiting the text wording and the loopholes of the law, and going against its real spirit. EU has estimated that the loss due to tax abuse in general amounts at more than 1 trillion euros every year. This huge phenomenon affects the economy and the society in a damaging manner, not just from tax revenues point of view. Tax avoidance creates inefficiencies, distortions, and costs, jeopardizing countries' growth, delaying government projects, triggering the achievement of a fair competition among the EU Single Market, and representing a threat for international security.

In an ideal situation, taxation should be neutral and should not interfere in any way. The process to reach uniformity among EU Single Market is still ongoing, through positive and negative integration. While the former is mostly used in indirect taxation, the latter is the major tool applied in the direct taxation field. This means that fundamental source of the anti-tax avoidance doctrine is the CJEU's case law. Since direct taxation remains the sole responsibility of Member States, since EU left it to their discretion, many obstacles and impediments to the market integration are today present, especially due to the differences in taxation system, approaches, and definitions of the same problematic phenomenon across EU Member States.

Trying to give a harmonized common framework, the EU Commission introduced a series of Directives, such as the Parent-Subsidiary Directive and the Interest and Royalty one, which aims at coordinating EU Member States, providing some ad hoc legislative solutions to major problems, such as double taxation. This slow process of attempts to create harmonization in the direct taxation field has been accompanied by a consistent volume of CJEU's case law, which have been decisive for the doctrine of *abuse of right*. Indeed, thanks to negative integration anti-tax avoidance provision, against artificial arrangements, start to be introduced in the directives, till, exploiting the propulsive moment of BEPS project, EU decides to issue the first Anti-Tax Avoidance Directive in 2016.

Nowadays, EU is facing new important challenges, which are completely changing the mainstays on which actual measures are based. The concepts of residence and source are outdated and no longer compatible with the dimension of globalization and digitalization.

Today, physical presence is not an essential feature to carry out an activity anymore. The digitalization of the economy leads to new opportunities to manipulate the existing principles through tax planning schemes. In response, governments have increasingly engaged in adopting a patchwork of anti-tax avoidance and evasion measures, that increases the level of complexity of tax systems, but, on the other hand, also the exploitation of loopholes.

International tax competition, tax rulings, freedom of establishment and intangible assets amplify residency transfer, profit shifting and aggressive tax planning. Actually, the destination countries of wealth are tax havens. As studied by Zuckman, trusts, foundations and shell entities spread out, since numbered bank accounts have been prohibited.

Triggered by numerous tax scandals, the EU decided to elaborate a new Anti-Tax Avoidance Directive. This proposal is addressed mainly to EU countries such as Luxembourg, Netherlands, Ireland, Cyprus, Belgium and Malta, with the aim of tackling shell entities problem at EU level.

The purpose of this thesis is to go deep into the formation process of EU anti-tax avoidance legislation, discovering the reasons why EU claims the need for an *Unshell Directive*, also-called ATAD III, and, trying to suggest an assessment of the new measures and requirements that the proposal would introduce.

The thesis is structured as follows. The first chapter provides an overview of EU tax avoidance situation, highlighting the huge problem of the tax compliance gap, its implications, and the future steps in the EU Agenda to oppose the problem.

In the second chapter is presented an historical excursus of EUCJ case law, starting from the concept of *abus de droit*, passing through the introduction of the first anti-avoidance measures in the directives and ending with an explanation of the main measures introduced by ATAD I and II. This chapter faces up also the concept of shell entity. Then, are identified the main indicators that could be implemented to quantify the number of existent letterbox companies, and the countries in which the phenomenon is more widespread. Furthermore, it is provided an analysis of the red flags that commonly characterized no-substance entities. Lastly, some MNEs' tax schemes are investigated as real examples of aggressive tax planning accomplished with the establishment of shell entities in European Tax Heaven.

The third chapter introduces the scope and the contents of *Unshell Directive* proposal, going deep into substance test's steps, and sharing experts' opinions and doubts. Moreover, are analysed the reactions and the possible future impact of ATAD III in Luxembourg and Netherlands. In the end, are provided some insights and final observations.

List of Abbreviations and Acronyms

AIF – Alternative Investment Funds

ALFI – Association of the Luxembourg Fund Industry

AMLD – Anti Money Laundering Directive

ATAD – Anti-Tax-Avoidance Directive

BEFIT – Business in Europe: Framework for Income Taxation

BEPS – Base Erosion and Profit Shifting

CCCTB – Common Consolidated Corporate Tax Base

CCN – Common Communication Network

CFC – Controlled Foreign Compony

CIT – Corporate Income Tax

CJEU/ECJ – Court of Justice European Union

CSSF – Financial Sector Supervisory Commission

DAC – Directive on Administrative Cooperation

DEBRA – Debt Equity Bias Reduction Allowance

ECOFIN – Economic and Financial Affairs Council

EESC – European Economic and Social Committee

EFTA – European Free Trade Association

EMEA – Europe, Middle East, and Africa

EPRS – European Parliamentary Research Service

ETUC – European Trade Union Confederation

FDI – Foreign Direct Investment

FTT – Financial Transaction Tax

GAAR – General Anti-Abuse Rules

GAAR – General Anti-Avoidance Rule

GDP – Gross Domestic Product

HMRC – Her Majesty's Revenue and Customs

I/R – Interest and Royalties Directive

ICIJ – International Consortium of Investigative Journalists

IP – intellectual property

JTPF – Joint Transfer Pricing Forum

LOB – Limitation of Benefit

MLI – Multi Lateral Instrument

MNE – Multinational Enterprises

MS – Member States

NCA – national competent authority

OECD – Organization for Economic Cooperation and Development

OFC – Offshore Financial Centre

P/S – Parent Subsidiary Directive

PE – Permanent Establishment

PPT – Principal Purpose Test

PWD – Posting of Workers Directive

SME – Small Medium Enterprise

SPE – Special Purpose Entities

TAAR – Targeted Anti-Tax Avoidance Rule

TEU – Treaty of European Union

TFEU – Treaty of Functioning of European Union

UBO – Ultimate Beneficial Owner

VAT – Value Added Tax

VTLL – VAT Total Tax Liability

CHAPTER 1

EUROPEAN UNION ONGOING FIGHT AGAINST TAX FRAUD AND TAX AVOIDANCE

1.1. The role of taxation in brief

"A tax can commonly be defined as a compulsory levy by the government on the people's income or wealth without a direct quid pro quo. As such, a high level of tax ethics is a prerequisite for a fair and successful tax administration" (Song and Yarbrough, 1978) [1]. "Tax revenue is fundamental to the existence of society and the provision of public goods" (Avi-Yohan, 2006)[2]. Taxes represent the collective contribution from citizens to the administration expenses of a country, for this reason they are an essential tool to a collectivity to function normally and for supporting and paying for the basic functions of the government, such as public welfare, transportation infrastructures and national defence. Tax may be seen as a membership subscription for the society in which we live. The Judge O.W. Holmes of US Supreme Court stated "Tax is the price we pay for living in a civilized society"[3]. This implies the compulsory nature of tax. Taxes are typically assessed on profits, wages, and other types of income, specific items are often excluded from taxability, generally because the taxing authority wants to promote a particular behaviour.

The European Commission in the last Annual Report on Taxation claims: "The primary purpose of taxation is to fund government's spending by reallocating funds from taxpayers (individuals/businesses) to governmental/public agencies or those acting on the public's behalf to maximise social welfare. The general aim of collecting public revenue is to secure funding for welfare-improving public goods, in particular in areas that tend to see significant market failures such as education, healthcare, social protection, infrastructure, pollution and climate change. However, tax collection has dead weight costs in itself and taxes can affect people's decision making." [4] Going on, they highlight that to maximise the performance of a tax system is important to think about fairness and efficiency as not mutually exclusive features. Moreover, they identify five channels through which taxation has the power to influence behaviour and social welfare:

- Taxation can influence or distort economic decisions, especially in absence of market

[1] Song Y. and Yarbrough T. E., 1978, Tax Ethics and Taxpayer Attitudes: A Survey, Public Administration Review, Vol. 38, No. 5, p. 442.

[2] Avi-Yonah et al, 2006, The three goals of taxation, Tax Law Review, 60 (1), p.3.

[3] See San Juan E. A., 2018, Who Pays the Price of Civilization?. *Columbia Journal of Tax Law*, *9*(1), p.47.

[4] European Commission, June 2022, Annual Report on Taxation 2022, Directorate-General for Taxation and Customs Union, Luxembourg, Publications Office of the European Union, p.29.

failure, raise public revenue via taxation can bring to sub-optimal outcomes because of distortion of otherwise efficient solutions. A stable tax system should minimise distortions.

- Taxation design is influenced by social preferences and affects income redistribution, for this reason a fair and efficient tax system must be designed to avoid loopholes and complexities that lead to aggressive tax planning, reducing redistribution ability and sustainability of public finances.
- Taxation can help address market failures, correcting economic inefficiencies in a cost-effective way, fighting activities that are bad for public health and environment, incentivizing ones with potential benefits.
- More uniform/coordinated taxation policy can help to take account of cross-border spill-overs taking more efficient choices
- Administrative costs, which represent a deadweight loss should be minimized by an efficient tax administration.

Coherent tax design, effective and efficient administration, effective and transparent legislation, cost and distortion minimization, and fair share payment of all taxpayers are necessary to ensure that taxation functions as intended.

1.1.1. The role of European Union in direct and indirect taxation

European Union Law is one of the two notable exceptions - the other one is Double Taxation Treaties between countries - where International Tax Law is not national law, but supranational, a truly international legislation. European Union Law encompasses provisions, which are the same for all 27 EU Member States and are simultaneously applicable in 27 different countries. European Union Law is a legal system, but it is realized on an economic principle, thus provisions are shaped in the perspective of creating a certain economic result. The goal is to build a common market, which guarantees pareto-efficiency, a result that idealistically goes close to the maximation of community wealth. The idea of common market needs to comply with the Four Fundamental Freedoms, which are free movements of goods, services, persons, and capitals, and the Principle of No Discrimination, on the ground of nationality. The role for taxation in the functioning of the market is avoid all inefficiencies and distortion, remaining neutral and convergent. One of the main tasks is to seek neutrality (same condition for all the market players) in this way taxation does not interfere with the decision of customers, investors, and the market can function properly as allocation mechanism. This degree of uniformity has been reached through positive and negative integration. Negative integration is about prohibition and depends on Court of Justice own decisions, while positive integration relies on the idea of EU Institution providing MSs with a tax legislation, using tools such as regulations

and directives as instrument through which told to the states what to do. There are two possible ways to integrate positively the tax law of Member States, they differ just for the degree of intensity: harmonization (Art. 113 TFEU) and approximation (Art.115 TFEU), which is less intense.

Obviously, during the negotiation for the Treaty of Rome, was thought that integrating the one hundred percent of the taxes of MSs would have been an excessively difficult task. Changing all in once the entire system would have mean lose a great amount of tax revenues, and a loss of total sovereignty for MSs, thus it was decided to proceed step by step, establishing a list of priorities. The harmonization process is still ongoing today. The final goal EU would achieve at the end is to become one federal state, with EU taxes and one EU tax administration, but it still has twenty-seven different legal systems and twenty-seven national tax authorities. Clearly. EU does not have a direct role in collecting taxes or setting tax rates. The amount of tax each citizen pays is decided by their national government, along with how the collected taxes are spent. The EU does, however, oversee national tax rules in some areas; particularly in relation to EU business and consumer policies, in order to avoid unfair competitive advantage between businesses of one country and competitors in different Member States, taxes discrimination against consumers, workers or businesses from other EU countries.[5]

Tax policy in the European Union has two components: direct taxation, which remains the sole responsibility of Member States, and indirect taxation, which affects free movement of goods and the freedom to provide services in the single market.

Direct taxes are based on the relationship between the tax and the index of ability to pay of the taxpayer, so are levied on index that displays immediately and directly the ability to pay of the taxpayer, for example the more the income the more the ability to pay taxes. This kind of taxes are paid directly to authorities by the taxpayer on income, wealth, and capital. They include personal and corporate income tax, tax on property and on assets. Direct taxes are not harmonized, they fall into the task of approximation. As opposite to harmonization, just some single aspects or parts of the legislation needs to be similar, not the whole model. Approximation is issue only with directives, no regulations.

EU works closely with MSs on the coordination of economic policies and corporate and income taxes. The aim is to make them fair, efficient and growth friendly. This is important to ensure clarity on the taxes paid by people, especially for who move to another EU country, or businesses that invest across boundaries. Coordination is essential since it helps to prevent tax evasion, tax avoidance, tax planning and situation of double taxation.

[5] European Union, Priorities and actions, Taxation, available at: https://european-union.europa.eu/priorities-and-actions/actions-topic/taxation_en

On the other hand, indirect taxes are paid by consumer as part of the purchase price of a good or service. They are collected by an intermediary, usually a producer or retailer, which pays them to the competent public authorities. These taxes are applied on items or indexes that do not display the ability to pay in a direct manner, in this case the relationship is indirect, if you consume a lot, you have a lot of spending capacity, so you have the ability to pay. The harmonization is the field of indirect taxes. The EU coordinates and harmonises law on value added tax (VAT) and excise duties, for example the one on alcohol and tobacco products, import levies, energy, environmental taxes, tourist taxes. It ensures that competition on the internal market is not distorted by variations in indirect taxation rates and systems, giving businesses in one country an unfair advantage over others.
It is important to highlight that EU law prevails on domestic law, over any domestic provisions. The Member State loses its sovereignty wherever EU situation need to be regulated, and the national legislation must follow EU legislation.

1.2. Defining tax fraud, tax evasion, tax avoidance, tax planning

There is often a fine line that separates tax evasion, tax fraud, tax planning and tax avoidance, what is certain is that all aims at reducing the tax burden, benefiting from tax advantage or prevent the tax burden from occurring.
Tax fraud and tax evasion have been frequently used, both clearly denoting a criminal conduct and recognized as punishable offences in different formations across EU and OECD countries. Thus, they are explicitly illegal conduct.
Tax fraud is a form of deliberate evasion of tax which is generally punishable under criminal law. ISA 240[6] defines fraud as "An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage". Three conditions are needed to demonstrate a fraud: an action (not just a desire), an intentional manoeuvre, an illegal or unjust advantage obtained. The term includes situations in which deliberately false statements are submitted or fake documents are produced, it occurs when an individual or a business entity intentionally and wilfully falsifies information, cheating the State to pay less taxes.
Tax evasion generally comprises illegal arrangements where tax liability is voluntarily hidden or ignored, for example when the taxpayer pays less tax than he/she is supposed to pay under

[6] ISA 240 Redrafted, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, p.5. International Standards on Auditing (ISA) are professional standards for the auditing of financial information. The Audit Directive of 17 May 2006 enforces the use of the International Standards on Auditing for all statutory audits to be performed in the European Union.

the law by hiding income or information from the tax authorities.[7] Tax evasion is any dishonest or dubious action taken outside the legal framework to reduce or conceal taxable income amounts or increase deductions so as to reduce the true tax liability to less than the obligated amount under the legal tax framework.

Vleck (2019) [8] asserts: “Tax avoidance is an evolving concept. […] tax avoidance is a product of the tax system itself. Just as legislation determines what is to be taxed and by how much, this legislation simultaneously creates the opportunities to avoid that particular form of taxation”. Tax avoidance (or tax mitigation) refers to a situation where the taxpayer is acting within the law, sometimes at the edge of legality, to minimize or eliminate the amount of tax that would otherwise be legally owed based on enumerated provisions in the tax law. Tax avoidance is an accepted and expected element in a corporate entity’s tax planning function. Arranging affairs to make the tax burden as low as possible is reasonable and allowed if it is done through legal means. It is stated in the literature that tax avoidance is sometimes divided into *acceptable* and *unacceptable* categories to distinguish those activities using the law to best advantage to reduce tax liability through an appropriate, rational good faith business planning, with full disclosure and realistic possibility of tax position being sustained, with no violation of either the letter or the spirit of the law; from those activities which were not envisaged when the law was put in place. In the latter, activities go against the object and the purpose of the law. Aggressive tax avoidance is based on potentially questionable tax position or suspect legal interpretation, taking advantage of legal loopholes and of the exploitation of the strict letter of the law and mismatches to obtain a tax benefit that was not originally intended by the legislator or tax authorities. This action constitutes an indirect violation of law; although they appear to be in accordance with the law, indeed it operates within the letter of the law, but in possible violation of the spirit of the law.

Tax planning, on the other hand entails the use of tax reliefs for the purpose for which they were intended. With tax planning, taxpayers effectively work within the regulatory framework to plan their way out of certain avoidable burdens or liabilities in the tax system, through the most ingenious use of allowances, deductions, or tax exemptions to their advantage. In this way, tax planning is not considered to be tax avoidance or as a felony.

When tax planning is aggressively used in a way that overstretches legality, it can be prosecuted as a civil and criminal offense. Even though tax fraud and tax evasion define the criminal domain of tax offences, tax avoidance and tax planning can contribute to enhance tax crimes in

[7] European Commission, Time to get the Missing Part Back, available at: https://taxation-customs.ec.europa.eu/time-get-missing-part-back_en

[8] Vleck W., 2019, Tax Avoidance, Chapter 22 in: Shaw, M. T., et al. (eds) The Palgrave Handbook of Contemporary International Political Economy, London, Palgrave Macmillan, pp. 345.

the EU when there is abuse or aggressiveness that appears to extend into tax evasion and tax fraud and related criminal conduct.

Aggressive tax avoidance and tax evasion could be grouped under *non-compliance*.

The underlying difference between tax fraud and tax evasion, on one hand, and tax avoidance and tax planning on the other hand is that, while the latter can be procured entirely through legal means whereby the law does not automatically provide punishment thereof, the former is automatically criminalized and may accordingly be sanctioned and/or punished.[9]

While tax avoidance entails taking steps to arrange the taxpayer's affairs before the tax liability arises, in tax evasion, the taxpayer takes actions to avoid the tax liability which has already arisen. Tax avoidance can also be defined as a way of removing, reducing, or postponing the tax liability through other means than tax evasion and tax saving.

Tax avoidance joints to the complexity in identifying and comparing tax evasion and tax fraud, since its operations are legal but can provide a launch pad for tax evasion and tax fraud or related non-compliant conduct. Since the actions and intention therewith in tax avoidance are entirely recognized by the law as lawful, and these actions sometimes bear similarities to tax evasion (apart from the illegal component), it is always possible for taxpayers to collaborate with professional tax enablers such as accountants, lawyers, and tax consultants to identify unsuspecting legal lacunas. To smartly exploit the tax loopholes, taxpayers can make use of professional enablers, complex structures such as offshore holdings in secrecy jurisdictions and structured financial products such as insurance or derivatives, which are put in place to enhance tax avoidance.

Popular among multinational corporations and wealthy individuals is international tax avoidance. The taxpayer moves holdings, interests, or property in one jurisdiction to another to minimize tax liability due in the country of origin. Shifting the registered beneficial ownership and the location of the assets are also common methods to evade and avoid taxes. The country of destination usually has advantageous tax policies and laws which are favourable to the taxpayer. When tax avoidance is abused in a way that overstretches legality, it can be prosecuted both civilly and criminally.

[9] European Commission, Time to get the Missing Part Back: What does it mean-Tax fraud, available at: https://taxation-customs.ec.europa.eu/time-get-missing-part-back_en

1.2.1. Lack of harmonised definitions among EU MSs and EU legislative framework

Turksen (2020) [10] asserts that neither the EU nor OECD has clearly and accurately defined tax crimes. The OECD provides the following definition of tax fraud: "Tax fraud is a form of deliberate evasion of tax which is generally punishable under criminal law. The term includes situations in which deliberately false statements are submitted, fake documents are produced, etc." [11]. Searching tax avoidance and tax evasion definitions, in both cases the OECD starts with: "A term that is difficult to define but…". As highlighted by Turksen, the European Commission adopts these definitions casually and not legislatively. Since it has been challenging to reach an agreement across its Member States, the EU still lacks a common definition of tax offences. National legal systems define tax crimes differently, according to their own criminal laws. An illustration (Table 1) of the various terminology used in a sample of ten EU Member States is given by Rsmouki, Turksen et al. in 'Approaches to tax crimes in the European Union' (2019)[12]. Looking at the definitions of tax crimes in each legal system, it can be drawn a distinction between nations that adopt a few law provisions having multiple definitions of tax crimes and nations that adopt multiple provisions, each defining tax crimes.

Table 1- Examples of tax crimes' divergent connotations in a sample of 10 EU countries[13]

Country	Tax crimes
Austria	• Tax evasion (Article 33 of the Fiscal Offences Act 1958) • Tax fraud (Article 39 of the Fiscal Offences Act 1958)
Czech Republic	• Evasion of taxes, fees and similar compulsory payment (Section 240 of the Penal Code 2009) • Evasion of taxes, social security insurance fee and similar compulsory payment (Section 241 of the Penal Code 2009)
Estonia	• Concealment of tax liability and unfounded increase of claim for refund (§ 3891 of the Penal Code 2001)
Finland	• Tax Fraud (Section 1, Chapter 29, of the Penal Code 1889) • Aggravated tax fraud (Section 2, Chapter 29, of the Penal Code 1889) • Petty tax fraud (Section 3, Chapter 29, of the Penal Code 1889) • Tax Violation (Section 4, Chapter 29, of the Penal Code 1889)
Germany	• Tax crimes (Section 369 of the Fiscal Code 2002) • Tax evasion (Section 370 of the Fiscal Code 2002)
Ireland	• Revenue Offences (1078 of the Taxes Consolidation Act 1997)
Italy	• Fraudulent return by using invoices or other documents for non-existent operations (Article 2 of the Legislative Decree no. 74/2000) • Fraudulent return by using other artifices (Article 3 of the Legislative Decree no. 74/2000)

[10] Turksen U., 2020, The importance of a common definition of tax crime and its impact on criminal countermeasure in the EU: An explorative study, European Law Enforcement Research Bulletin Nr.20, pp.92-93.

[11] Organisation for Economic Co-operation and Development, Glossary of Tax Terms, available at: https://www.oecd.org/ctp/glossaryoftaxterms.htm

[12] Rsmouki, Turksen et al., 2019, Approaches to tax crimes in the European Union, PRO TAX. Available at: https://ec.europa.eu/research/participants/documents/downloadPublic?documentIds=080166e5c8c7ea6a&appId=PPGMS

[13] This list only includes the most common tax crimes, so it is not exhaustive. It also includes UK because the study was done in 2019, before the Brexit of 2020.

	• False tax returns (Article 4 of the Legislative Decree no. 74/2000) • Failure to file tax returns (Article 5 of the Legislative Decree no. 74/2000) • Issuing of invoices or other documents for non-existent operations (Article 8 of the Legislative Decree no. 74/2000) • Concealment and destruction of accounting records (Article 10 of the Legislative Decree no. 74/2000) • Failure to pay withholding tax due or certified (Article 10-bis of the Legislative Decree no. 74/2000) • Failure to pay the value added tax (Article 10-ter of the Legislative Decree no. 74/2000) • Undue offsetting (Article 10-quater of the Legislative Decree no. 74/2000) • Fraudulent subtraction of tax payments (Article 11 of the Legislative Decree no. 74/2000)
Malta	• Penal provisions relating to fraud, etc. (Article 52 of Chapter 372 – Income Tax Management Act 1994)
Portugal	• Tax Scam (Article 87 of the General Regime of Tax Infringements) • Tax Fraud (Article 103 of the General Regime of Tax Infringements)
United Kingdom	• Conspiracy to defraud (Common law offence preserved by the Criminal Law Act 1977, s5(2)) • Cheating the Public Revenue (Common Law offence, preserved by Theft Act 1968, s32(1)(a)) • Untrue Declarations (Customs and Excise Management Act 1979, s167)

Source: Rsmouki, Turksen et al., 2019, Approaches to tax crimes in the European Union, PRO TAX., pp.17. Available at: https://ec.europa.eu/research/participants/documents/downloadPublic?documentIds=080166e5c8c7ea6a&appId=PPGMS

Furthermore, the problem of the lack of harmonized definitions impacts on the treatment of the crime, on who bears the burden of proof, and on how specific tax violations are prosecuted. In his research, Rsmouki and Turksen compares the definitions offered by each MS and identifies general key differences and their implications. The initial distinction between definitions' contents has to do with who can be held accountable for committing tax offenses. In some nations, only liability of individuals is provided. For instance, unlike many other EU nations, Germany has not yet implemented corporate criminal liability. Companies are not subject to criminal prosecution under German law since the German Criminal Code (Strafgesetzbuch, or StGB) only applies to individuals. However, the Act on Regulatory Offenses imposes administrative liability on companies. The liability of legal entities is established in other nations. For instance, the Czech Republic and Estonia.

A further distinction derives from the constitutive elements of tax crimes. Tax crimes are typically defined as violations of tax obligations with different contents across distinct national legislation. The biggest obstacle to the harmonization of criminal sanctions is the harmonization of fiscal policies at the EU level, because the scope of criminal provisions is influenced by tax rules. Being identified by different titles, the various formulations make legislative data much more challenging to compare. There are certain nations where the titles are less complicated, such as in Austria, and other where are more complex, as in case of Estonia. In addition, EU MS adopt different approaches to recognize tax crimes and threshold based on which certain behaviors can be classified as crimes. For some country the definition used is more general, capturing a wide range of activities, while other use more details, so include precise actions.

While the latter can bring to the impunity, the first can lead to clarity problems.
The last difference launched by the author concerns the various level of severity of the sanctions imposed by the European countries. This variance has an important impact also on the perception and movement of taxpayers to most advantageous jurisdiction, undermining the integrity of the tax system.
Moving from the single national definitions to the EU legislative tax documents another problem arises. Öner (2018)[14] investigates whether there is a common understanding of the meaning and the use of the term *tax avoidance* within the EU. The real aim is to point out the absence of a coherent use and to display the consequences derived from this terminological chaos. As mentioned before, deter tax avoidance is extremely complicated, furthermore sometimes the same situation is described with different terms, or different situation are covered by the same one. Among EU legislative framework is very difficult to find a clear statement distinguishing tax avoidance from all other concepts. As a result of generalization, tax avoidance, tax evasion and tax abuse are often used in the same document referring to the same situation, as they were synonymous. Also, aggressive tax planning and tax fraud are used interchangeably. Öner shows that in EU's legal document there is a lack of consistency in referring or approaching to tax avoidance. The risk of combining fiscal and criminal tax matter into one single pot is the negative effect of this inconsistency. Often the terminology of the title does not correspond to the one of the text[15]. The lack of attention lead to a loss of clarity about the position taken against tax avoidance. As highlighted in the analysis of the author, the term is usually mixed with words such as aggressive tax planning, tax fraud, money laundering, abuse of law in order to emphasize that is an undesired, but the underlying justification is not clearly articulated. This phenomenon is pervasive also among case law.
The meaning of the terms used depends on the respective author's intentions and attitudes.[16] It is very common the use of the term tax avoidance as an umbrella term encompassing all the expression that belong to tax crime and abuse sphere. Tax avoidance conceptually refers to a continuum, moving along which tax avoidance becomes more aggressive, becoming illegal.[17] The result of these chaos is that legislative and juridical authorities share a confused approach,

[14] Öner C., 2018, Is Tax Avoidance the Theory of Everything in Tax Law? A Terminological Analysis of EU Legislation and Case Law, EC TAX REVIEW 2018/2, pp.96-112.
[15] Öner reports some examples to put in evidence the mix of terminology used in EU tax legislation. The first is about the Commission Recommendation on aggressive tax planning, C(2012) 8806 final [2012] OJ L 338/41. The formulation of a general anti-abuse rule is placed in the document which deals with tax avoidance. In the same document, aggressive tax planning is accepted as an abusive practice. In the second document used as example, instead of aggressive tax planning, the term 'abusive tax planning' is preferred and accepted as abusive tax practice. The title of the document, however, is 'An Action Plan to strengthen the fight against tax fraud and tax evasion'.
[16] Kovermann, J. H., & Velte, P., 2021, CSR and tax avoidance: A review of empirical research, Corporate Ownership & Control, 18(2), p.21.
[17] Hanlon, M., & Heitzman, S., 2010, A review of tax research, Journal of Accounting and Economics, p.137.

so long as is not provided a single definition of tax avoidance and it is always associate with other terms, which has a completely different connotation. For EU authorities is even more difficult to develop and implement specific instrument to tackle tax avoidance. Moreover, the improper use of the term could violate the legal certainty principle, jeopardize the accuracy of Court's decisions, and undermine the functioning of the internal market.

1.3. Tax loss: a huge problem for EU

Every year, European Union estimates a loss of public money of almost €1 trillion. Based on the data of 2015 provided by the study of the European Parliament S&D Group[18], this loss can be split in two sources, tax evasion accounted for €825bn, and tax avoidance between €50bn to €190bn[19].

According to the European Commission, this phenomenon occurs in several ways including:

- tax fraud and evasion which illegally deprive public budgets of money
- tax havens which facilitate tax evaders and avoiders by storing money offshore, often unreported, and untaxed
- aggressive tax planning by big businesses or individuals, which exploits the limits of the law with the aim of minimizing taxes paid.

The post-financial crisis's recession[20], the resulting budget constraints, the repeated tax leaks, and the related journalistic investigations (i.e., LuxLeaks, the Panama Papers, Football Leaks, Bahamas Leaks, Paradise Papers, and Pandora Papers), which were mostly conducted on the basis of information provided by whistle-blowers[21], highlighted the importance of fighting tax fraud, increasing people awareness of tax injustice and reducing damaging tax practices' acceptance.

Comparing the data of 2009[22] with the one of 2015, the study of the European Parliament S&D Group had found evidence of a slight decrease. There was a reduction of the gap of the 11,8%. This suggests that the fight against tax crime is paying off, and tax authorities have become more effective in tackling tax abuse since the 2008 downturn began. The size of the shadow economy in the European Union has fallen according to all available evidence, thus the effort

[18] Murphy R., January 2019, Tax Research UK, The European Tax Gap, A report for the Socialists and Democrats Group in the European Parliament, University of London, pp.1-2.

[19] The number is based on a simple average of tax authority estimates and the methodology in TUC (2008) and may, for the reasons stated above, over- or underestimate the actual revenue loss.

[20] Financial crisis of 2008-2009.

[21] A whistle-blower is a person, often an employee, who reveals information about activity within a private or public organization that is deemed illegal, immoral, illicit, unsafe, or fraudulent. From 16 December 2019, whistle-blowers are protected by the EU Whistleblowing Directive (Directive (EU) 2019/1937 on the Protection of Persons Who Report Breaches of Union Law).

[22] The estimate of 2009, disclosed in the study of 2012, recorded €860 billion of public revenue being lost every year due to tax evasion. Considering the inflation, this equals €935 billion in 2015 prices.

expended has clearly worked. Nevertheless, the remaining gap is still alarmingly high. The percentage tax gaps vary from 7.98% in Luxembourg to 29.51% in Romania. In absolute amounts the biggest tax gaps are in Italy, France, and Germany.

Quantifying unpaid taxes is by nature difficult to estimate, available assessments is made by comparing distinct flows of economic activities and estimating the missing portion of economic activity. The EU considers tax avoidance as one of the missing parts that must be brought back, and paid attention to. Measure tax avoidance loss is even harder due to the complexity of the phenomenon and data limitation. Álvarez-Martínez et al. (2022)[23] find that tax avoidance in the EU-28 entails €36 billion corporate tax revenues losses annually, also Zucman et. al (2018) estimate a similar loss around €37 billion. While Dover et al. (2015)[24] finds that the revenue loss from profit shifting within the EU amounts to about €50-70 billion, equivalent to at least 17% of corporate income tax (CIT) revenue in 2013.

Murphy (2019)[25], director of Tax Research LLP, highlights that too few EU Member States prepare tax gap estimates. Only fifteen EU Member States, at most, are engaged in this activity at present and do so on too limited a basis. Just seven prepare VAT estimates. In addition, there is a cloak of secrecy over much of the data that is required to establish best possible tax gap estimates. This is most especially true with regard to the size of the shadow economy that states include in their estimates of their GDP.

The tax gap is composed by two mains parts: the tax policy gap and the tax compliance gap. The first is made of unpaid taxes in a country because of the decision made by a government not to tax a potential tax base, such as wealth. Moreover, it is the value of the tax reliefs, allowances and exemptions given by a government for offset against a source of income that might otherwise be taxable.

While the tax compliance gap can be defined as the difference between the amount of tax that would be collected by a jurisdiction if current legislation was enforced properly, and the amount truly collected in tax. The three reasons why taxes are not collected are: tax evasion, tax avoidance and tax liabilities that a taxpayer has declared but which are not actually paid, usually because of taxpayer insolvency before the money can be collected.

Below, Table 2 reports the estimates of tax compliance gap in 2015 by European Union country, making a comparison with the health care spending by MS and the portion of that expense that

[23] Álvarez-Martínez M., Barrios S., D'Andria D., Gesualdo M., Nicodeme G. & Pycroft J.,2022, How large is the corporate tax base erosion and profit shifting? A general equilibrium approach, Economic Systems Research, p.169.

[24] Dover, R., Ferrett B., Gravino D., Jones E. and Merler S., 2015, Bringing transparency, coordination and convergence to corporate tax policies in the European Union, I – Assessment of the magnitude of aggressive corporate tax planning, Research Paper prepared for the European Parliament Research Service, p.4.

[25] See note 18.

could be covered by the gap. Looking at the percentage of the last column is clear that the gap weighs heavily in the coffers of the states.

Table 2- Suggested size of the EU tax compliance gap in 2015 and comparison with health care spending

Member state	**EU sourced GDP data 2015**	**EU reported tax yield as a proportion of stated GDP 2015**	**Average tax gap estimate[26]**	**EU state healthcare spending**	**Proportion of healthcare spending that the tax gap represents**
	€'bn	%	€'bn	€'bn	€'bn
Austria	344.5	43.20%	12.9	26.4	48.7%
Belgium	410.3	45.20%	30.4	32.5	93.5%
Bulgaria	45.3	29.10%	3.8	1.9	197.6%
Croatia	44.5	37.10%	3.5	2.5	139.9%
Cyprus	17.7	33,20%	1.6	0.5	302.9%
Czech Republic	168.5	34,00%	8.8	10.1	87.6%
Denmark	271.8	46,50%	17.5	23.5	74.2%
Estonia	20.3	33.70%	1.4	1.0	135.4%
Finland	209.6	43,90%	10.7	15.3	69.8%
France	2194.2	45.60%	117.9	193.3	61.0%
Germany	3043.7	38.40%	125.1	284.3	44.0%
Greece	176.3	36.60%	19.9	8.4	235.7%
Hungary	110.7	38.80%	9.1	5.3	171.7%
Ireland	262	23.40%	6.9	13.9	49.7%
Italy	1652.6	43.00%	190.9	110.8	172.3%
Latvia	24.3	30.10%	1.7	0.8	214.6%
Lithuania	37.4	28.90%	3.1	1.6	187.4%
Luxembourg	52.1	37.20%	1.6	2.6	60.7%
Malta	9.5	32.10%	0.9	-	-
Netherlands	683.5	37.40%	22.2	57.6	38.5%
Poland	430.1	32.40%	34.6	19.1	181.0%
Portugal	179.8	34.40%	11.0	10.7	103.1%
Romania	160.3	28.00%	16.2	6.2	262.0%
Slovak Republic	78.9	32.10%	5.4	4.3	125.0%
Slovenia	38.8	36.60%	2.6	2.4	109.8%
Spain	1080	33.70%	60.0	70.2	85.4%
Sweden	449	43.10%	16.9	41.2	40.9%
United Kingdom	2602.1	33.10%	87.5	202.8	43.1%
EU-28	**14798**	**36.10%**	**823.5**	**1149.0**	**71.7%**

Source: R. Murphy, The European Tax Gap, January 2019. Eurostat[27].
Health spending is government spending plus compulsory contribution spending in the EU per Eurostat at http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=hlth_sha11_hf&lang=en

[26] Average between the tax gap estimate based on average grossed up GDP and the tax gap estimate based on reported GDP.
[27] Eurostat does not publish data on how much of the estimated shadow economy of each country is included in its GDP.

1.3.1. VAT Gap

Moving from the whole economy amount of tax loss to specific taxes, there are several national estimates of how much taxes remains uncollected. The most popular gap that Member States usually measures is the VAT Gap. The Value Added Tax gap is the difference between the amount of VAT collected and VAT Total Tax Liability (VTTL), in absolute or percentage terms. The VTTL is an estimated amount of VAT that is theoretically collectable based on the VAT legislation and ancillary regulations. It is a measure of the effectiveness of tax compliance, comprehensive of both a loss due to voluntary non-compliance caused by tax avoidance and evasion, and a loss due to bankruptcies, financial insolvency errors and miscalculations.

The European Commission (2022)[28] estimates that in 2019 European Member States lose €134 billion, which means €4,000 lost every second. With the current trends, the European Commission estimates that thirteen years is the amount of time it would take to eradicate the VAT Gap.[29] Compared to 2018, the gap went down by approximately €6.6 billion. Looking at the timeframe between 2015 and 2019 (Table 3), the gap declined by € 18 billion. In relative terms, denoted as the share in the VTTL, it declined by 2.6 pp., which stands for more than 20% of the VAT Gap observed in 2015. In other words, more than one-fifth of the VAT Gap was reduced over a five-year period. With 34.9% of VAT revenues missing in 2019, Romania is the country with the biggest national VAT compliance gap, followed by Greece (25.8%) and Malta (23.5%). Croatia (1.0%), Sweden (1.4%), and Cyprus (2.7%) had the smallest gaps. The higher VAT gaps, measured in euros, were recorded in Italy (€30.1 billion) and in Germany (€23.4 billion).

Table 3-VAT Gap in EU Member States (in million EUR)

Member State	2015	2016	2017	2018	2019
Belgium	3,984	3,513	4,126	4,007	4,444
Bulgaria	985	621	648	617	508
Czechia	2,794	2,499	2,223	2,567	2,835
Denmark	2,938	2,539	2,528	2,516	2,778
Germany	20,820	22,091	23,212	24,291	23,443
Estonia	113	115	117	98	116
Ireland	1,712	1,426	1,910	1,541	1,721
Greece	5,080	5,374	6,730	6,237	5,350
Spain	4,370	4,577	5,411	5,252	5,840

[28] European Commission, 2022, COM (2022) 137 final, REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL, Ninth report from the Commission on VAT registration, collection and control procedures following Article 12 of Council Regulation (EEC, EURATOM) No 1553/89, Brussels, p.3.

[29] European Commission, Taxation and Customs Union, VAT Gap, available at: https://taxation-customs.ec.europa.eu/business/vat/vat-gap_en

France	15,841	14,852	15,329	14,428	13,858
Croatia	702	553	482	553	77
Italy	36,856	36,852	32,611	32,415	30,106
Cyprus	141	47	169	171	54
Latvia	484	309	402	277	237
Lithuania	1,065	1,070	1,116	1,137	1,048
Luxembourg	519	589	226	333	267
Hungary	2,103	1,748	1,891	1,261	1,483
Malta	220	244	225	203	287
Netherlands	5,010	2,651	3,190	3,039	2,660
Austria	2,488	2,466	2,605	3,033	2,895
Poland	9,836	7,880	6,810	5,288	5,379
Portugal	2,230	2,123	1,847	1,759	1,609
Romania	6,858	6,453	6,797	6,258	7,411
Slovenia	271	186	142	163	298
Slovakia	1,808	1,360	1,206	1,414	1,313
Finland	1,095	985	1,320	884	646
Sweden	1,712	1,228	1,713	1,483	597
United Kingdom	20,151	20,102	20,714	19,835	17,176
EU-28	**152,188**	**144,452**	**145,698**	**141,059**	**134,436**

Source: European Commission, Center for Social and Economic Research, Poniatowski, G., Bonch-Osmolovskiy, M., Śmietanka, A., 2021, VAT Gap in the EU Report 2021, Luxembourg, Publications Office of the European Union, pp.95.

1.3.2. Cross-border tax evasion

Among the causes of the loss of one trillion euros, we can also include for a sizeable part international tax evasion. The global offshore wealth is estimated at €8.6 trillion in 2018 compared to €7.3 trillion in 2016.[30] The EU share is valued at €1.7 trillion. The EU's estimated revenue loss due to international tax evasion was of €124 billion in 2018.[31] A greater sum was computed by the Polish Economic Institute in 2020[32]. They suggest that the value of tax revenue lost by EU Member States due to cross-border tax evasion would be 170 billion, of which: €60 bn due to artificial profit shifting by multinational companies, €46 bn due to moving wealth by rich individuals, €64 bn due to cross-border VAT frauds.

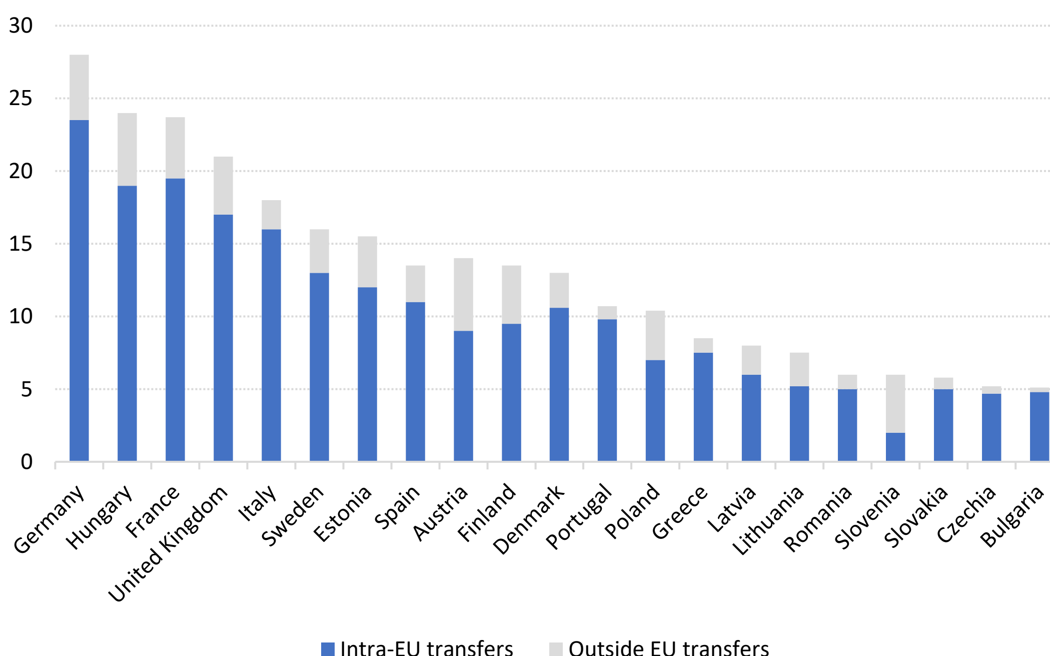
According to the data of 2019[33], shown in Figure 1, EU Member States lose on average the 13% of their Corporate Income Tax (CIT) due to multinational enterprises artificial profit shifting.

[30] Data from European Commission, June 2022, Annual Report on Taxation 2022, Directorate-General for Taxation and Customs Union, Luxembourg, Publications Office of the European Union.
[31] Data from Vellutini C., Casamatta G., Bousquet L., et al, European Commission, 2019, Estimating International Tax Evasion by Individuals, TAXATION PAPERS Taxation and Customs Union WORKING PAPER No 76, Luxembourg, Publications Office of the European Union.
[32] Polish Economic Institute, 2020, Tax unfairness in the European Union Towards greater solidarity in fighting tax evasion, BGK, Warsaw, p.6.
[33] The report of the Polish Economic Institutes uses data from the study of Tørsløv, Zucman, 2019, The Missing Profits of Nations. Available at: https://missingprofits.world/

The highest losses are suffered by Germany (€18 bn), France (€11 bn) and the United Kingdom (€14 bn). Most of the artificial profit shifting process in the EU takes place among the EU Member States. Almost 80% of the CIT revenue lost due to artificial profit shifting by EU Member States is a loss in favour of other EU Member States, indeed the countries that benefit the most are Belgium, Cyprus, Ireland, Luxembourg, Malta and the Netherlands, also called EU tax havens.

Their total balance resulting from profit shifting amounts to €16 bn. The share of the benefits from artificially attracting profits in total CIT revenue varies from 16% in Belgium and 30% in the Netherlands to 54% in Luxembourg and 65% in Ireland, to as much as 88% in Malta. That means that an important part of public revenue in the countries in question is generated to the disadvantage of public revenue in other EU Member States.

Figure 1-Revenue loss due to profit shifting as % of CIT revenues



Source: Tørsløv, T., Wier, L., Zucman, G. (2019). The Missing Profits of Nations. Available at: https://missingprofits.world/

For what concerns the second component of the whole cross-border tax evasion[34], the rich citizens of the EU hold almost €1.5 trillion wealth in international financial centres, and at least 75% (so almost EUR 1.1 trillion) of this value is not reported to tax authorities, thus contributing to a €46 bn loss in public revenue, equal to the 0,32% of EU GDP in 2016. The countries with the largest offshore wealth are Germany (€331 bn), France, UK and Italy (€142 bn), which are also the ones that suffer the most in loss nominal values (Germany loss:10 bn, France loss: 7bn).

[34] The report of the Polish Economic Institutes uses data from the Vellutini, C., Casamatta, G., Bousquet, L., Poniatowski, G., 2019, Estimating International Tax Evasion by Individuals. European Commission, Taxation Papers, No. 76.

Cyprus, Malta, Bulgaria and Greece are the countries whose citizens transfer the greatest amounts of wealth, in terms of share of GDP, with a range from 29% of GDP in Bulgaria to nearly 50% of GDP in Cyprus and Malta. On average, the EU Member States lose 4% of direct tax revenue due to individual wealth being transferred offshore. Those most negatively affected in percentage terms are Bulgaria, Cyprus, Latvia and Malta, with a range between 7% and 17% of direct tax revenue loss.

Figure 2-EU Member States offshore wealth as a % of the GDP

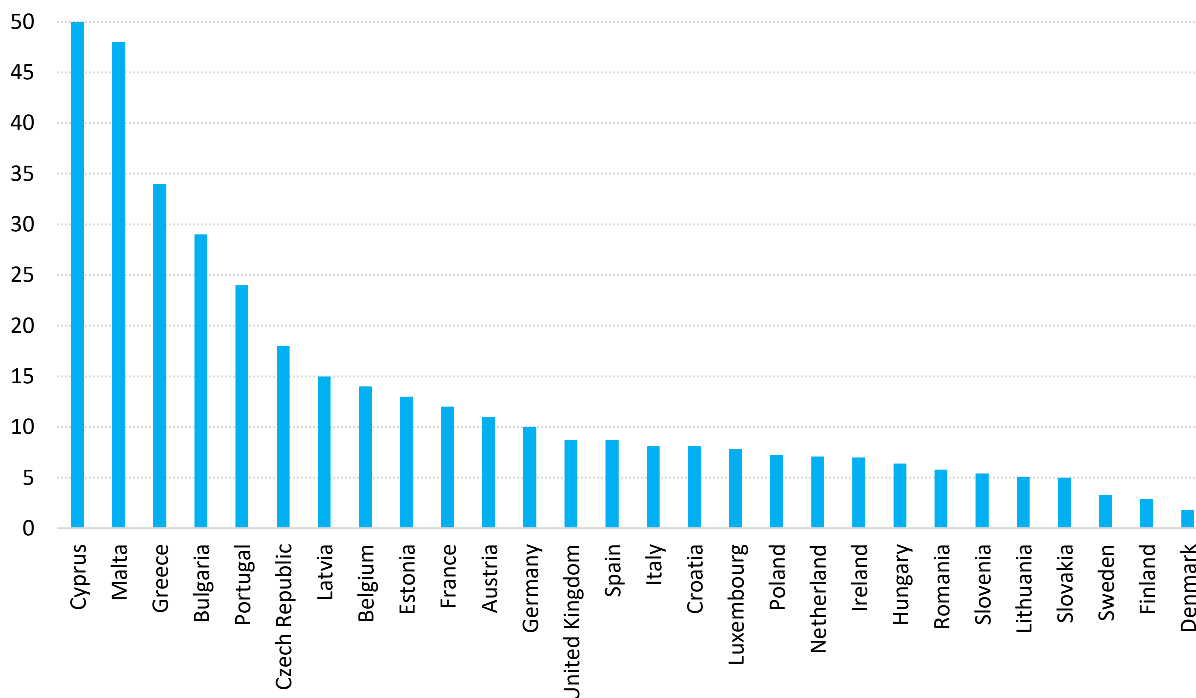


Figure 3-International tax evasion by member state as % of GDP

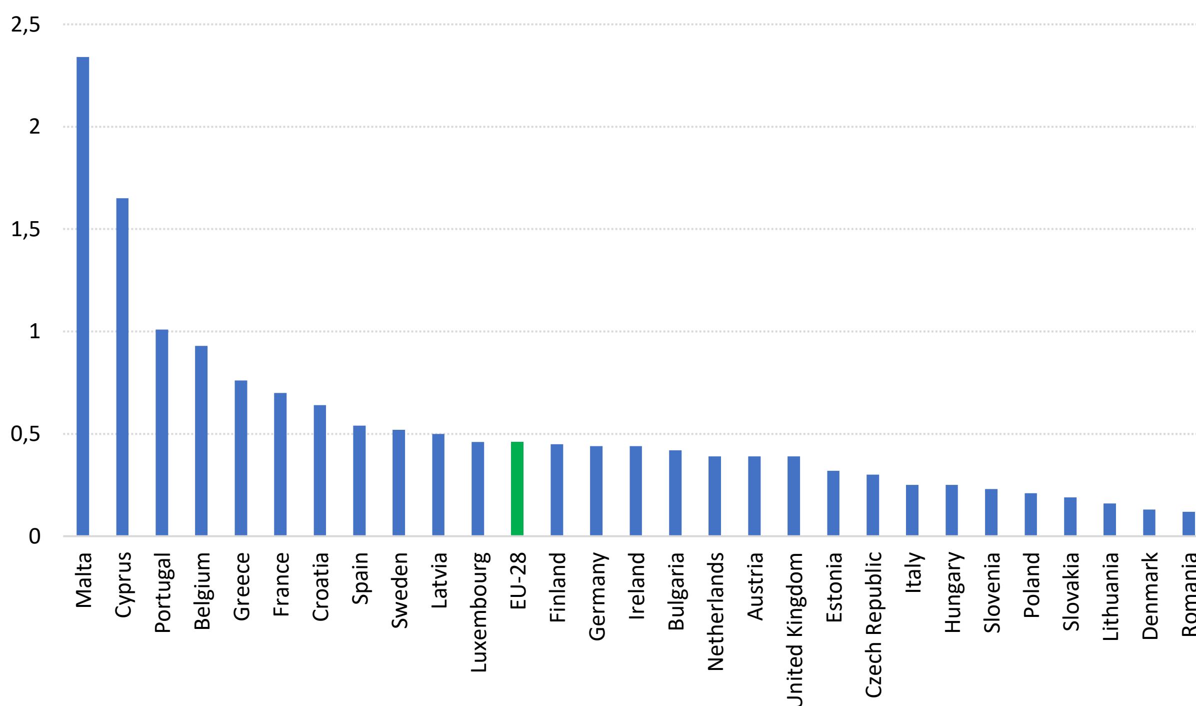
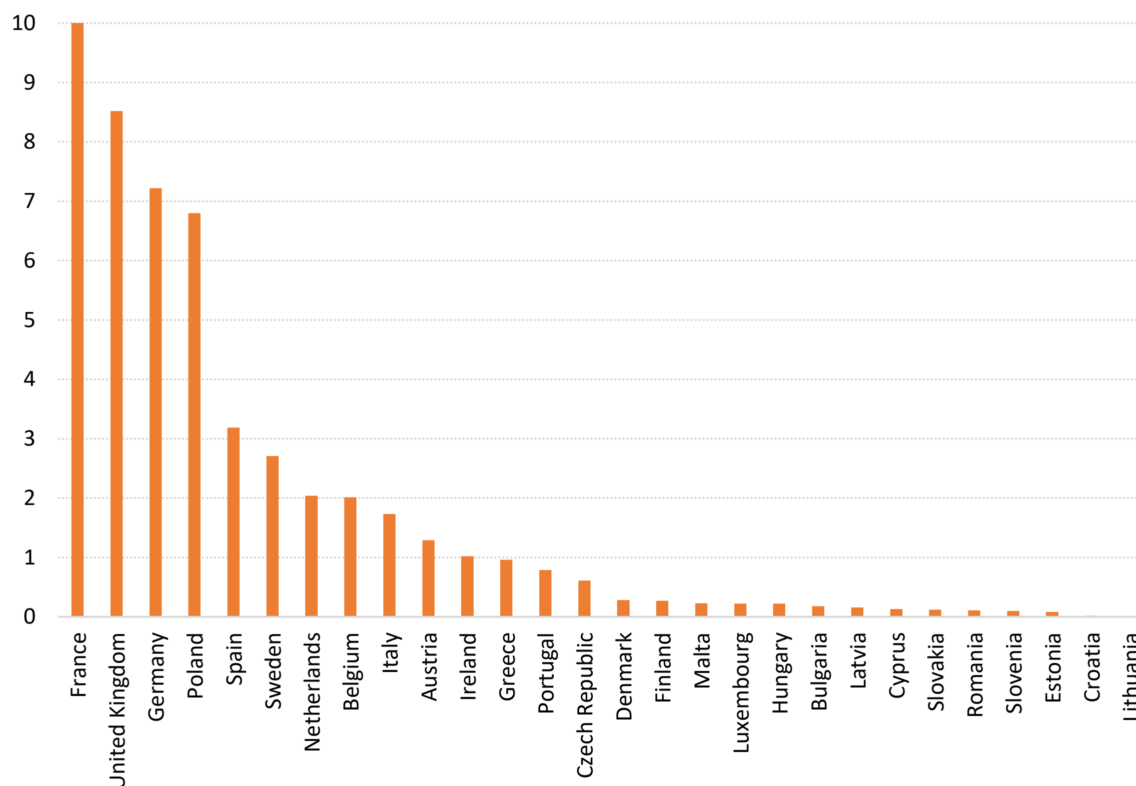


Figure 4-Public revenue loss due to individual wealth transfers in EUR bn



Source: Vellutini, C., Casamatta, G., Bousquet, L., Poniatowski, G. (2019). Estimating International Tax Evasion by Individuals. European Commission, Taxation Papers, No. 76. Data from pp. 13, 87, 185-213 (country by country).

With regard to the VAT Gap the Polish Economics Institute's report highlighted that a substantial part, approximately between 40-47%, results from cross-border VAT frauds. The EU has a trade surplus with itself because exporters report higher levels of exports than importers report as imports. According to Braml and Felbermayr (2019) [35], the EU massive trade surplus with itself amounts to €307 billion euros in 2018 or 86% of the entire global self-surplus. The most implemented strategy used by organized criminal groups is VAT carousel[36]. As the European Commission has always stressed tax evasion and tax avoidance are huge problems that knows no borders and can only be solved effectively with coordination and a joint effort. [37]

[35] Braml, M., Felbermayr, G., 2019, The EU Self-Surplus Puzzle: An Indication of VAT Fraud?, Kiel Institute for the World Economy, Kiel Working Paper, No. 2146, p.4.

[36] It consists in creating a fictional supply chain of goods which crosses the borders within the EU. Companies engaged in the carousel buy goods and immediately sell them to another company, carrying out up to several hundred transactions a month. Payments are purely artificial; the transactions are intended solely to extort tax.

[37] European Commission, Taxation and Customs Union, A huge problem, available at: https://taxation-customs.ec.europa.eu/huge-problem_en

1.3.3. Why is EU so interested in the fight against tax evasion and tax avoidance?

As previously said, taxes provide revenues for use by national governments, public authorities, including local ones. Aggressive tax avoidance, tax evasion and tax fraud limit the capacity of EU countries to raise money and implement their economic and social policies; this entails cuts in public services and spending, and a slower economy, jeopardizing countries' growth and delaying government projects.

The fight against tax fraud aims at recovering revenue not paid to the public authorities. Moreover, it ensures that fraudsters do not have an advantage over compliant taxpayers, guaranteeing tax fairness between taxpayers. Unpaid taxes represent reduced resources for national and European Union budgets, as well as a dent to the efficiency of MSs' tax systems. Compared to their fraudulent counterparts that engage in aggressive tax planning and tax avoidance schemes, honest businesses find themselves at a competitive disadvantage. An equivalent situation occurs with honest citizens carrying a heavier burden, in terms of tax hikes and spending cuts, to compensate for the unpaid taxes of evaders. Honest taxpayers start having a sense of inequality as compared to those who are avoiding tax and not facing any consequences. Fighting tax evasion and corporate tax avoidance is therefore essential for fairer and more efficient taxation.

Bird and Davis-Nozemack (2018) [38] explain that tax avoidance is not just a financial problem for tax authorities, but it can be considered also a social and enterprise problem. Indeed, it erodes critical common spaces necessary for the smooth functioning of regulatory compliance, organizational integrity, and society. For this reason, they support that the integration of the sustainability principle can advance the goals of decreasing the occurrence and the acceptability of tax avoidance. The authors identify three common resources that can be depleted by tax avoidance: the social commons, the regulatory commons, and the organizational commons.

Social commons[39] have a great power to promote general welfare, but this depends on the fairly and equitably contribute of every participant. With tax avoidance, societal actors may want to reap the benefit and services coming from tax revenue collection, without contributing to the shared pool. The problem is that tax non-compliance brings to an increase of non-compliance, because when taxpayers believe that other are non-complying, are less likely to comply. This creates an incentive to hide income, as the drop of individual and corporate taxes combined with corruption lead to an insufficient or bad services' offer.

[38] Bird R., Davis-Nozemack K., 2018, Tax Avoidance as a Sustainability Problem, Springer, pp. 1009-1025.
[39] Also called Public Commons, revenue collected by tax authorities and distributed to the benefit of society, represents a fundamental underpinning for a functioning society.

For what concern regulatory commons[40], the authors assert that if it is robust, then there will be benefits for both the authority and the firm, because shared expectations reduce enforcement and monitoring costs as well as decreases conflicts, delivering efficient bargaining for both the regulator and the enterprise. This shared understanding gives clarity and certainty to regulatory language that might be opaque. Tax avoidance threatens this environment of shared trust and understanding, for a mere individual gain. Seeking their own self-interest, tax avoiders minimize their tax liability analysing tax rules from the linguistic point of view in an aggressive manner. From avoiders' perspective, it is undoubtedly lucrative, but it implicates a series of externalities. Most of the time tax authorities are unprepared and unaware in front of tax avoiders' interpretation and new strategies, but they must react quickly to plug the legislative loopholes. To foster compliance all provisions are continuously analyzed to be enforced, monitored, and updated, to keep up with the versatility of tax fraud and the pace of digital evolution globally. The revision and response are costly and cumbersome. Inevitably, these manoeuvres complicate the statutory language, imposing time and resource costs to other taxpayer, which must interpret and analyse new standard, as well as on the authorities that are obliged to hire counter-avoidance experts who are highly compensate. Further exploitative actions drain time and resources from other important tasks, such as advising small businesses or engaging low-income taxpayers. The most affected are often small businesses which are not skilled in managing substantial tax complexities, while large firms may have already highly experienced accounting and legal staff. This obviously creates a disproportionate burden. Tax morale is also eroded by avoiders, tax avoidance indeed lowers the perceived justice of the tax system and decrease the cost of other to pursue the same avoidance strategy. The alteration of the legitimacy leads to an increase in tax evasion by those who perceived inequalities in the tax system. Summing up tax avoidance generates unnecessary complexity, mistrust, adversarial relations and destroy the idea of a common long-term interest to be pursue.
Regarding organizational commons[41] the paper highlights that tax avoiders negatively impact the fair functioning of the organization, disrupting the culture of integrity. Tax avoidance corrodes corporate governance, bringing obfuscation and opaqueness, which permit individual actors to perpetrate and hide managerial opportunism from shareholders. It also signals to managers that regulators are not worthy of respect. Moreover, managers[42] whose tax avoidance

[40] It involves the interaction between enforces of government regulations and those that must comply with those regulations. It is the collective acceptance and shared understanding between regulator and regulated of clear and unambiguous regulatory language that authorities administer, and entities follow.
[41] Organizational commons refer to the smooth functioning of ethical organizations and their positive business culture, that emphasizes legal compliance and fair dealings with shareholders. Such culture manifest in firm's corporate governance.
[42] Sometimes not just managers but also the board can play a crucial role in tax avoidance.

practices are validated by peers and superiors may take those methods and apply them to other areas.

Economic growth, financial stability, uniform competition, business investment, employment prospects, global welfare are all harmed by tax fraud in general. As explained before, the cost of tax inequality is high, especially if it becomes endemic. If the tax system is widely abused than economic policy is likely to be ineffective.

Another important reason that justifies European Union interest and efforts to tackle this huge problem is that tax fraud and money laundering are the most popular tools used to finance illegal activities, terrorism, and organized crime; undermining jurisdictions' political and economic interests and seriously threating national and international security.

The European Commission reiterated that the cross-border nature of tax evasion and avoidance, along with Member States' concerns to maintain fair competitiveness, make it very difficult for purely national measures to have the full desired effect. Tax evasion is a multi-facetted problem requiring a multi-pronged approach, at national, EU and international level. EU Member States need to cooperate closely to increase the fairness of their tax systems, secure much needed tax revenues and help to improve the proper functioning of the Single Market. In addition, EU, as a united block, can strive for achieving faster and more ambitious progress at international level in the area of tax good governance. [43]

1.4. Megatrends, new taxation challenges and future objectives

Over the past few years, there has been a radical change of the context for EU business tax policy. Globally and in Europe, the coronavirus deeply impacts economies and societies. The public health issue evolved into the most severe economic crisis in the history of the EU, with significant social repercussions and rising inequality.

The pandemic took place jointly with some pervasive megatrend that are shaping our economies and communities too. These key phenomena are population aging, climate change, environmental degradation, globalization, and labour market changes.[44] The pandemic itself contributes to accelerate pre-existing trends towards digitalization. The trend powerfully affects the existent tax base and lead to reflect on how to shape an efficient, sustainable, and fair tax system for the future.

In the past, EU taxation policies had developed in a complex and inconsistent way, several rules are nowadays outdated and new cooperative solutions, also at global level, need to be found.

[43] European Commission, MEMO, Fighting Tax Evasion and Avoidance: A year of progress, available at: https://ec.europa.eu/commission/presscorner/detail/en/MEMO_13_1096

[44] European Commission, June 2022, Annual Report on Taxation 2022, Directorate-General for Taxation and Customs Union, Luxembourg, Publications Office of the European Union, chapter 1.

During the European Tax Observatory conference[45] of June 13th 2021, G. Zuckman, director of the Observatory, asserted that the tax system for the 21st century is still to be invented. He reminded us that the current tax system is still the brainchild of the 1950s, a time when it made sense to exempt savings and tax consumption and wages because capital stocks and inequality of revenues were low. The dramatic change in this picture since the 1950s makes the transformation of the EU tax system a necessity to face the inequality and ecological challenges. In the years ahead, a fair and efficient taxation will become even more fundamental, in order to keep up with times supporting the green and digital transition and recovering from the COVID-19 crisis, exacerbated in recent times by the war in Ukraine and its dramatic consequences in terms of energy supply security and fossil fuel dependency on Russia.

The digitalization of the economy leads to the awareness that fundamental concepts as tax residence and source, on which the international tax system has been based until now, are outdated. Today, physical presence is no more an essential feature to carry out an activity. Moreover, the digitalization of the economy leads to new opportunities to manipulate the existing principles through tax planning schemes. In response, governments have increasingly engaged in adopting a patchwork of anti-tax avoidance and evasion measures. Obviously, this increases the complexity of tax systems. Triggered by several scandals and the need to finance public expenditure after the 2008-2009 crisis, the dialogue on the international corporate tax reforms accelerated in 2010s, bringing to the Base Erosion and Profit Shifting project (BEPS), that nowadays includes 139 countries all around the globe. This project leads to an important implementation of the legislation also in EU with the Anti-tax avoidance Directives (ATAD Package). Even if a lot has been achieved, more need to be done. The discussion is now continuing towards new global solution, shaping the EU tax agenda.

1.4.1. Globalisation, digitalisation, and technological change

Digitalisation has transformed, and continues to transform, people everyday lives and the way societies and businesses interact and function, with profound impact on international and national taxation systems and on tax administrations.

Digitalisation and globalisation are reshaping economies. Globalisation facilitates the movements of people, wealth, and labour. It is widely believed to have had a generally positive impact on global economic growth in aggregated terms. Digitalisation has offered new tools connecting people and societies and offering new business and working opportunities. It has led to an unprecedented and increasing number of people and businesses working, making

45 EU Tax Observatory, 13th June 2022, conference on ‘Tax Avoidance and Offshore Wealth: Policies for Tomorrow’, SOFITEL EUROPE BRUSSELS.

purchases, and selling, and interacting remotely without necessarily residing in the territory where the actual activity or sale takes place. Together, globalisation and digitalisation have created new opportunities for long-term economic growth, but they lead to new challenges. The trend had created winners and losers because of unequal distribution of the benefits. The ability of governments to choose fair tax rates is threatened by the exacerbation of international tax competition.

Globalisation and digitalisation have boosted the creation of new opportunities for tax avoidance, tax base erosion and profit shifting by corporations and wealthy individuals, which calls for a future stringent international cooperation. Now virtual presence is increasing against physical one. Cross-border nature of activities, globally active businesses, digital platforms jeopardize the traditional value creation and transactions chain. Corporate taxes, that until now have been based on physical presence (where the company is headquartered) and value creation (where it generates value), are outdated. The linear correlation between taxation rights and physical presence flawed since corporations can now contact consumers worldwide and offer their goods and services practically without the need of a physical presence in the market jurisdiction. Activities are carried out without the need for the people engaging in the activity to be physically present in a country.

In 2020 and 2021, the COVID-19 pandemic and the related lockdowns facilitate teleworking (from a different country) or working from home, posing a new problem: where to tax the income of employees who can work anywhere in the world. Current rules based on residency are out of sync with the new digital and global realities.

Another development regards the raise of multisided platforms and intangibles assets, including cryptocurrencies. The emergence of intangible assets like data and algorithms in global value chains raises questions about where value is created and where the corresponding taxing rights are located. For instance, when a website user clicks on a webpage, he gives his preferences to a company that will either sell the data or use it in its value chain. This value creation is monetised by the platform itself but raises several tax challenges about how such intangible can be valued. In this context, income earned through digital platforms has often gone unreported and potential tax due gone unpaid.

The investments in intangibles are gaining growing importance, especially intellectual property (IP) assets done by digitalised enterprises. The question is how these assets are valued and taxed, especially as they can cross borders more easily. Indeed, reliance on intangibles increases the ability of companies to structure themselves to minimise their tax liabilities. New technologies can also help to create more advanced mechanism of tax evasion, in particular

blockchain technologies such as cryptocurrencies or Non-Fungible Tokens (NFTs), that because of the lack of a centralized control generate many troubles for tax authorities.
On the other hand, digitalization and new technologies has the potential to support tax authorities of European Union and of the whole word in the fight against tax fraud. Indeed, the digitalization of tax services could improve taxpayer services, alleviate compliance burdens, improve tax collection, facilitate information exchange and administrative cooperation. It allows authorities to collect a huge amount of data and process them in an easier way, gaining more information about taxpayers, such as their earnings, capital incomes, consumption expenditures, gifts, and bequests, enabling the identification of tax evaders.

1.4.2. International tax competition

Due to the globalization processes' quick changes in national economies, included the advantages of a nation, such as the tax rates and its tax policy, start to play a significant role in the conditions of intense global competitiveness among a variety of industries. Nowadays, the position of a country in the world framework is significantly impacted by how much it can afford to be open in the international arena. Regarding tax collections, this is extremely fundamental for investors and multinational firms.
Around the world many countries have started competing to each other to have the lowest rate, but in this way, they contribute to the collective decline of tax rates. This phenomenon has two different effects, in a short-term perspective, corporations benefit from this low-rate policy, while in long term it has a negative development implication for governments and citizens.
Bi (2018)[46] affirms that usually countries manipulate corporate tax rates for competitive purposes, and the main reasons are: attract business activity or raise tax revenues. However, it is unclear what role tax rates actually play. Despite having corporate tax rates that are higher than those of the majority of developed countries, United States are still an attractive location for firms, more than European nations. In truth, a variety of elements, including a nation's level of government, education, and infrastructure, can influence where businesses choose to base their operations considerably more than the corporate tax rate.
Eric Toder[47], Institute fellow and codirector of the Urban-Brookings Tax Policy Centre at the Urban Institute, suggests that although higher corporate tax rates might cause capital to leave the country, the decrease in revenue could be balanced by an increase in pre-tax returns. Indeed, when the supply of capital in a country is lower, the returns on that capital increase. As a result,

[46] Bi K., Spring 2018, International Tax Competition: causes, consequences, and potential remedies, Vol. 39, No. 2, GLOBAL WATERS: OCEANS OF OPPORTUNITY AND STRIFE, Harvard International Review, pp. 20-22.
[47] In his current position, he oversees the modelling team at the Tax Policy Centre; serves as its leading expert on corporate and international tax and tax compliance issues; and authors and directs research studies.

investors seeking a better rate of return on their money may offset the capital outflows linked to higher tax rates with capital inflows.

On the other hand, cutting taxes plays a more direct role in drawing tax revenues: if a nation is more appealing for businesses to declare their taxable income, then the raise in taxable income balances the decline in the tax rate. So, at the end, the capital outflows associated with higher tax rates could match the capital inflows produced by investors seeking the higher rate of return on their capital. The ongoing increase in globalization lead to the exacerbation of international tax competition. When all countries apply the same policy and pursue the same strategy, the problem becomes huge.

Developed countries are not the greatest victims of this heated competition, but those who lose the most are developing countries. They do not possess many non-tax factors in order to attract corporations, so the only competitive advantage they can provide is a lower tax rate.[48]

Having a narrow corporate tax base, it is impossible for developing countries keep tax revenue steady by lowering down tax rates, as developed countries do. Moreover, for them is complicated to collect income taxes, so their major source of revenue are corporate tax revenues. It was observed that between 1990 and 2001, developing countries decrease corporate tax rates' percentage of twenty points (-20%). This implies a public spending revenue loss of hundreds of billions that could have been invested in economic growth, infrastructures, and citizens welfare. Tax competition has undesirable distributive implications in developed countries and leads to significant revenue losses in the developing world. According to this view, tax competition seriously constrains the autonomy of national policy.[49]

1.4.3. 2020 Tax Action Plan

In July 2020 the European Commission adopted a new Tax Action Plan, which contains a set of 25 initiatives that will be implemented till 2024. The primary efforts support actions to strengthen the fight against misuse, assist tax authorities in keeping up with the changing economy, enhance collaboration with non-EU nations, and provide support for those in developing nations.

To achieve the aim to make taxation fairer, simpler, and more adapted to modern technologies, the Action Plan tries to address the following problems:

- *Complexity and administrative burden that obstacles EU businesses*

Young and innovative enterprises, such as start-up or SMEs, struggle with costly tax compliance and administrative complexity. For SMEs, the cost of tax compliance might reach

[48] See note 45.
[49] Dietsch P. and Rixen T., 2016, Global Tax Governance What is wrong with it and how to fix it, Ch.1, p.4.

30% of taxes collected, unlike multinational companies for which it amounts to only 2%.[50] Additionally, having to cope with 27 distinct tax systems causes ambiguity for honest taxpayers, who may become overwhelmed and inadvertently non-compliant.

- *Tax abuse and harmful tax competition*

Aggressive tax planning, fraud, and evasion are changing quickly due to globalization, digitization, and changing company models. The EU has to keep improving its framework to combat tax fraud and give tax authorities the resources they need to collect the amounts that are legally due to them. It may be necessary to modernize the standards to obtain a fairer tax competitiveness, in order to reflect contemporary reality and stop certain nations from undermining the tax bases of other nations. International tax competition is an evolving problem since many years. EU in 2020 decided with the 'Communication on Tax Good Governance in the EU and beyond'[51], to include a reform of the Code of Conduct, improving the list of non-cooperative jurisdictions, extending the parameters to general features of corporate tax regimes.

- *Gap in tax transparency rules, due to online business ongoing evolution*

Digital platforms are expected to expand in the future, the problem is that many of them do not report income earned, so earnings are not taxed properly. The cross-border nature of this kind of platforms makes very difficult for tax authorities to detect the income earned. To tackle the problem the European Commission proposed to revise the Directive of Administrative Cooperation, to extend the transparency rules also to this kind of platforms, through a direct exchange of information with the seller.

- *Unexploited potential technology, which can help administration and taxpayer*

The recent phenomenon of technological and digitalization growth can be seen not just as something that lead to an increase of tax avoidance practices and new tax planning strategy, but it can have also a positive implication. A better use and implication of the technology by the tax authorities has the potential to analyse in less time and in an easier way the huge amount of data that are available, allowing synergies with other actors such as customers. Moreover, it could become a tool to reduce the cost for compliance and the administrative burdens.

Summarizing, the Tax Package sets out measure to reduce tax obstacles and unnecessary administrative burden, to improve business environment and competitiveness; help MSs to progress the existing rules to tackle tax non-compliance; support tax authorities to exploit existing data to collect taxes in an easier way, fighting tax fraud and evasion more effectively through technologies; promote taxpayers' rights, simplifying their obligations and facilitating compliance.

[50] https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/tax_survey.pdf
[51] COM (2020) 313 final.

1.4.4. Business Taxation for the 21st Century

Another step forward was made on May 18th 2021, when the European Commission exposed the 'Business Taxation for the 21st Century'[52]. EU puts forward an ambitious tax policy agenda which will include a series of action that will be implemented in near future, but also address the road to 2050. The core objectives that will be pursue are enabling a fair and sustainable growth and ensuring tax effectiveness. Taking a long-term perspective, EU tax mix will go through many changes. Nowadays, Member States' budget rely for 50% on labour tax revenue, for the 15% on VAT revenue, while environmental taxes account for about 6%, property taxes 5% and corporate income taxes 7%. With the population becoming older every day, there will be a reduction in the ability of labour taxation to collect the same amount of taxes in the future. The European Commission spotlights the importance to rethink about how labour is taxed and the need to find sustainable revenues and a new tax base. EU is focusing on environmental and health taxes (i.e. tobacco, alcohol taxes), in order to make the polluters pay and decrease pressure on public health. Moreover, the European Commission asserts that a future proof-tax mix will require the effective taxation of capital income of individual as well as corporations, and taxes on immovable property can become an efficient way to raise tax revenue.

The key problem discussed in this Communication are:

- the outdated principles of tax residence and source, which are increasingly difficult to apply to modern businesses;
- the difficulty for a cross-border operating business to interface with 27 different corporate tax systems, which lead to unnecessary compliance costs, discourages cross- border investments in the Single Market;
- the high compliance costs and the risk of double taxation arising because corporate income is taxed at national level, while business models are every day more international, complex, and digital. At the same time big companies has the potential to exploit loopholes and ideate new aggressive tax planning strategy, which hurt the fair competitiveness, growth, and investments.

To delate distortions of investment and financing decision and reduce competitive disadvantage as outcome of a lack of a common corporate tax system, the commission will propose the *Business in Europe: Framework for Income Taxation* (or BEFIT), an action for a longer-term business taxation framework in EU. It provides a single corporate tax rulebook for the EU, based on apportionment (allocation of profit through a formula) and a common tax base. The

[52] COM (2021) 251 final.

idea is based on the methodology proposed by the OECD in Pillar 1[53] for the partial reallocation of the profits and Pillar 2[54] for the computation of tax base. BEFIT aims to cut red tape, reduce compliance costs, reduce tax avoidance opportunities, and support jobs, growth and investment in the Single Market. This new proposal will replace the pre-existing proposal of a *Common Consolidated Corporate Tax Base*[55] (CCCTB), which will be withdrawn. These initiatives will lead to a revision of some ATAD and Transfer Pricing measures, the Commission with MSs and Parliament will work closely to prepare the proposal.

Taking a short-term perspective, focused on the next two years, the Communication sets out a series of targeted initiatives focused on two main priorities: promote productive investment and entrepreneurship, and ensure fair and effective taxation.

Since taxation has a considerable role in supporting investment and growth, the Commission proposes to Adopt a *Recommendation on the domestic treatment of losses*. SMEs have a reduced capacity to absorb finance losses than big corporations, with this recommendation EU requests Member States to permit firms to carry back losses at least to the prior fiscal year. The advantage of loss carry-back is that it helps companies that were successful prior to the pandemic. Businesses that generated profits and paid taxes in the years prior to 2020 would be entitled to deduct their losses from taxes in 2020 and 2021. In this way no public funds are being used to support private businesses that are failing for reasons unrelated to the crisis, since the policy is only targeted at businesses that are directly affected by the pandemic.

Another Action is the legislative proposal to create a *Debt Equity Bias Reduction Allowance* (DEBRA). The current tax framework allows companies to deduct interests attached to debt financing, but not the costs related to equity financing debt, thus there is a persisting pro-debt bias of tax rules. This has negative spill-over effects, especially now that with Covid-19 and Ukraine war crisis, companies' stock of debt has increased, and countries should face insolvency waves. The proposal aims at the re-equitization of financially vulnerable companies.

[53] Pillar 1 aims to adapt the international rules on corporate profits taxation to reflect the changing nature of business models, including the ability of companies to do business without a physical presence. Through a reallocation of a portion of global profits, market jurisdiction will have the right to tax part of the profit of certain non-resident businesses.

[54] Pillar 2 will set a floor to excessive tax competition by ensuring that multinational businesses are subject to a certain minimum level of tax on all of their profit each year.

[55] The CCCTB, developed by the European Commission and originally issued in March 2011, is a proposal for a common tax system for the European Union that suggests a uniform set of guidelines for how EU firms should compute EU taxes and consolidate. The initial plan came to a standstill, partly because of the objections from nations like Ireland and the UK.

To ensure fair and effective taxation the Commission puts on the table two actions:

- *Table a legislative proposal for the publication of effective tax rates paid by large companies, based on the methodology under discussion in Pillar 2 of the OECD negotiations*

The proposal aims at ensuring greater public transparency regarding the real effective tax rate paid by businesses, especially large companies operating in EU. Through this new methodology the effective corporate tax rate provides information on corporate tax share paid by businesses relative to the amount of profits they generate rather than in relation to their taxable profits, which can be reduced by various means, such as tax deductions.

- *Table a legislative proposal setting out union rules to neutralise the misuse of shell entities for tax purposes*

Shell companies are legal entities with no or minimal substance and economic activity. The use of these kind of company as intermediate vehicle is very widespread, especially for aggressive tax planning practices, such as treaty shopping. It was measured that inside EU there are almost 75 000 shell companies[56]. To tackle the misuse of these entities, the Commission proposes to ask them a series of requirements, for example the necessary information to assess substantial presence and real economic activity, to monitor the transparency of these entities and avoid abusive benefits and situation of double non-taxation of interest, royalties or dividends. The European Parliament stressed the importance of tackling tax avoidance and tax evasion via shell entities. The Commission tabled on 22 December 2021 a key initiative to fight the misuse of shell entities for improper tax purposes, the so called *Unshell Directive*[57].

[56] SWD (2022) 34 final, here are considered just shell companies and trusts, not other forms of potential shell entities, such as partnership.
[57] COM (2021) 565 final.

CHAPTER 2

FROM *ABUS DE DROIT* TO ATAD III

2.1. Historical excursus of EU anti-tax avoidance legislation and ECJ case-law[58]

In order to understand deeply why EU claims the need for an *Unshell Directive* it is crucial to understand which is the legislative past background and the process by which the EU has created the Anti-Tax Avoidance Package.

As Vanistendael asserts, "The story of anti-tax avoidance starts with the concept of *abus de droit*, the idea that a person may abuse his rights which he has under the law, as it was developed in French case law[59] under the Civil Code of 1804."[60] The concept becomes a pillar of EU communitarian law, with the power of limiting the unrestricted exercise of fundamental freedoms under the Treaty on the Functioning of the European Union (TFEU). The principle has been applied in customs duties, VAT, and income taxation. The *abuse of law* made its way into European communitarian law, especially through the Court of Justice of the European Union's case law. Indeed, as stated in Chapter 1, tax harmonization in EU is based not only on positive integration brought by instruments of secondary law, such as directives and regulations, but also on the jurisprudence of the Court of Justice, which is called to rule on the compatibility of national tax provisions with the principles of Community law contained in the TFEU.

Vanistendael mentions another fundamental source for the EU anti-tax avoidance doctrine. It is a sentence pronounced by the Court of Justice of EU in the *Cassis de Dijon*[61] case (1979): "Obstacles to movement within the Community resulting from disparities between the national laws relating to the marketing of products in question must be accepted in so far as those provisions may be recognized as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer." MS used it as a justification for the restriction imposed by national law to the fundamental freedoms, indeed as

[58] The legal doctrine in this field is very extensive, but for the purposes of this thesis only Vanistendael, Greggi, Panayi De Broe and De Charette will be mentioned. These authors have been chosen as exemplification, remaining deeply aware that it might seem reductive with respect to a theme on which the most illustrious scholars have expressed themselves. Clearly, this choice is imposed by the limit of space and the final aim of this thesis.

[59] The author makes a reference to a sentence of the Court of Appeal, Colmar, 02.05.1865: "The exercise of any right must be limited to the satisfaction of a serious and legitimate interest."

[60] Vanistendael F., 2020, From Abuse to Base Erosion, How Did It Come to This?, from the book of Werner Haslehner et alt., A Guide to the Anti-Tax Avoidance Directive', Edward Elgar Publishing Limited, p.1-2.

[61] Case 120/78 Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein, 1979, ECLI:EU:C:1979:42. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61978CJ0120

asserts by Greggi (2008)[62] when a national taxpayer chooses a tax avoidance-oriented approach to the national tax law, he may attempt to defend his actions under the banner of a fundamental freedom. So, according to the European Court of Justice, the EU law cannot be relied on for abusive and fraudulent ends.

When the European Community was created in the 1950s, the harmonization of direct taxation was not the priority, by contrast indirect taxes represent the main objective to stem the distortion caused by national trade barriers that hindered the formation of the Single Market.

Panayi (2013)[63] puts in evidence that direct taxation, and EU taxes more generally, have not been addressed in any European Treaties after the primary Treaties. So, while indirect taxes were somewhat covered by the Treaties, direct taxes were never included. As a result, the harmonisation of direct taxes has never had a clear legislative harmonization base. Direct tax law has been based on general legislative foundations established by Articles 115 and 352 of the Treaty on the Functioning of the European Union[64]. According to Article 115 of the TFEU, the Council may issue directives to harmonize laws, regulations, or administrative rules of Member States. On the other hand, Article 352 TFEU gives the Council the authority to take proper measures to achieve Treaty's goals, upon the Commission's recommendation and with the approval of the European Union. In both cases unanimity is required.

The combination between the lack of explicit competence and the fiscal veto[65] left the sovereignty on direct taxation in the hands of MSs. This leads to many tax obstacles and impediments to the market integration, especially because of the different approaches[66] applied by MSs in corporate tax field, leading to phenomenon of juridical and economic double taxation. Because of the inefficiencies and economic distortions created by MS differences, some topics becomes extremely imperative for EU, such as the harmonisation of the corporate tax base, the taxation of subsidiaries, the taxation of passive investment income, corporate reorganisations and anti-abuse rules. Decisive was and still today is the role of CJEU in

[62] Greggi M., 2008, Avoidance and abus de droit: The European Approach in Tax Law, eJournal of Tax Research, vol. 6, no. 1, p.34.

[63] Panayi, 2013, European Union Corporate Tax Law, Cambridge University Press, Ch. 1.

[64] Panayi (2013) also includes Article 116 TFEU among the general legal basis for harmonisation. It could be used for legislative action when differences in Member State laws are distorting the conditions of competition in the Internal Market. Even if it does not require unanimity and can be implemented for direct tax measures, it has never been used for tax harmonisation purposes.

[65] Fiscal veto is the power of even one Member State to object to a harmonising measure in direct tax law. It still survives today, despite many attempts to move to majority.

[66] The three different system of taxation:
classical system: profits are taxed independently in the hands of the company and its shareholders, leading to economic double taxation (same income taxed twice in the hands of different persons)
imputation (or tax credit) system: part of the corporation tax on distributed profits is credited against income tax, so relief to mitigate economic double taxation on dividends is given at shareholder level.
split-rate system: relief for economic double taxation on dividends is given at company level, as a lower rate of corporation tax applies for distributed than for retained profits.

addressing many legislative vacuums, for this reason the volume of case law (negative integration), in the field of direct taxes, is higher than the volume of positive integration, which results very scarce.

Obviously, as reiterated many times by the literature, the Court of Justice can only respond to specific questions in litigated cases and cannot act as a substitute legislator with the power of constructing a concrete tax system.

Panayi analysing the evolution of corporate taxation through some main initiatives and recommendations of various reports, such as *The Neumark Report*, *The Segrè Report, The Program for the Harmonization of Direct Taxation, The Van den Tempel Report, The Ruding Report,* produced by the Commission with committee of experts, between the 1960 and 1997, asserts: "Proposals for the harmonization of corporate taxes have a long history. Whilst initial proposals recommended the unification of Member States' corporate tax systems with a single tax rate and a uniform tax on distributed profits, subsequent proposals moved away from harmonisation to coordination and ad hoc legislative solutions. What is evident early on is that the Community oscillated between the classical system and the imputation system, with its main focus being harmonisation rather than coordination"[67]. The author spotlights that, during years, the problem was not the lack of vision of the Commission, but the institutional limitations that delayed integration. Many proposals of that years were not followed up, but on the other hands the efforts made by the Commission give raise to ad hoc and targeted measures, which includes also significant anti-tax avoidance actions.

Among the established harmonized standards, noteworthy are the Parent–Subsidiary Directive, the Merger Directive, the Savings Directive (replaced by Council Directive 2014/107/EU regards mandatory automatic exchange of information in the field of taxation), the Interest and Royalties Directive, the Mutual Assistance Directive for the Recovery of Taxes, Mutual Assistance Directive for the Exchange of Information (replaced by Council Directive 2011/16/EU on administrative cooperation in the field of taxation), and the Arbitration Convention. Moving to 2013, a fundamental development took place in the international tax community, also affecting EU corporate tax law evolution: the Base Erosion and Profit Shifting project. EU Commission decided to exploit the political momentum created by BEPS, pushing through several amendments to existing tax legislation as well as completely new measures such as the Anti-Tax Avoidance Directive and the Tax Dispute Resolution Mechanisms Directive. Even if MS still maintain their sovereignty in the field, this evolution also affect the definition and the application of the *abuse* concept by ECJ.

[67] Payani, ch.1, p.9.

De Broe and Beckers (2017)[68], asserts: "The concept of abuse of law is a model illustration of judge-made law which has been invoked and further refined over the years in many fields of EU law." *Emsland-Stärke* case[69] (2000) was the starting point for the ECJ to provide the Member States with adequate criteria when assessing whether abusive behaviour occurs.
During the case, the Court pointed out that the concept of abuse entails two elements:

1) a combination of objective circumstances in which de despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved (objective test)
2) a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it (subjective test)

Halifax[70] (2006), on VAT, was the first case in which ECJ ruled on abuse of EU law in application to the field of indirect taxation. In that case it used a similar double test and applied to VAT the principle of prohibiting abusive practices.
What remains uncertain is the application of this revolutionary decision to other fields, such as the one of direct taxation. Another remarkable case is the *Cadbury Schweppes*[71] (2006), concerning the UK Controlled Foreign Company (CFC) legislation of that years. Although it was a case of direct taxation, the Court referred to *Emsland-Stärke* two prong test with some minor modifications. In *Kofoed*[72] (2007) and later in *Foggia*[73] (2011), both on Merger Directive, the European Court of Justice seemed to consider the idea that the anti-abuse provision of the Directive reflected the general Community law principle that abuse of rights is prohibited, but a stricter interpretation was applied in *Zwijnenburg*[74]. This gave raise to the issue about whether a general principle of abuse of rights could be applied to all taxes, both harmonised and not

[68] De Broe L., Beckers D., 2017, The General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Analysis Against the Wider Perspective of the European Court of Justice's Case Law on Abuse of EU Law, EC Tax Review, Volume 26, Issue 3, p.133.
[69] C-110/99 Emsland-Stärke, where the key question was whether EU Regulation No 2730/79 precluded an obligation to repay a refund that had already been granted when the specific circumstances of the operation potentially suggested an abuse, 'that is to say, a purely formal dispatch from Community territory with the sole purpose of benefiting from export refunds'.
[70] Case C-255/02 Halifax plc Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v. Commissioners of Customs & Excise [2006] ECR I-1609. This case dealt with an aggressive and complex VAT planning scheme intended to locate the place of supply of services outside the EU.
[71] Case C-196/04 Cadbury Schweppes [2006] ECR I-7995. The Court of Justice found that the UK CFC rules restricted freedom of establishment. This was because profits of a controlled company were only attributed to the UK parent company when this controlled company was incorporated in a low tax Member State (within the meaning of the UK CFC rules). Profits were not attributed to the UK parent if the controlled company was UK resident. This difference of treatment dissuaded UK-resident companies from establishing, acquiring or maintaining a subsidiary in a Member State with such lower level of taxation, and therefore constituted a restriction to the freedom of establishment.
[72] Case C-321/05 Hans Markus Kofoed v. Skatteministeriet [2007] ECR I-05795.
[73] Case C-126/10 Foggia – Sociedade Gestora de Participagdes Sociais SA v. Secretario de Estado dos Assuntos Fiscais [2011] ECR I-10923.
[74] Case C-352/08 Modehuis A. Zwijnenburg BV v. Staatssecretaris van Financie¨n [2010] ECR I-04303

harmonised.

Panayi (2020)[75] claims that a general clear principle of abuse of rights is not provided by EU in the field of direct taxation, being a non-harmonized area. De Charette (2019)[76] confirms that, as explicitly stated in *3M Italia Spa*[77] (2012), the CJEU wanted to keep separated doctrines for each field, distinguishing the principle of abuse defined in *Halifax* from the one of Court's case laws on direct taxation. Therefore, the author clarifies that, in the first case, abuse doctrine was developed because the EU legislation's expansion in areas like indirect tax leads to opportunities for a diverted use of EU benefits; while in direct taxation is used by the defendant governments as a public interest containing the application of Treaty freedoms. As a result, the scope of application of the abuse-concept as a general principle of EU Law applies directly in the context of harmonized taxes (indirect taxation), without requiring a transposition in national law. On the other hand, its role is limited in non-harmonized field (direct taxation) in which can be used to excuse restrictions imposed by national legislation on the fundamental freedoms.

For what concern the ambiguity left by *Halifax* on whether Member States have the duty to combat abuse of EU Law by relying directly on the general EU Law principle, or if they should recourse to Domestic Anti-Abuse Rules or Judicial Doctrines, in *3M Italia Spa*, the Court emphasized that there is no general principle in EU law that might imply an obligation of the Member States to combat abusive practices in the area of direct taxation, and, if they do, that they cannot directly rely on a general principle. As a consequence, if MS want to protect themselves from abuse through domestic measures that restrict the fundamental freedoms, they must respect the standard imposed by the CJEU (two prong-test of abuse, principles of proportionality, legal certainty). The situation is not different where direct taxation has been harmonized at EU level.

Looking at the major Directives concerning direct taxation, De Broe and Beckers quoted some measures aimed at preventing specific form of abuse, moreover the Directives authorize MS to apply GAARs. The Parent-Subsidiary Directive provided: "This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse". The Merger Directive stated: "A Member State may refuse to apply or withdraw the benefit of [the Directive] where it appears that one of the operations referred to in Article 1 has as its principal objective or as one of its principal objectives tax evasion or tax avoidance." The Interest and Royalties Directives at Art.5(2) asserted: "Member States may, in the case of

[75] Panayi Christiana, 2020, European Union Corporate Tax Law, Cambridge University Press, p.334.

[76] De Charette D., 2019, The Anti-Tax Avoidance Directive General Anti-Abuse Rule: A Legal Basis for a Duty on Member States to Fight Tax Abuse in EU Corporate Direct Tax Law, EC Tax Review, Volume 28, Issue 4 (2019) p.177.

[77] C-714/10 3 M Italia Spa, Judgment of 29 Mar. 2012, point 30.

transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive."

It is evident that the Directives just authorised MS to deny the benefits provided by themselves, when the transaction were implemented with the sole purpose of a tax advantage. The content of these Directives precisely complied with the ECJ's position, according to which MS might establish anti-abuse regulations in direct tax affairs provided that they stay within the strict boundaries of the abuse concept as developed in its case law.

The turning point came in 2011 with the Financial Transaction Tax (FTT) plan, which stated in Article 11(1) "Member States shall adopt measures to prevent tax evasion, avoidance and abuse." This time the proposal does not simply allow Member States to take anti-abuse measures, it also requires them to do so. This was made further clearer in the second FTT proposal, which included a GAAR, practically an exact replica of the EU GAAR that the Commission had suggested as part of its Action Plan of 2012 to improve the fight against tax fraud and tax evasion. Another important step has been accomplished in November 2013 when a proposal to change the Parent Subsidiary Directive also included the addition of a required (not just authorized) GAAR. The GAAR became law in January 2015, establishing a precedent. Years of uncertainty and ambiguity were broken in 2016, with the adoption by EU Member States of the EU ATAD GAAR, to be used in corporate taxation.

2.1.1. Focus on Anti-Tax Avoidance Package

The Economic and Financial Affairs Council configuration (ECOFIN) of the Council of the European Union, triggered by the launch of BEPS project by OECD/G20 (2013) and after a difficult negotiation process, issued the Anti-Tax Avoidance Package for a fairer, simpler, and more effective corporate tax system. The Package includes specific actions to stop aggressive tax planning, boost tax transparency, and create a level playing field for all EU businesses. It supports Member States in taking decisive and well-coordinated action against tax avoidance, to ensures that companies pay taxes wherever they make profits within the EU.

On July 12, 2016, the Council adopted ATAD I[78] to harmonize the adoption of anti-BEPS measures into domestic laws across EU Member States. ATAD I introduced five sets of rules of minimum standards of which three are largely consistent with the OECD's BEPS recommendations, while the others (GAAR and exit taxation) go beyond the scope of the OECD's BEPS project. The initial proposal[79] foresaw one more main measure: the *switch-over*

[78] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

[79] Proposal for a Council Directive Laying Down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, COM (2016) 26 final (28 January 2016).

clause, which was delated in the final version.

Below is provided a brief overview[80] of ATAD I's five specific measures:

1) ***Interest limitation rule (Article 4),*** also called EBITDA rule, states that the deduction of 'exceeding borrowing costs'[81] is limited up to 30% of taxpayer's EBITDA. Member States are allowed, under ATAD I to use a lower percentage. Member States may allow taxpayers to fully deduct exceeding borrowing cost of up to EUR 3 million (de minimis threshold).
   The scope of this measure is to prevent multinational groups from artificially shifting their debt to jurisdictions with more advantageous deductibility rules.
2) ***Exit taxation rules (Article 5)*** applies to impose a tax charge (exit tax) on asset transfers from a corporate taxpayers' head office to its PE in another Member State or in a third country and vice versa (i.e. from a PE to head office as well as between PEs in different States) where the Member State no longer has the right to tax the transferred asset. Exit tax should also become due when a corporate taxpayer transfers its tax residence or its entire business from one Member State to another Member State or a third country.
   The purpose is to prevent companies from avoiding tax when relocating assets in another country, giving to the first state the power to tax the economic value of any capital gain created in its territory even though that gain has not yet been realised at the time of the exit.
3) ***General Anti-Avoidance Rule (Article 6)*** establishes that when calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine[82] having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or particle. General anti-abuse rule aims at covering any gaps that may exist in Member State's specific anti-abuse rules.
4) ***Controlled Foreign Company Rules (Articles 7 & 8)*** attribute undistributed income of a foreign company or permanent establishment (PE) to a domestic parent company (such income will have to be included in the taxable income of the domestic taxpayer). An entity or a PE whose profits are not subject to tax or are exempt from tax in a member state will be treated as a CFC if the following requirements are met:
   – A domestic taxpayer/parent company (alone or together with its associated enterprises) holds directly or indirectly more than 50% of the voting rights, capital, or entitlement to the

[80] Using KPMG, Deloitte and PwC reports on ATAD Package.
[81] Exceeding borrowing costs are defined as "the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law".
[82] Not put into place for valid commercial reasons that reflect economic reality.

profits of the entity

– The actual corporate tax paid by the entity/PE on its income is lower than the difference between the corporate tax that would have been paid on the same profits in the Member State of the domestic taxpayer/parent company and the actual corporate tax paid by the entity/PE in the source state.

ATAD provides two options, among which MS can choose, to impose the CFC charge:

- Model A: certain predefined categories of passive income of the CFC are attributed to the taxpayer/parent company.
- Model B: undistributed income of the CFC from non-genuine arrangements that have been put into place for the essential purpose of obtaining a tax advantage is attributed to the taxpayer/parent company.

The aim of these rules is to discourage multinational companies from shifting large amounts of profits from their parent company in high tax country to controlled subsidiaries in low or no tax jurisdiction, to reduce the group's tax liability.

5) ***Hybrid mismatches (Article 9***) develop in case of a situation between a taxpayer in one Member State and an associated enterprise in another Member State or a structured arrangement between parties in Member States, where the following outcome is attributable to differences in the legal characterization of a financial instrument or entity:

-Double deduction: a deduction of the same payment, expenses or losses occurs both in the Member State in which the payment has its source, the expenses are incurred, or the losses are suffered and in another Member State. In this case the deduction shall be denied in the investor Member State as a primary rule or, as a secondary rule, in the payer Member State.

-Deduction without inclusion: there is a deduction of a payment in the Member State in which the payment has its source without a corresponding inclusion for tax purposes of the same payment in the other Member State. The deduction shall be denied in the payer Member State, as a primary rule, or, as a secondary rule, the amount of the payment shall be included as taxable income in the payer Member State.

The goal of hybrid mismatches rules is to avoid corporate taxpayers from taking advantage of disparities between national tax systems in order to reduce their overall tax liability.

Importantly, subsequent rules relating to hybrid mismatches were finalised on 29 May 2017 when the ECOFIN adopted ATAD II[83], which amends ATAD I but only in hybrid mismatches fields. Indeed, the second directive is focused on extending Article 9 to include hybrid mismatches not just between EU Member States, but also mismatches arrangements arising

[83] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

with third countries. Moreover, the scope was further broadened to introduce rules on branches (involving PEs) mismatches, hybrid transfer, hybrid financial instrument mismatches, dual resident mismatches, reverse hybrid mismatches and imported mismatches. The proposal's rationale was to harmonize MS tax policy with that of the third country, unless the latter had already done so.

ATAD seeks to transpose a number of Base Erosion and Profit Shifting (BEPS) Action Plan Recommendations that would ensure that companies pay tax wherever they produce their profits in the EU through a coordinated action against tax avoidance.

From the 1970s to the early 21st century, the focus of EU authorities was on removing protectionist barriers to the fundamental freedoms. As stated above, the idea of EU tax abuse[84] was often developed in direct taxation law in a setting of poor harmonization, but significant negative integration, with the intention of controlling illegitimate Member States' protectionist interferences. Even if the ECJ require the use of national anti-abuse rules, these domestic anti-abuse measures impacting the exercise of the freedom of establishment, or any other right, must be justified by the Member States implementing it, respecting the criteria of the genuine economic activity. The adoption of the ATAD GAAR carried forward the continuing integration process. Indeed, at international level, was of extreme importance preventing double taxation issues that could undermine trade and mobility freedoms. For the international community's and the EU's taxation policy it represents a substantial paradigm shift. "It illustrates a new step forward through an ordoliberal method. In that sense, within EU tax policy and from a liberal point of view (prevailing since the 1970s and also indirectly encouraged by Member States' reluctance to give up on this eminently sovereign competence) harmonising tax rates would in theory be superfluous as tax competition should eventually result in the convergence of national practices towards a similar efficiency optimum. In addition, tax competition is recognized as inherent to federal ensembles and potentially beneficial in so far it could encourage fiscal discipline. However, persisting inconsistent approaches to abuse on the part of Member States (either by leniency or unreasonable prophylaxy) are undesirable interferences to the way to such equilibrium (market failures), leading to harmful competition that the law should combat. This technocratic approach focusing on addressing harmful competition is that of the Commission."[85] (De Charette, 2019)

[84] Tax abuse is very widespread in common law countries, but become popular also in the civil law, when you are abusing legislation is when you take advantage from legislation using it for aims that are not intended to be granted by it. The outcome achieved by the taxpayer is different from the one expected by the legislator.
[85] De Charette D., 2019, The Anti-Tax Avoidance Directive General Anti-Abuse Rule: A Legal Basis for a Duty on Member States to Fight Tax Abuse in EU Corporate Direct Tax Law, EC Tax Review, Volume 28, Issue 4 (2019) p.178.

The new GAAR gives EU a judicial review authority over the laws and policies of Member States, laying further groundwork for more uniform fiscal discipline among MSs. This action overcomes the ambiguous applications of the EU tax abuse principles of past decades, clarifying that in combating tax abuse are included both the direct and indirect fields. It also enables EU authorities to impose sanctions when necessary. For tax authorities, ATAD Article 6 acts as a residual *catch-all clause* or *safety net* to prevent taxpayers from benefiting from unfair tax practices, that would not be covered by ATAD or other directives' targeted provisions.
ATAD GAAR is designed based on previous source, such as the main purpose or one of the main purposes tests of the Parent Subsidiary Directive, which was itself based on the *Principal Purpose Test* (PPT) of the OECD BEPS Report on Action 6, and the CJEU's artificiality tests. For this reason, GAAR does not represent a break, but a continuous evolution of CJEU case law. As previously said, the CJEU had already promote convergence in national laws and practices involving direct tax abuses, but with the implementation of the ATAD GAAR, its action has a considerably greater impact, with no distinction between domestic or cross-border situation. Member States that, until 2016, did not have a GAAR in their domestic laws will be required to implement it. The newly introduced obligation aims to prevent tax shopping by addressing certain *patterns* of behaviour on Member States that are harmful to the establishment of a tax level playing field, by excessively burdening businesses or by high-level indulgence. In a domestic setting, Member States may, of course, continue to impose stricter anti-abuse regulations and penalties on benefits that fall outside the scope of ATAD.

2.1.2. The next step: ATAD III against shell entities for aggressive tax planning

The latest proposal of the European Commission in the field of direct tax harmonization is the *Unshell directive*. Nowadays, as previously said, EU Member States already have an arsenal of legislative tools to tackle aggressive tax planning schemes, including the misuse of shell companies, in the form of GAARs, multilateral instrument (MLI) and European Court of Justice case law.
At domestic level every state has developed Transfer Pricing Legislation, in order to tackle the problem of benefit obtained by a transaction between two related, or associated, legal entities of the same group, located into two different states (tax domains), using the price as a lever to keep profit where they want. The entities are legally separated but economically act like one. Transfer pricing legislation is based on a very simple concept that is arm's length. It is a principle upon which all transactions falling within the scope of transfer pricing are redetermined in the price, in the sole prospective of taxation.

In addition, there are other two Targeted Anti-Avoidance Rules (TAARs) in domestic legislation dealing with international legislation:

a) *Anti-Thin Capitalization* refers to the fact that the tax treatment of interest is traditionally different from the tax treatment of dividends. The former are debt payoff and are fully deductible in the determination of taxable income, while the latter are obtained from equity payoff, so are nondeductible. There is a tax advantage given by interest taxable regime. So, shareholders prefer to finance their company with debt, making equity thinner. The benefit becomes even greater if applied in a low tax jurisdiction country. As counter measure, just for tax purposes, the legislator indicates a maximum amount of debt financing, and the exceeding part is treated as dividends, not deductible.
b) *Controlled Foreign Company rules*, which tackle conduit problem with *look through approach*. The corporate vehicle is supposed to be not existent, and the interests/royalties/dividends are attributed directly to the shareholder in the same proportion as its right to receive a dividend. There are some exceptions to CFC in case can be proven that the middle company is running a genuine business activity and is incorporated for good reasons, such as an economic advantage and not for gaining taxation benefits.

For what concern another widespread problem, treaty shopping, Double Tax Treaties gives targeted solutions, such as the *beneficial owner* concept. It was introduced specifically to tackle the problem of shell companies, or letter box companies, that were incorporated for the sole purpose to cash income and reduce the income to third parties. The measure consists in showing that the true beneficiary is not the conduit, but another person who cash in incomes, with no obligation to reimburse them to another individual or entity. The problem of this measure is the high degree of uncertainty because of the grey areas around this concept, which left big space for litigation whit tax authorities. Even if it is very powerful tool for tax authorities, it may overspill in situation where it has not to be applied. This uncertainty represents also a problem for economic growth, high costs and risks of compliance.

The OECD suggested to implement other tools, which in some cases are used in substitution to the beneficial owner. These are the Limitation of Benefit (LOB) clauses. The person who is taking advantage, must satisfy a number of requirements, in order to have the recognition of the tax benefit provided by the tax treaty. While the beneficial ownership remain undefined and very uncertainty, LOB is grounded on a number of requirements that aimed at certifying that the person or the entity has a true and sound economic activity. The requirements to fulfill are minimum space, minimum number of workers, minimum turnover, expenses for electricity.

Obviously, many times big corporation rearranges the group to fulfill LOB, going on with aggressive tax planning practices.

Across treaties other measures are the Principal Purpose Test, introduced by Action 6 of BEPS, and Multi-Lateral Instrument (MLI). The latter is an agreement open to the signing and ratification of all countries, in order to modify, in the same moment and way, all existing bilateral tax treaties. Through this measure tax treaties are automatically ratified, avoiding expensive renegotiation time. Moreover, articles 26 and 27 of OECD Model Convention provide tools that give the opportunity to tax administrations of the two engaged countries to cooperate in information exchange.

The problem is that the major part of the measures illustrated above require the active involvement of tax authorities in the different EU Member States to be efficient, hence, even if these provisions remain relevant, many abusive constructs remain unchallenged due to a lack of capacity at tax authorities' level. ATAD III is designed to target shell companies, establishing a minimum substance standard, according to which treaty and directive benefits are automatically denied if the requirements are not met. In this way the burden shifts from the tax authorities to the taxpayers.

Before presenting the proposal issued by the European Commission is fundamental to go deep into shell entity definition and misuse.

2.2. Shell entity

As a result of the development of the internal market and globalization, the phenomenon of shell entities has exponentially expanded in last decades, also despite the increased awareness of the negative impact this phenomenon creates for the economy and the society. The misuse of letterbox company is a complex borderless phenomenon, that damages various economic sectors and policy areas from company law to employment, social security, taxation and criminal justice. The phenomenon is linked to the EU effort to create a Single Market, based also on the freedom of mobility and establishment. The fundamental freedoms' main consequence is that companies search for competitiveness at global level, looking at countries with favourable and advantageous jurisdictions, to increase profit, lowering down taxation and wages costs. As stated by European Commission's Vice-President, Frans Timmermans (2018): "In our thriving EU Single Market, companies have the freedom to move and grow. But this needs to happen in a fair way", highlighting the increasing attention of public and political debates on shell entity problems.

The term *shell company* has been used widely in recent years, often interchangeably with terms such as letterbox company, mailbox company, special purpose entity, special purpose vehicle, paper companies, offshore companies, shelf company, ghost company and similar, hindering a clear delineation of a single agreed definition. These expressions do not, however, always

denote the same thing, but they may differ based on circumstances and contexts. Among the several reasons that determine the lack of a formal definition can be mentioned the difficulty to categorise the phenomenon, due to the high number of different types of shell companies with different purposes, a very large playing field and a broad spectrum of users. Despite the very varied terminology, the European Parliamentary Research Service (2018)[86] distinguishes three main categories each with custom features:

c) *Anonymous shell companies*

   Companies that offer anonymity as a crucial component, while also ensuring control over the shell corporation and its resources, fall under the first type. The ultimate beneficial owner (UBO) is hidden behind this company or behind a network of connected shell companies. Over the years, the International Consortium of Investigative Journalists (ICIJ) has published numerous investigations featuring this type of corporation, such as Panama, Paradise and Pandora Papers leaks. These businesses are frequently brought up in connection with evasion, corruption, money laundering and terrorist financing.

d) *Letterbox companies*

   Also called *mailbox company*, is generally a company registered in one Member State while its substantive economic activity takes place in another. Circumvent labour laws and social contributions, in the Member State in which the substantive economic activity is taking place, are its principal aims. Indeed, generally are mentioned in the context of circumvention of the Posting of Workers Directive.

e) *Special purpose entities (SPE)*

   Group financing or holding activities are the core business of this last category. These are companies that have few or no employees, little to no physical presence in the host economy, and assets and liabilities that are made up of, or originate from, investments made in/from other nations. SPEs are frequently mentioned for aggressive tax planning.

Nevertheless, there are a combination of common elements, a sort of alarm bells, that are shared by all these different definitions. The first feature is the lack of economic activity in the MS of registration, which typically indicates that the businesses is an artificial arrangement, in which there are no independent operations, significant assets, ongoing business activities or employees. The International Bureau of Fiscal Documentation in reference said, "lacks any further business substance", while the OECD and the International Monetary Fund provides the same following description reported by Damgaar and Elkjaer (2017): "While there is no

[86] European Parliamentary Research Service, authors: Kiendl Krišto I., Thirion E., 2018, An overview of shell companies in European Union, STUDY EPRS, Ex-Post Evaluation Unit and European Added Value Unit, Brussels, pp.11-12.

uniform international definition of SPEs, statistical manuals provide similar criteria for identifying an SPE. These include formally registered legal entity that is subject to national law, ultimate owners are not residents of the territory of incorporation, few or no employees, little or no production in the host economy, little or no physical presence, most assets and liabilities are vis-à-vis non-residents, and the core business of the enterprise consists of group financing or holding activities”[87].

Another commonly recognized characteristic is the existence of a cross-border or international element; in fact, the OECD specifies “the actual commercial activities are carried out in another country”. Similarly, the European Trade Union Confederation (ETUC) reports that a mailbox company is a “business that establishes its domicile in one Member State merely with a mailing address, while conducting its activities in other Member States”. Lastly, the intentional elements, which refers as companies’ behaviour/intention/purpose behind the use of a shell company, to perform illegitimate abuse activities. Among subjective elements the most quoted by European Commission are “purpose of benefitting from legislative loopholes” and “their aim is the circumvention of obligations”.

“A shell company is supposedly an independent, legal business entity that is used to separate and hide the identity of its real owner. The use of shell companies can be legal when they serve as technical vehicles facilitating complicated business transactions, but they are often used for illegal purposes”[88] (Jancsics, 2018). It is important to highlight that shell companies may also be used for legal purposes, for example, they can be used to hold personal or family assets to facilitate inheritance. Often, well-known brands, during the purchase of property or land, use shell entities to hide their identity as a form of protection from high price increase by the owner. Another legitimate purpose for which shell companies are used is to facilitate corporate mergers, joint ventures, and estate planning. The problem arises when shell entities are used as a vehicle for tax avoidance, tax evasion, and money laundering. Shell companies do not necessarily carry risks because of what they are but if used in combination with other instruments, such as international tax agreements or poor transparency requirements, they can increase and facilitate the concealment of the origin of assets and the hiding of beneficial owners, or fraud workers’ rights, abusing of labour and social laws. Due to the negative economic, political, and social effects of these illegal uses, both the economy and society are in danger.

[87] Damgaard J., Elkjaer T., 2017, The Global FDI Network: Searching for Ultimate Investors, IMF Working Paper, WP 17/258, IMF, p.8.

[88] Jancsics D., 2018, Shell companies and Government Corruption, in: Farazmand (ed.), Global Encyclopedia of Public Administration, Public Policy, and Governance, Springer International Publishing AG, part of Springer Nature 2018A, p.1.

In April 2018, the European Parliament's Special Committee on Financial Crimes, Tax Evasion and Tax Avoidance (TAX3) asked the European Parliamentary Research Service (EPRS) to produce a study on shell companies in the European Union. The report[89], according to the relevant literature, identifies three main risks that the misuse of shell entities can generate, which are:

f) *Risks associated with anonymity*

Anonymity is a key function that makes the use of shell companies attractive. This important element hides the ultimate beneficial owner, still guaranteeing to him/her the control over the shell company and its resources, such as profit and benefit. Obviously, the disguise of the ownership aims at operating without scrutiny from law enforcement or the public, impeding to traceback the real beneficial owner. For this reasons shell entity is a tool for criminals and money launderers to hide businesses, especially illegal activities, from authority.

g) *Risks associated with treaty abuse*

This risk is associated especially to SPE. As analysed before, the lack of harmonization in direct taxation leads to many differences among EU countries, and usually to limit the double taxation situation, born from different treatments and definitions, States enter into bilateral tax treaties in order to allocate powers of taxation between themselves. The problem is that not all companies use treaty to eliminate double taxation, but other also take advantage of the treaty, establishing a shell entity in a third country with attractive desirable treaties. The idea is exploit treaties in the best possible way to obtain double non taxation, taking an indirect route. Treaty shopping leads to tax avoidance through aggressive tax planning, profit shifting and transfer pricing.

h) *Risks associated with the circumvention of the Posting of Workers Directive*

Additionally, shell companies are created and exploited to enable undeclared work and escape social security contributions. In the EU, the coordination of different national social security systems, in cross border situations, is based on the *lex loci laboris* principle, under which people moving within the EU are subject to the social security scheme of only one EU Member State, the one in which the work is carried out. According to it, foreign workers have the right to the same treatment of host state’s citizens. However, there is an exception to the principle, the so-called *posting of workers*. It means that even if a worker temporarily stays in another MS to provide services, he/she remains subordinate, as employees, to the

[89] European Parliamentary Research Service, authors: Kiendl Krišto I., Thirion E., 2018, An overview of shell companies in European Union, STUDY EPRS, Ex-Post Evaluation Unit and European Added Value Unit, Brussels, pp.27-32.

posting company in home country. In this way posted workers stay under the home-country social security regime rather than the host-country regime. Shell companies are used in foreign labour subcontracting and cross-border labour recruitment, eluding the regime of the Posting of Workers Directive (PWD)[90]. The scheme consists in situating a shell company in a low social contributions state to employ workers to be sent exclusively to another MS with higher social contributions. In this way the group achieves the goal of making marginal profits on the social contributions. This represents an abuse of EU free movement rules, evidently obstructing worker protection and jeopardizing social protection systems.

2.2.1. Indicators to quantify shell companies

Reliable data of the real number of shell companies existing is not available, especially for the anonymous and letterbox types. For this reason, EU studies, carried out by the work of the TAXE, TAX2 and PANA committees, focus on researching proxies as potential indicators of the presence and size of shell entities inside its boundaries. The most consistent macroeconomics indicators identified are the number of foreign owned companies inside a MS, the ratio of foreign direct investments (FDI) to GDP, the profitability gap between foreign and domestic companies, the number of Special Purpose Entities/Vehicles (SPEs/Vs), the use of cross-border subcontracting processes. Obviously, these indicators cannot give definitive evidence of the real existence of an exact number of shell entity, but combined with other source, such as investigative journalism, may contribute for a better understanding of this widespread phenomenon. Other indicators with a more indirect link to the existence of shell companies include the dimension of undeclared work, the number of posted workers, specific sectoral estimates. When these indicators are disproportionate to the size of the MS economy, this could indicate an increased likelihood of the presence of letterbox companies in that Member States, especially in smaller EU economies, where it would point to some form of financial engineering.

The studies of the European Parliamentary Research Service (2018), and of the ICF Consulting Services (2021), are the two principal studies taken into consideration to give some insights about the volume of shell companies inside European Union.[91]

[90] Directive (EU) 2018/957 of the European Parliament and of the Council of 28 June 2018 amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services.

[91] It is important to highlight that UK is taken into consideration as part of EU in both, because the data used has been measured before Brexit.

2.2.1.1. Foreign-owned companies

Starting from the number of foreign-owned companies in a MS, it is important to spotlight that not all foreign-owned companies are shell companies, but when this number is unusually high, it is a symptom of aggressive tax planning. The London School of Economics (LSE) (2016) estimates that there are approximately 420 000 incorporations of foreign businesses in the commercial registers of the EU Member States, with the UK accounting for 227 000 (more than half). The remaining foreign companies are divided between Estonia (33 500), Romania (30 000), France (27 000), Slovakia (26 600) and the remaining 23 Member States (75 000).[92] The findings indicate that the UK is by far the most popular target country, while the possible explanations for the popularity of some central and eastern European Member States are favourable tax and labour laws.

It is evident that estimating the size of a phenomenon that wants to remain hidden is a difficult task, but, over time, other instruments have been put in place to try to define the magnitude of shell entities, among these the Orbis Database. The Orbis database is the flagship provided by the Bureau van Dijk, a major publisher of business information, specialised in private company data combined with software for searching and analysing companies. It contains both financial and non-financial information from private companies across the world, collected from over one-hundred-and-sixty providers and own sources, which are then treated, appended, and standardised to ensure comparability. It has two main limitations: some data is missing, and it does not allow certain ownership data to be downloaded. The Orbis database makes possible to look for companies owned by a foreign shareholder, which means that the ultimate owner, who owns a minimum of 51% of the company is located in a country different from the establishment one, and in addition companies owning a foreign subsidiary, so the company must be the global ultimate owner (owning at least 51%) of the foreign subsidiary.

The research carried out in 2019, based on EU-28, estimated that the number of companies located in the EU-28 with a foreign majority shareholder amounted to 1.2 million, which means the 4.2% of all companies in the EU-28. Of these, 706 764, the 57%, had a foreign majority shareholder located inside EU. Table 4 shows the number of companies with a foreign majority shareholder per EU country, confirming the study of LSE, according to which UK has the highest percentage. Germany and Romania also had a high share of foreign shareholder companies, as well. While the 61% of the shareholders is located in the EU-28, the 39% is outside EU boundaries, mainly concentrated in Far East and Central Asia (30%) and North America (21%). Looking at the % on the total number of foreign shareholder companies in each

[92] The study does not provide estimates for all the Member States.

Member State, Luxembourg and Malta stand out, with more than 25% and 22% of the companies located in these countries having a foreign majority shareholder. Slovakia and Ireland also had a high percentage of companies with a majority foreign shareholder.

Table 4-Estimated number of companies with a foreign majority shareholder (2019)

State	N° of co. with foreign majority shareholder	% of co. with foreign majority shareholder on total EU-28 foreign shareholder co.	% of co. with foreign majority shareholder on total co. of that MS
Austria	17173	1,39%	3,4%
Belgium	20800	1,68%	2,3%
Bulgaria	18932	1,53%	2,3%
Croatia	14425	1,16%	8,3%
Cyprus	18152	1,46%	6,4%
Czechia	50070	4,04%	8,9%
Denmark	17180	1,39%	3,3%
Estonia	23384	1,89%	9,2%
Finland	9626	0,78%	1,3%
France	35393	2,86%	0.6%
Germany	103409	8,34%	4,8%
Greece	5125	0,41%	2,5%
Hungary	3476	0,28%	0,6%
Ireland	36533	2,95%	14,5%
Italy	46941	3,79%	2,2%
Latvia	19292	1,56%	9,8%
Lithuania	2570	0,21%	1,9%
Luxembourg	45172	3,64%	26,6%
Malta	13335	1,08%	22,3%
Netherlands	41284	3,33%	2,4%*
Poland	23484	1,89%	3,3%
Portugal	26155	2,11%	4,9%
Romania	77965	6,29%	7,6%
Slovakia	47397	3,82%	14,5%
Slovenia	4213	0,34%	3,2%
Spain	28966	2,34%	1,2%
Sweden	14271	1,15%	1,5%
UK	503394	40,61%	9,9%
EU-28	1239612	100%	4,2%

* It is worth noting that the share in the Netherlands was unrealistically low. The same share was noted in another reliable study, using AUGAMA database Although the researchers are aware of this issue, but there is no robust explanation for this underrepresentation.

Source: own re-elaboration of data from European Commission, 2021, Directorate-General for Justice and Consumers, De Wispelaere, F., Schuster, E., Morel, S., et al., Letterbox companies: overview of the phenomenon and existing measures: final report.

Taking a money laundering international perspective, four common offshore tax havens can be identified as foreign shareholder location, British Virgin Islands with 2.4% of EU companies, Taiwan (0.4%), Bermuda (1.0%) and Cayman Islands (2.5%).

Even more interesting is the comparison proposed by De Wispelaere, Schuster, Morel, et al. (2021)[93] based on the turnover per number of employees. "In 2017, the average turnover per employee for companies located in the EU-28 without a majority foreign shareholder was around €202 000, those with a foreign shareholder located in the EU-28 had an average value of €1 100 000, and those with a foreign shareholder located outside the EU-28 had an average turnover per employee of €1 085 000, while the one with a foreign shareholder located in British Virgin Islands, Taiwan, Bermuda, Cayman Islands, had an average value of €1 392 000." Authors highlight that companies with foreign shareholders located in these countries had more turnover or fewer employees, compared to other companies, which could signal they were used as tax havens.

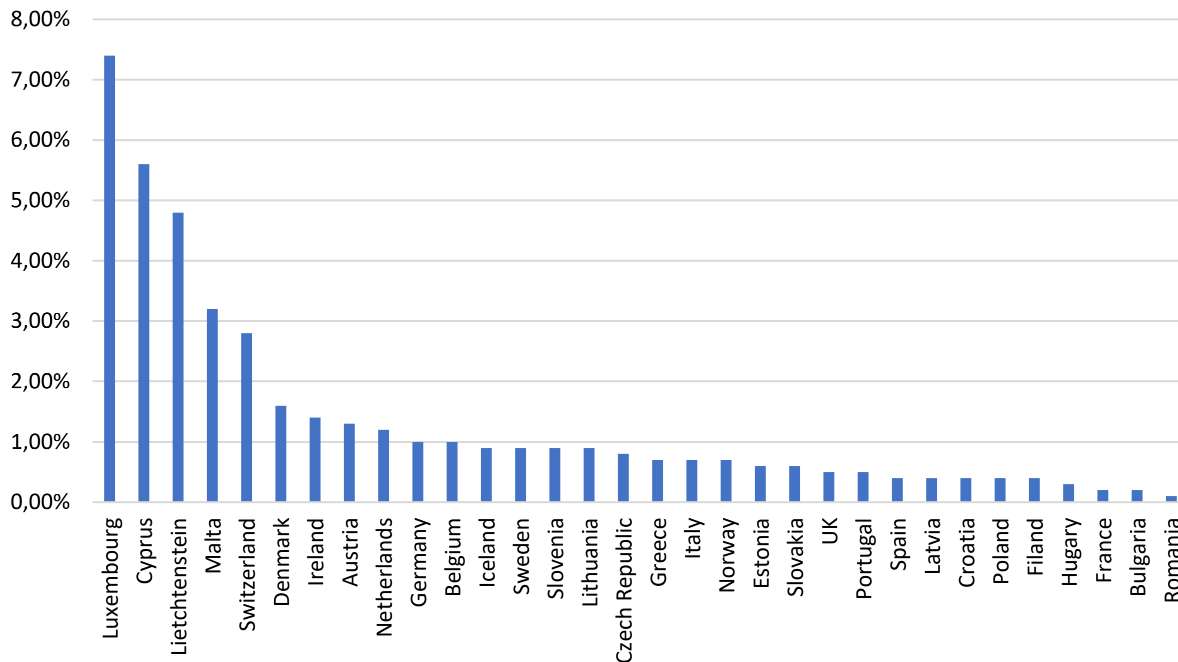
In the same Orbis study, a similar analysis has been undertaken for companies with a foreign subsidiary.[94] Authors estimates that, in 2019, 200 530 companies in the EU-28 had a foreign subsidiary, which means only the 0.7% of all companies located in the EU-28. The majority of these, 128 229, had a foreign subsidiary located in the EU-28, mostly in Germany, the Netherlands and the UK. The latter holds more than 10% of the total number of companies with a foreign subsidiary. Figure 5 shows the share of companies with a foreign subsidiary as % on the total number of companies in that precise Member States. Luxembourg with 7.4% has the highest number of companies with a foreign subsidiary, followed by Cyprus (5.6%) and Liechtenstein (4.8%). Even if it is not possible to investigate the exact location of the subsidiaries, the study found out that the highest shares of companies with a subsidiary outside EU-28 are located in Croatia and Cyprus, so in the periphery. In this way is more likely and easily for them to establish a subsidiary in a neighbouring country, not member of EU-28/EFTA[95]. The 20.8% of the companies with subsidiaries analysed had a foreign subsidiary located outside the EU-28/EFTA. This makes more difficult to understand if there is real economic activity in them, increasing the risk of shell companies' presence.

[93] European Commission, Directorate-General for Justice and Consumers, De Wispelaere, F., Schuster, E., Morel, S., et al., 2021, Letterbox companies: overview of the phenomenon and existing measures: final report, Publications Office.p.28

[94] For what concerns this variable, Orbis database may have uncomplete information about subsidiaries' location.

[95] European Free Trade Association (Iceland, Liechtenstein, Norway and Switzerland).

Figure 5-Estimated share of companies with a foreign subsidiary on total company of that MS (2019)



Source: European Commission, 2021, Directorate-General for Justice and Consumers, De Wispelaere, F., Schuster, E., Morel, S., et al., Letterbox companies: overview of the phenomenon and existing measures: final report.

2.2.1.2. FDI/GDP ratio

The second furthered indicator is the ratio of foreign direct investment (FDI) in an EU Member State to the GDP of that Member State. The OECD (2018) defines FDI as a "cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The *lasting interest* is evidenced when the direct investor owns at least 10 % of the voting power of the direct investment enterprise. Direct investment may also allow the direct investor to gain access to the economy of the direct investment enterprise which it might otherwise be unable to do."[96]

Inside FDI it is possible to distinguish inward foreign direct investment (inward FDI), which implies an investment by foreigners in business resident in a given Member State, and by contrast outward foreign direct investment (outward FDI), which refers to investment by resident entities in affiliated business abroad. Table 4, below, shows the total inward and

[96]OECD, FDI. https://www.oecd-ilibrary.org/finance-and-investment/foreign-direct-investment-fdi/indicator-group/english_9a523b18-en

outward FDI stocks for each EU Member State, both in terms of millions of dollars and as percentage of Member States' GDP.

Table 5-Inward and Outward FDI in EU countries (2015)

State	Inward FDI in million US$	Inward FDI in % of GDP	Outward FDI in million US$	Outward FDI in % of GDP
Austria	240056	70,6	284737	83,3
Belgium	418266	102,2	409880	100,1
Bulgaria	37958	86	1762	4
Croatia	23721	54	5035	11,5
Cyprus	159557	904,7	159879	906,5
Czech Republic	102756	61,5	16897	10,1
Denmark	104234	39,2	167672	63
Estonia	17462	86,2	5657	27,9
Finland	74154	35,5	85352	40,8
France	606370	27,8	1101103	50,5
Germany	722826	23,8	1264059	41,7
Greece	21348	12,1	25666	14,6
Hungary	176125	160,6	136093	124,1
Ireland	795644	311	815202	318,7
Italy	309620	18,9	429228	26,1
Latvia	13545	55,6	1196	4,9
Lithuania	13497	36,2	2397	6,4
Luxembourg	3005207	5766,8	3517234	6749,3
Malta	152216	1732	61553	700,4
Netherlands	3618685	534,9	4285080	633,4
Poland	167917	39,3	22354	5,2
Portugal	105475	58,7	54699	30,5
Romania	64440	40,2	745	0,5
Slovakia	40129	51	2177	2,8
Slovenia	11565	30	5461	14,2
Spain	502663	46,7	450361	41,9
Sweden	277877	62,2	343786	76,9
United Kingdom	1294795	50,2	1433450	55,6
EU28	**13078106**	**63,1**	**15088714**	**72,9**

Source: Eurostat, World Bank, in HIS Loretz S., Sellner R., Brandl B., European Commission, Aggressive tax planning indicators, Final Report TAXUD/2016/DE/319, FWC No. TAXUD/2015/CC/131, Institute for Advanced Studies (Project leader) Institute for Advanced Studies (Consortium leader).

Figure 6- Inward VS Outward FDI stock in US$ million (2015)

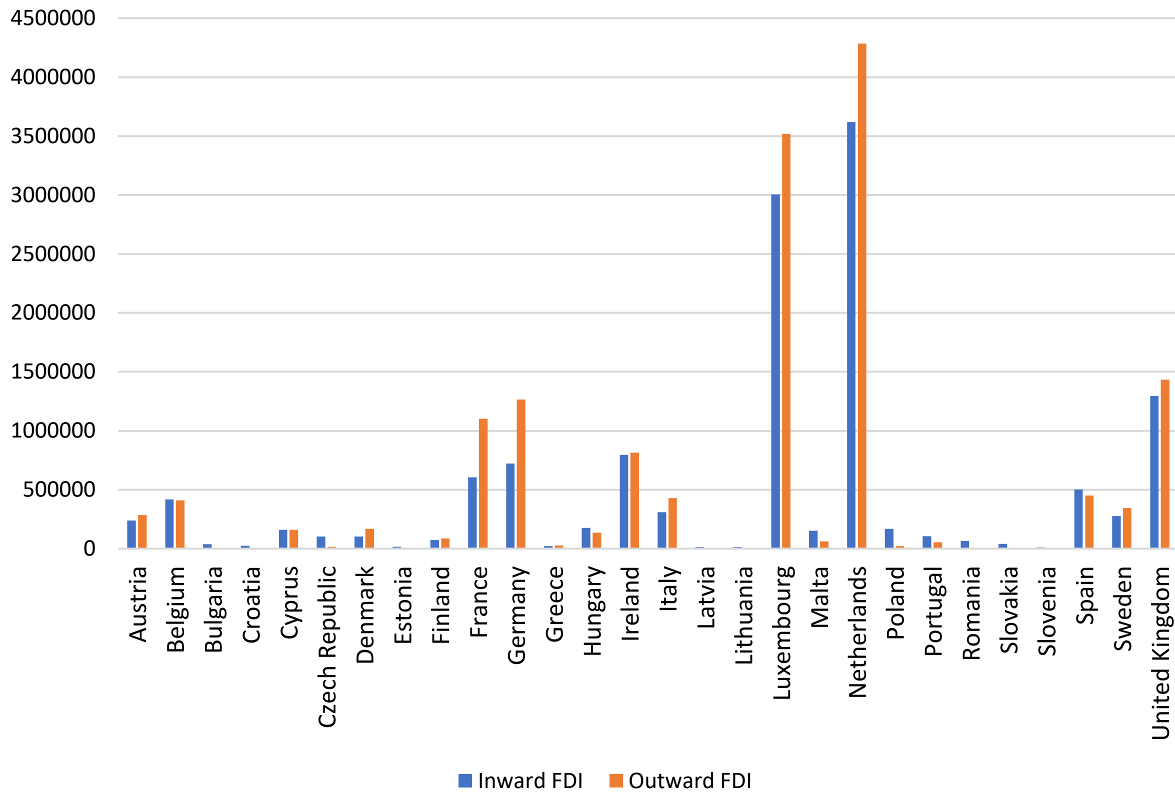


Figure 7- Inward VS Outward FDI stock as a percentage of GDP (2015)

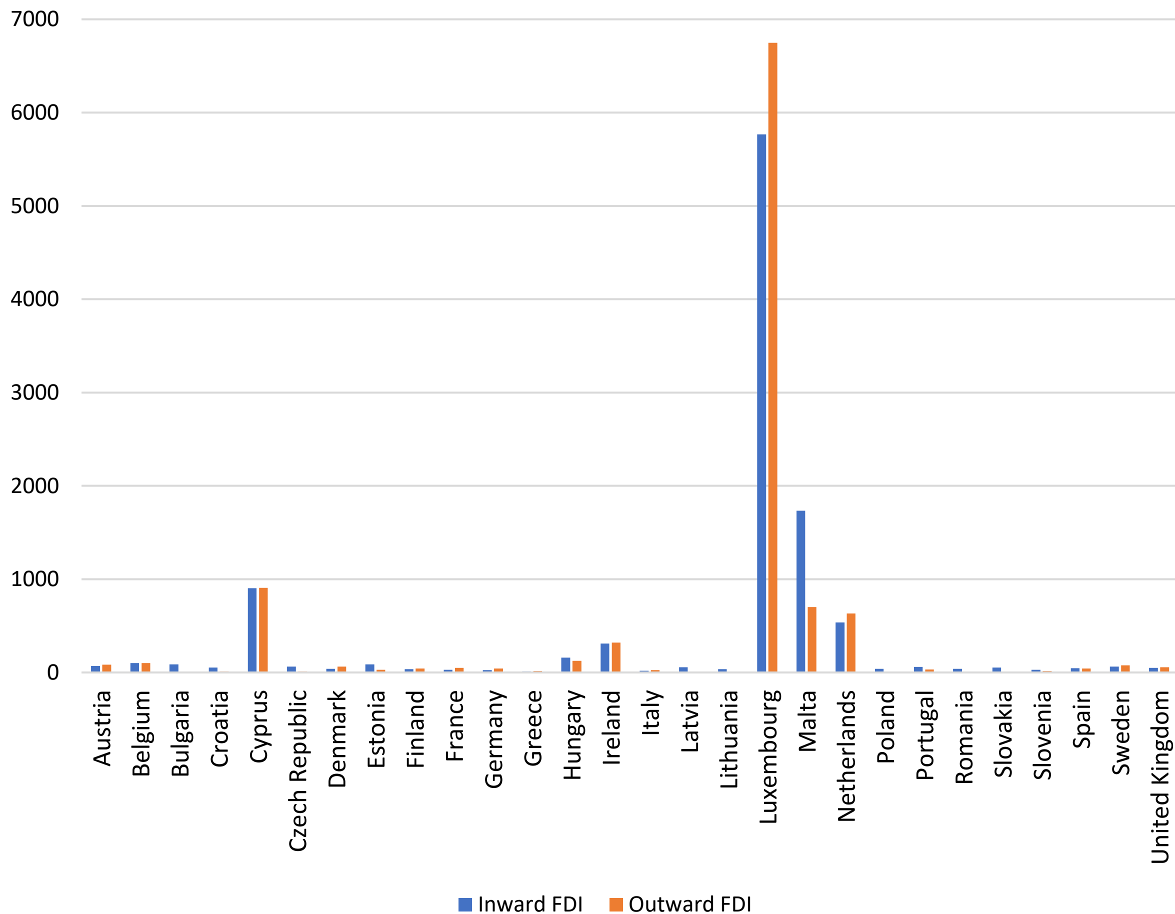
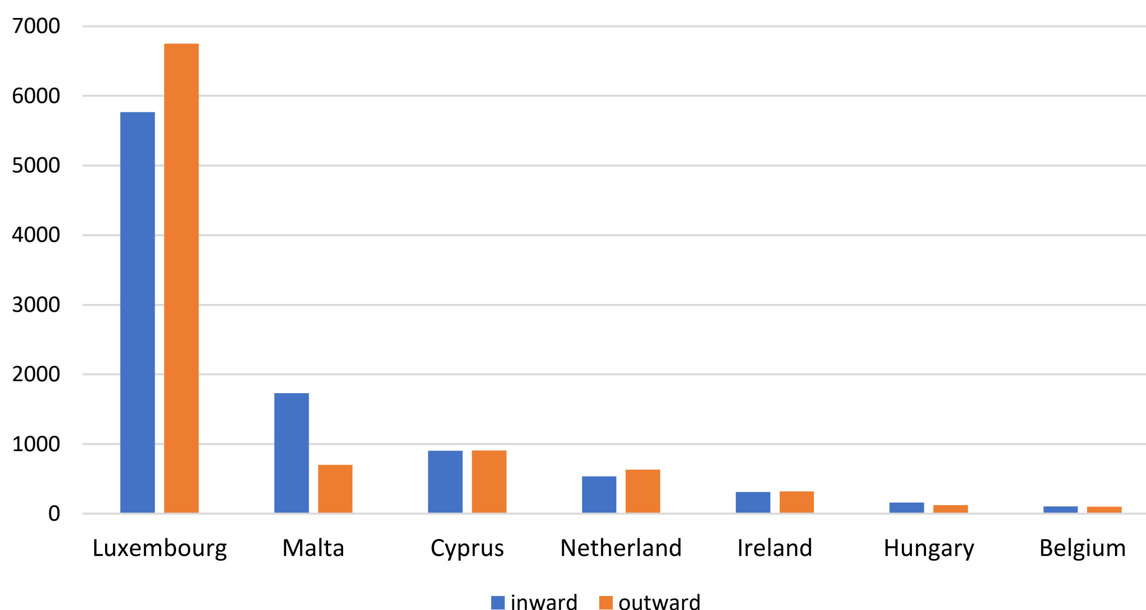


Figure 8- Focus on Inward and Outward FDI in EU countries where FDI exceed GDP



Source: own re-elaboration of data from HIS Loretz S., Sellner R., Brandl B., European Commission, Aggressive tax planning indicators, Final Report TAXUD/2016/DE/319, FWC No. TAXUD/2015/CC/131, Institute for Advanced Studies (Project leader) Institute for Advanced Studies (Consortium leader).

The charts above show that several Member States stand out with particularly high values of both inward and outward FDI stocks. Specifically, Luxembourg registered 5766% of GDP as inward FDI (57 times its GDP) and 6749% outward, while in Malta, inward FDI amount to more than 17 times of the GDP and the FDI outward stocks are also 7 times larger than the GDP. Also, Cyprus, with 9 times the GDP, Netherlands, to more than 5 times GDP, and Ireland, with more than 3 times the GDP, had an extraordinarily large inward and outward FDI stocks. The very high level of both inward and outward FDI stocks is a clear indicator of the significant attractiveness of Cyprus, Luxembourg, Malta and the Netherlands, often defined as European Tax Heavens. This phenomenon is link with SPEs' presence, indeed big portion of FDI is held by special purpose entities, and a major part of them does not seem a genuine investment, but a financial flows through that country. The aim is not about job creation, production, construction of factories or transfer of technologies, but the exploitation of the entity as a conduit through which channelling funds. The positioning of international investments is strongly affected by tax considerations, such as treaty networks and advantageous tax regimes. Moreover, SPE are a cheaper solution for multinational corporations, and at the same time offer taxation regulatory and confidentiality benefits.

Last data provided by the International Monetary Fund database about inward and outward direct investment positioning, at world level, are shown below by Figure 9 and 10.[97]

[97] An interesting illustration of the evolution of FDI from 2009 to 2020 its available at https://www.imf.org/en/Blogs/Articles/2021/12/16/the-worlds-top-recipients-of-foreign-direct-investment

Figure 9- Inward Direct Investment Position of top 10 reporting economies in the world, in US million dollars (2020)

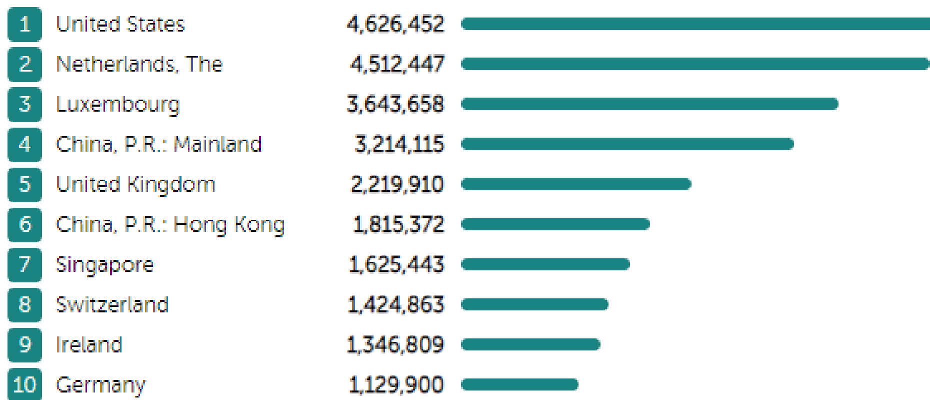
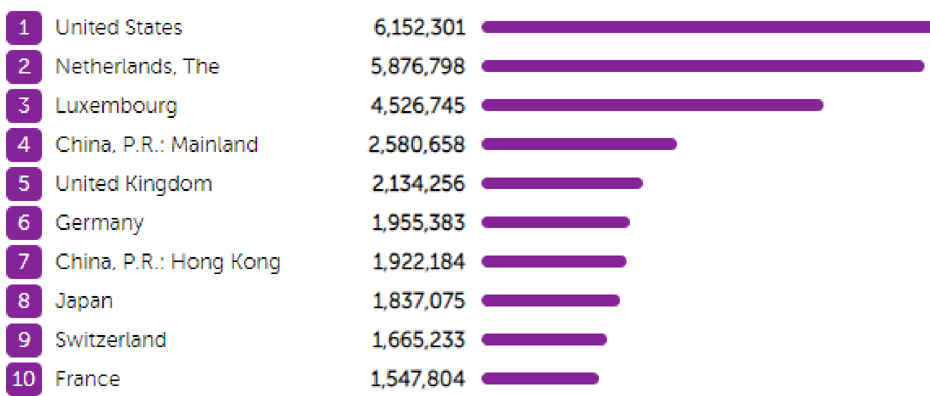


Figure 10-Outward Direct Investment Position of top 10 reporting economies in the world in million US dollars (2020)



Source: IMF, Coordinated Direct Investment survey (CDIS), 2020.
Available at: https://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5&sId=1482247616261

The United States took the leadership position as the largest recipient of foreign direct investment in 2019 and consolidated that position in 2020, followed by two European Country, namely Netherlands and Luxembourg. Low-tax jurisdictions such as the Netherlands, Luxembourg, Hong Kong SAR, Singapore, and Ireland remained among the top direct investors and investee economies. Garcia-Bernardo J. et al., (2017)[98] assert that the top three conduits of inward FDI in the EU are the Netherlands, Luxembourg, and the UK. Moreover, they explain that each of them is specialised in a specific geographical area. For example, UK is used as a conduit between European countries and Luxembourg, Bermuda, Jersey, the British Virgin Islands, and the Cayman Islands; while the Netherlands serves as a conduit between European companies and Luxembourg, Curaçao, Cyprus and Bermuda. They specify that investments from countries identified as tax havens usually require the exploitation of a conduit, in addition companies located in such jurisdictions invest in other offshore financial centres (OFCs).

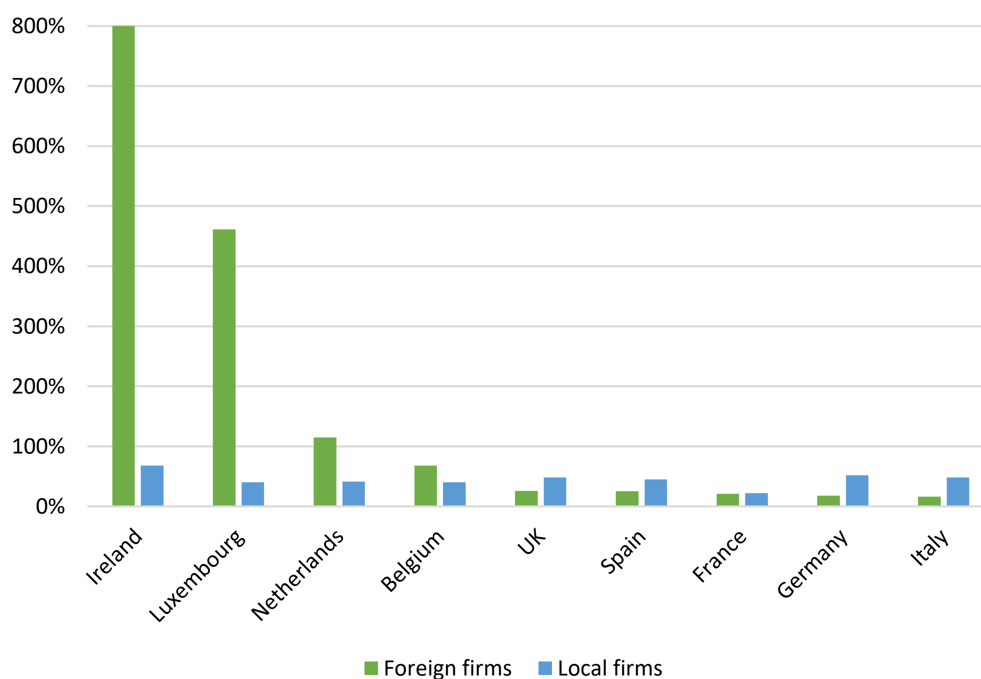
[98] Garcia-Bernardo, J., Fichtner, J., Takes, F.W. et al., 2017, Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network, p.8-9.

This leads to a large rerouting of international investment through these jurisdictions for tax optimisation or other investment benefits purposes. In this case SPEs have a relevant role, while letterbox companies are more widespread to route funds to more traditional tax havens, the so-called sink OFCs, five of which were identified in the Netherlands, the UK, Switzerland, Singapore and Ireland. These countries have a double role, on one hand they facilitate the transfer of value between sink OFCs, on the other are often used as conduits to non-OFCs.

2.2.1.3. Profitability gap between foreign and domestic companies

The third proxy indicator taken into consideration is the profitability gap between foreign and domestic companies in a Member State. Tørsløv, Wier and Zucman (2018)[99], in their paper 'The Missing Profit of Nations', highlight that sometimes countries have systematically higher profitability in the foreign-controlled sector than in the domestic one. Looking at Figure 11 is evident that this feature is typical of companies positioned in tax heavens. Authors explain this profitability gap as the result of a combination of multinationals intra-group transfer prices, movement of intangible assets (such as patents, logos, algorithms) in low-tax affiliates and movements of profits within divisions of multinational groups, away from high-tax affiliates and towards low-tax affiliates.

Figure 11-Pre-tax corporate profits as % of compensation of employees



Source: Tørsløv, Wier and Zucman (2018), The Missing Profit of Nations.

[99] Tørsløv, Wier, Zucman, 2018, The Missing Profits of Nations, R Nber Working Paper Series, Working Paper 24701, National Bureau of Economic Research, Cambridge (USA).

2.2.2. Red Flags

After having analysed indicators, which are variable and/or composition of variables that can be used to detect letterbox companies in a larger sample, it is important to introduce criteria, which when met, has the potential to identify the existence of shell companies. These criteria are the so-called *red flags*. The aim is to discover the fundamental element of shell company, namely the lack of economic activity. The most significant indicators to investigate, that can be match to red flags, are identification indicators, financial indicators, and corporate obligations. Moreover, also non-financial indicators, such as address and annual accounts availability are essentials and sometimes even more important than financial ones, which are suitable to point out aggressive tax planning. Finally, using indicators on the numbers of employees or labour costs could be useful to identify abusive behaviour in employment and social security law, including social dumping. Databases are fundamental, but also other interesting tool can be applied, such as the beneficial ownership registers at EU level, which were put in place by the 4th and 5th Anti-Money Laundering Directive. Indeed, usually the larger the network and the longer the chain of controlling entities, the higher the risk of money laundering and tax evasion. De Wispelaere, Schuster, Morel, et al. (2019)[100] identify three main red flags:

i) Address

When multiple companies are located at the same address, it is possible that no substantial activities are going on in that location and that the company merely functions as a letterbox. Based on Orbis database data, the study highlight that UK is an outlier, with over 4 200 companies located at a single address, in 2019, also Latvia (492), Czechia (467), the Netherlands (430), Luxembourg (409), Slovakia (334) and Denmark (318) report a high number of companies accommodated at a single address.

In Paradise Papers (2017) the data is even more alarming for UK. More than 15 000 companies appeared to be located at the same few addresses, with one address linked to more than 30 000 companies. From this address leaked files that exposed the offshore financial activities of multinationals and private persons to avoid taxes. This means that addresses, where many companies are located, were disproportionately favoured by companies with a foreign shareholder. For what concerns Luxembourg, more than 100 companies were located at certain addresses. As previously seen, Luxembourg is the MS with the highest share of companies with a foreign majority shareholder, not by chance the share of companies with a foreign majority shareholder of the total number of companies

[100] European Commission, Directorate-General for Justice and Consumers, De Wispelaere, F., Schuster, E., Morel, S., et al., 2021, Letterbox companies: overview of the phenomenon and existing measures: final report, Publications Office, pp.193-224.

located at one address, for the addresses that were investigated, always exceeded 30%. This makes it clear that these addresses are particularly attractive for foreign majority shareholder companies than for a domestic majority shareholder. Luxembourg leaks showed how big companies had disclosed secret tax deals in Luxembourg, to get favourable treatment for their tax-saving manoeuvres.

j) *Financial indicators*

The lack of economic activity is captured by looking at the amount of turnover per employees, pre-tax corporate profit per employees, and loans per employees. Usually, these indicators show a clear difference between domestic companies and foreign-owned firms, with the average value always considerably higher for the latter. Often, the first and the second indicators more than double the values of domestic companies. The countries where abnormal values were recorded are UK, Ireland, Portugal, and Belgium, especially in some specific industries such as real estate or building projects, activities of head offices, business support service activities and the production of electricity.

k) *Data availability and filing of annual accounts*

When the reporting obligations are not fulfilled or certain information is missing from annual accounts, this could indicate the existence of a letterbox company. Not providing any information is a simple but efficient technique for concealment purposes. It is important to say that paradoxically sometimes the companies that actively seek to stay under the radar are not letterbox entities but are often those of greatest interest. In spite of this observation, to investigate shell companies, the lack of data or the complete absence of information can be a red flag. Directive 2017/1132[101] specifies that limited liability companies need to disclose their annual accounts in the national business registers, providing accounting documents for each financial year. Because of the several exceptions, added to the simplification provided for SMEs and also the different requirements asked by each MS, it is very difficult to understand whether the lack of data on a company is a deliberate omission, or if it is simply not required from the MS's law. Regarding ownership information, while disclosing shareholders' information is required in some jurisdictions, there is no EU obligation for publicly disclosing shareholders. Particularly difficult to see are intermediary ownership relationships. As a result, it is impossible to determine whether a company's global ultimate owner owns it directly or indirectly through a middle company, located in another nation. Each year, 5–10% of businesses add their ownership data to Orbis, by contrast 4% leave. As a result, tracking ownership changes over time is quite impossible.

[101] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification)

Companies frequently fail to submit their annual reports deliberately, this is clear evidence of the fact that they only exist on paper. A dormant company that is still registered but has no significant accounting transactions, may be established for many purposes: hold an asset or intellectual property, protect company name for a future project, etc. A dormant company is not fraudulent in itself but can be considered the ideal vehicle and the perfect cover-up for tax fraud, drug trafficking and the financing of terrorism. Among companies located in the EU-28 with a foreign shareholder in the EU-28, 216 207 did not report any financial variable available in the Orbis database. Most of them are located in UK, Luxembourg, Netherlands and Romania. Focusing on Cyprus, Luxembourg and Netherlands, more than 50% of the total number of foreign-owned companies of these MSs did not have information available on turnover, employees, loans, and pre-tax profit or loss. This information was not provided also by more than 30% of the Austria, Bulgaria and Croatia companies with a foreign majority shareholder in the EU-28.

The main findings of this analysis highlight the impossibility to present a single figure for the number of letterbox companies located in the EU. Depending on the context, sector, and area of law, the set-up and use of letterbox companies may differ. What is evident is the need of harmonisation of some fundamental aspects related to annual accounts and information requirements. A big effort must be implemented to improve and increase information collection, in order to make a significant difference.

2.3. Multinational companies' schemes, shell entities and European tax heavens

For long time, tax competition among states was something little or no warned at all. As claimed by Baggio (2018)[102], before the creation of the Single Market and the development of globalization, the taxation criteria were strictly territorial, based on land wealth, customs duties, exchange taxes or issue of licenses' taxes. The mobility of capital was scarce because wealth was mostly represented by real estate assets. Tax privileges, such as exemptions and deductions, were just provided and guaranteed by the state of residence, so in case of moving to another state these privileges would be lost. Nowadays the situation is exactly the opposite.

The criterion for taxing world profits has gradually made progress and over the last few decades has been adopted by most industrialized countries, mainly by linking it to the taxpayer's tax residence, or in some cases, as the United States of America, to citizenship. This criterion of taxation is typical of capital-exporting countries, which cannot and do not want to renounce to levy taxes on the wealth produced abroad by their residents or citizens. Obviously, such an

[102] Baggio R., 2018, La concorrenza fiscale tra ordinamenti, in Daniele Velo Dalbrenta et alt., Imposizione Fiscale e Libertà: Sottrarre e ridistribuire risorse nella società contemporanea, IBL Libri, Torino, pp.83-106.

attitude has given raise to, first of all, the problem of double taxation, arising from the concurrent exercise of taxing powers by the taxpayer's home State (residence), on the one hand, and the source State with respect to the same income, on the other hand. Hence the widespread practice of stipulating agreements between states aimed at eliminating double taxation, or by resorting to exemptions, in the state of residence, on the income produced in the source state, or recognizing to its resident a credit for taxes paid in the other State, to be deducted from those due on global income. In absence of corrective actions, the low taxation applied by a State, aimed at attracting foreign investments, is effectively nullified by the weight of the tax burdens due to the State of residence. The solution find by taxpayers is to transfer one's tax residence to the state with the most advantageous taxation. This option is even easier for companies, whose assets consist mainly of brands or patents, or investments in other companies or financial assets, which are completely detached from the territory and do not require a constant physical presence in a determined locality. What is even more interesting, as asserted by the author, is that "there is no international customary rule prohibiting tax competition between states, not even what is commonly classified as harmful. […] It is certain that no one can seriously affirm that, from the point of view of international law, a State cannot shape its own tax system and legislation at will, granting concessions, exemptions or detraction to certain economic subjects or phenomena, even if they have weak connections with its territory or its legal system[103]" [104].
Another significant aspect is the freedom of establishment, guarantee in EU by articles 49 and 54 of the TFEU. The former provides that "restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited", while the latter clarifies that companies "formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union enjoy the freedom of establishment in the same way as EU nationals". Consequently, any company validly formed under the laws of any Member State is entitled to exercise its freedom of establishment.
Over the past two decades, the CJEU has ruled on the issue many times in its case-law, especially in the field of company law. A series of decisions to clarify the extent to which companies can exercise their freedom of establishment has been taken.

[103] Obviously, this is true by excluding the obligations assumed by the signing of treaties between states. In this case there could be a limitation to the exercise of tax authority, but it is important to say that this obligation is voluntarily taken by mutual agreement.
[104] Baggio R., 2018, La concorrenza fiscale tra ordinamenti, in Daniele Velo Dalbrenta et alt., Imposizione Fiscale e Libertà: Sottrarre e ridistribuire risorse nella società contemporanea, IBL Libri, Torino, pp.90-91.

Among the most decisive, the *Centros*[105] decision can be mentioned. The Court held that the reasons presented by Denmark to deny the registration of the subsidiary were not sufficient. A company as long as complies with all incorporation requirements for the formation and the existence in the Member State can enjoy freedom of establishment. Moreover, it is immaterial that the company was formed in the first MS only for the purpose of establishing itself in another MS, to conduct its entire business. In this context, CJEU clarifies that the connection between a company and the jurisdiction of incorporation does not have to go beyond what is required under the relevant national company law. As for the *Segers*[106] judgment the mere fact that a company does not conduct any business in the country of incorporation "is not sufficient to prove the existence of abuse or fraudulent conduct". This ruling acted as a driving force for the creation of companies incorporated in one Member State but whose headquarters were in another, or which operate exclusively in that other MS. This trigger impact was greater for the big company than for the smallest one.

In 2017, the CJEU, in its *Polbud*[107] judgment, took another significant decision about the reinforced of the freedom of establishment's principle in the cases of cross-border conversions. The Court ruled: "Freedom of establishment therefore encompasses the right of a company or firm, formed in accordance with the legislation of a Member State, to convert itself into a company or firm governed by the law of another Member State, provided that the conditions laid down by the legislation of that other Member State are satisfied and, in particular, that the test adopted by the latter State to determine the connection of a company or firm to its national legal order is satisfied"[108]. Thus, company can transfer they registered office also for reasons of benefitting from a more advantageous tax regime, indeed the CJEU clarified that the real fact that the company does not conduct any business in the host Member State is insufficient to prove the existence of abuse or fraudulent conduct. At first sight this decision seems very risky, because the EU freedom of establishment might be invoked as a defence for abusive schemes,

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[105] Centros Ltd v Erhvervs- og Selskabsstyrelsen, C-212/97. Mr. and Mrs. Bryde, Danish citizens, had set up the company in the UK in order to circumvent the Danish legislation that requires the freeing of a capital social minimum, with the aim to exercise their commercial activity exclusively in Denmark. The idea was to exploit the empty box in UK, to open a subsidiary in their country. Denmark accused them of elusive behaviour to creditors, denying the registration of the subsidiary.

[106] Segers v Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen., Case 79/85.

[107] Polbud - Wykonawstwo sp. z o.o., C-106/16. The dispute concerns Polbud, a Polish limited liability company, which in 2011 decided by resolution of the extraordinary shareholders' meeting to transfer its registered office to Luxembourg. After the resolution became effective and Polbud was registered in Luxembourg, a few days later an application for its cancellation was filed with the Polish company register judge. However, this requirement was denied on the basis that the company had not submitted the documents required by law to obtain the cancellation. Polbud refused to provide these documents on the grounds that they simply did not exist, this because the company had not dissolved and therefore the assets had not been divided among the partners but continued to exist having only moved to another country.

[108] C-106/16, paragraph 33.

establishing a domicile in a more tax-friendly country, while conducting business elsewhere.
Resuming *Cadbury Schweppes*[109] and *Eurofood*[110], the ECJ asserted that national company law rules may provide measures against tax abuse and restriction related to wholly artificial arrangements. On the other hand, the Court highlights that a shell company is not necessarily a company which does not has office space or has a limited or no staff, but it has to be commensurate to the activity nature exercised by the company. Holding activities, financing activities, asset management do not necessarily require a large office space or a considerable number of staff. In the CJEU judgment of 29 February 2019, related to Directives on company taxation[111] the Court confirmed the abuse of rights principle, according to which MS has the power to withdraw a tax benefit derived from EU legislation, if the company has artificial arrangement features, and tax benefit as main objective. Focusing on *T Danmark*[112] case, about tax abuse related to cross-border dividend payments, the ECJ decides that the benefits of the Parent-Subsidiary Directive must be refused if financial arrangements are set up with the essential aim of obtaining just those benefits. Also, in this case the Court reiterated that a group of companies may be regarded as an artificial arrangement where the conduit subsidiary is not set up for reasons that reflect economic reality.
What is sure is that distinguishing the real uses of shell entities is difficult. Most of the time these vehicles are used in ambiguous way, between legal and illegal. Moreover, there are some elements contributing to escalating the challenge such as the lack of a commonly agreed definition of shell entity, different national legislative frameworks about entity classification, different interpretations linked to political, historical, and cultural aspects; between law and economic areas; discrepancies in stakeholder perceptions. The first exploiters of these ambiguities, asymmetries and loopholes are multinational companies.
The Tax Justice Network estimated that MNEs shift $1.38 trillion worth of profit into tax havens every year, causing to countries a loss of $245 billion in corporate tax every year. [113] The most common way to shift profit is by setting up a shell company in a tax haven. What is even more interesting is that the *axis of tax avoidance,* composed by UK spider's web[114], Netherlands,

[109] Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, C-196/04.
[110] Eurofood IFSC Ltd., Case C-341/04.
[111] Joined cases C-116/16 and C-117/16 concerning the application of the Interest and Royalty Directive167, and joined cases C-115/16, C-118/16, C-119/16 and C-299/16 on the Parent-Subsidiary Directive168.
[112]Skatteministeriet v T Danmark and Y Denmark Aps., C-116/16.
[113]Data from Tax Justice Network https://taxjustice.net/2020/11/20/427bn-lost-to-tax-havens-every-year-landmark-study-reveals-countries-losses-and-worst-offenders/
[114] The *UK spider's web* refers to the way in which the UK and its Overseas Territories and Crown Dependencies operate as a web of tax havens that enable corporate tax abuse and private tax evasion. At the center of the web sits the City of London, where money is illicitly transferred after being routed through the territories and dependencies. The UK spider's web is estimated to be responsible for over a third of the worlds global tax losses to corporate and private tax abuse. (Tax Justice Network)

Luxembourg, and Switzerland, are together responsible for half of the corporate tax losses. Also, Oxfam's latest analysis (2021)[115] identifies five EU Member States acting as tax havens: Cyprus, Ireland, Luxembourg, Malta and the Netherlands.

Zucman (2015), in its book 'The hidden wealth of nations: the scourge of tax havens', explains: "The reason for the current failure is that the corporate tax is based on a fiction, the idea that one can establish the profits earned, by each multinational, subsidiary by subsidiary. But this fiction is no longer tenable today, because multinational groups, advised by great auditing and consulting firms, are in practice free to move their profits wherever they want, which is usually wherever it is taxed the least; and large countries have themselves mostly given up taxing the profits booked outside of their territory" [116]. He mentions two main techniques used by multinational corporation to make their profit appears in tax heavens: the intragroup loans and the manipulation of transfer prices. The first consists in loading with debt the subsidiary located in high tax jurisdiction countries, so industrialized one, to reduce profits and make them appear in Luxembourg or Bermuda. The problem of this scheme is that it is simple to detect, for this reason the second technique is easily applicable given the volume of similar trade in the world every year and the intangible assets exchanged, which are difficult to evaluate and quantify. In spite of arm's length, which helps to impose severe limitations, it is impossible for tax authorities check that all the transactions are correctly priced.[117]

LuxLeaks spotlight that the second strategy explained above is a very typical and widespread practice of big IT companies when they send intangibles to shell companies in negligible tax jurisdiction countries. As Zuckman claims "There is nothing less risky, by contrast, than manipulating the prices of patents, logos, labels, or algorithms, because the value of these assets is intrinsically difficult to establish. This is why the giants of tax avoidance are companies of the new economy: Google, Apple, and Microsoft. Taxing companies wanes to the same extent as immaterial capital gains in importance"[118]. Among the tax havens mentioned by him such as Bermuda, Switzerland, Singapore and Virgin Island, there also some recurring EU countries, first of all Netherlands and Luxembourg, followed by Ireland and Cyprus. In order to investigate where billion of foreign profits comes from, he looks at the balance of payments statistics making a country-by-country decomposition. Below, in Figure 11 the share of tax havens in US corporate profits made abroad. As shown, the 55% of the total US foreign profits is made in low or zero tax countries. In 2013, the total income on US direct investment abroad was about

[115] Oxfam International, 15th February 2021, Time for a real reform to stop tax havens escaping the EU blacklist, available at: https://www.oxfam.org/en/press-releases/time-real-reform-stop-tax-havens-escaping-eu-blacklist

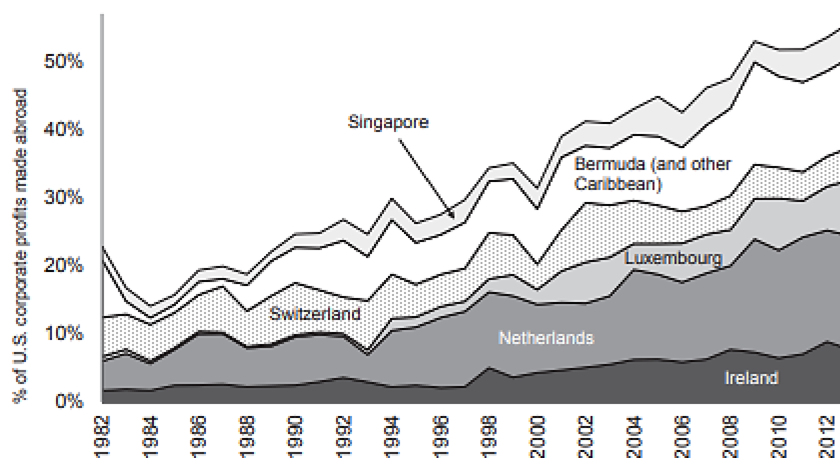
[116] Zuckman G, 2015, The Hidden wealth of Nations: The Scourge of Tax Havens, The University of Chicago Press, Chicago 60637, p.102.

[117] Ibid, ch.5.

[118] Ibid, p.104

$500 billion, 17% coming from the Netherlands and 8% from Luxembourg.

Figure 11- Evolution of the share of tax haven in US corporate profits made abroad, from 1982 to 2012.



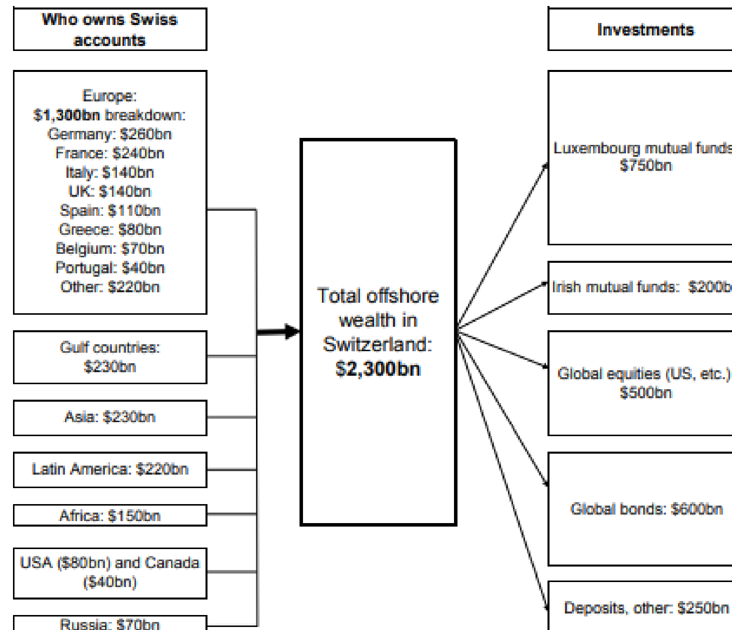
Source: Gabriel Zucman, “Taxing Across Borders: Tracking Personal Wealth and Corporate Profits,” Journal of Economic Perspectives 28, no4 (2014): 121–48.

Much of the profits of US corporations, are earned in Europe, so in absence of tax heavens EU industrialized countries would collect more taxes. Accounting manipulations lead to adverse consequences from the macroeconomic, regulation and stability point of view. Focusing for example on Ireland balance of payments, from which results a trade surplus of 25% of GDP, it is clear that Irish population does not benefit from it, because it is entirely paid back to the owners of Irish branches, which import at low prices and export at artificially elevated prices.
In addition, Zuckman explains that tax havens rather than competing with one another had the tendency to specialize in different stages of wealth management. [119] While in the past Swiss bankers provides all kind of services, from carrying out to investment strategy to hide owners' identity under a numbered account, today only securities custody remains of their competence. All other services have moved to Luxembourg, Virgin Island and Panama. Rich people today invest more in other three tax heavens: Luxembourg, Ireland and Cayman Island.
Nowadays the Anti-Money Laundering Legislation forbids numbered bank accounts, so trusts, foundations and shell corporation are more widespread. Always according with Zuckman, even if Switzerland has lost its past hegemony, it remains the heart of the entire machine. The main part of shell entities is created in Geneva, on Swiss bankers' advice. In Spring 2015, as showed by Figure 12, banks domiciled in Switzerland managed $2.3 trillion belonging to non-residents, $1.3 trillion of which belonged to Europeans, the 40% of the wealth managed in Switzerland is placed in mutual funds, principally in Luxembourg. The author highlights that Swiss data also

[119] Ibid, p.25.

"shows an ever-rising fraction of wealth held through shell companies, as well as in Luxembourg, where official statistics show that assets are moving to legal structures such as family wealth-holding companies"[120].

Figure 12- Switzerland's total offshore wealth split by investment in 2015



Source: Swiss National Bank and calculations by Zuckman, The Hidden Wealth of Nations, p.31.

2.3.1. The role of Advance Pricing Agreements

As previously highlight by Baggio and confirmed by Zuckman, every country has the right to choose its form of taxation. The problem exacerbates when those countries defined as tax heavens offers tailored tax deals to multinational corporations or enables money launderers to create anonymous companies for a penny as in case of British Virgin Islands.

Tax rulings are an institution through which multinationals can agree with the tax authorities of a country on the tax treatment for a specified period of time, defining beneficial methods for applying taxes or calculates the tax base in a reductive manner. Through the ruling, a multinational can also obtain certainty about how a country will fiscally treat the disbursement of dividends, royalties, interest payments to company's subsidiaries not resident in the same country. Moreover, a non-resident multinational can also ascertain the correct interpretation of the rules of a country relating to the attribution of profits or losses to its own PE there. In theory, the final aim of preventive agreements is to avoid possible disputes, between the MNE and State, on some corporate practices potentially qualifying as elusive.

The situation become riskier, from tax avoidance point of view, in front of *Advance Transfer Pricing Agreements*, which concern intra-group transactions carried out by multinational

[120] Ibid, p.47.

companies. This kind of agreements allow artificial prices application and the transferring of corporate profits in countries where tax rates are lower. This uninhibited practice used by EU countries has facilitated the establishment of foreign enterprises in the national territory because of State aids. Orlandi (2017)[121] faces up the most recent Commission practice concerning the application of Art. 107 and 108 of TFEU, about state aid for tax purposes. The Commission has focused its attention on the exam of tax rulings given by the national tax authorities, which could be used to attract foreign companies by offering them a tax advantage. The Commission records that in various circumstances substantial profits of many corporations, in compliance with state legislation, were just in minimum part/not at all subjected to taxation. Orlandi mentions some significant cases, such as the *FIAT*'s decision [122]. In this circumstance, the European Commission challenged a ruling by which the *Administration des Contributions Directes of Luxembourg* recognized the exactness of the methodologies used to compute transfer prices for the financial transactions between FFT Ltd (treasurer of the Fiat Chrysler Automobiles group, operating in Luxembourg) and the European branches of the same group. These prices, considered compliant by the Luxembourg tax administration, were instead considered as computed in an arbitrary manner and not in accordance with the EU principle of free competition, and in any case so reductive to justify the state aid in favour of FFT.

Similar is the *Starbucks* decision[123], concerning royalty payments made by Starbucks Manufacturing EMEA BV (SMBV) to Alki LP (a UK-based subsidiary of Starbucks) in exchange for specific know-how relating to the stature of the coffee, which were considered non-economically justified. Likewise, purchases of fresh coffee made by EMEA BV from Starbucks Coffee Trading SARL (a Swiss subsidiary) were assessed as above market prices. Therefore, all the transactions were considered to have occurred in violation of the arm's length principle and aimed at unjustifiably reducing the tax base of Starbucks Manufacturing EMEA BV, materializing in substantial not justifiable tax aid.

In 2016 the EU Joint Transfer Pricing Forum (JTPF) reported that the number of Advanced Pricing Agreements (Apa) signed by EU Member States increased from 1252 to 2053, between 2015 and 2016. The most involved countries were Belgium with 1080 rulings, Luxembourg (599), Netherlands (even if refused to provide data about Apa). In 2015 Luxleaks scandal, brought to light over 548 tax agreements signed from 2002 to 2010 between the tax authorities of Luxembourg and over 300 multinational groups, including Pepsi, Ikea, Deutsche Bank, Apple. These agreements encouraged aggressive tax planning schemes by incentivising a shift

[121] Orlandi M., 2017, Principio di libera concorrenza, interpelli e disciplina degli aiuti di Stato: un rapporto complesso, Giappichelli, Il diritto dell'Unione Europea, Fascicolo 3.
[122] Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission, Case T-755/15.
[123] Netherlands and Others v Commission, T-760/15 and T-636/16.

to Luxembourg of profits made in higher tax jurisdictions in exchange for paying a negligible effective rate, often less than 1% of reported profits.

Mikhail Maslennikov (2018), Oxfam Italia's tax justice policy advisor, highlights the different treatment reserved just to big corporation, adding "More and more often the secret rulings of the EU countries are revealed as a fundamental element for the aggressive tax planning of multinationals, facilitating their profit-shifting towards jurisdictions with friendly tax authorities and guaranteeing ad hoc tax treatment to the large giants that their effective rates are reduced considerably. From being an institution of fiscal certainty, the rulings thus become an instrument of downward competition available to the States"[124].

2.3.2. Case studies on shell entity misuse and state aid

On 23 October 2015, as reported by Evertsson (2016)[125] the European Parliament presented a blacklist of corporate tax avoiders in Europe, which includes Amazon, Apple, Anheuser-Busch, Barclays, Coca-Cola, Facebook, Fiat, HSBC, IKEA, McDonald's, Philip Morris, Starbucks, Wal-Mart, and Walt Disney. So, before addressing the latest scandals that have overflowed the camel's back, bringing European Union to the *Unshell proposal,* it is important to delve into some of the most emblematic cases about multinationals' no-compliance tax schemes exploiting European tax havens jurisdiction, through the misuse of shell entities and advantageous agreements. What is important to highlight, before starting, is that, many times, countries define as tax havens are fully compliant with OECD criteria on what constitutes a tax haven. Nevertheless, this does not change the benefits and advantages provided by these countries to MNEs, for which they remain an attractive destination for investments or incorporated company's establishment.

2.3.2.1. Apple Inc. case

One of the most popular scandals is the one of Apple Inc.[126]. In 2016 the European Commission, ordered Apple to repay up €13bn plus interest, ruling that Ireland had been breaking EU rules on state aid by giving Apple illegal tax interruptions from 1991. The group for many years made use of the well-known *Double Irish and Dutch Sandwich* scheme, avoiding paying taxes for millions of dollars. As reported by Zuckman and by Koutsias and Dine (2019)[127], Ireland is successful in attracting massive investments due to its low corporate tax rate, which amount to

[124] Mincuzzi A., 15 marzo 2018, Sempre più tax ruling. Così gli Stati Ue si fanno concorrenza fiscale, Il Sole 24 Ore.

[125] Evertsson N., 2016, Corporate tax avoidance: a crime of globalization, Springer Science+Business Media Dordrecht 2016, Crime Law Soc Change (2016) 66:199–216.

[126] Ireland and Others v European Commission, T-778/16 and T-892/16.

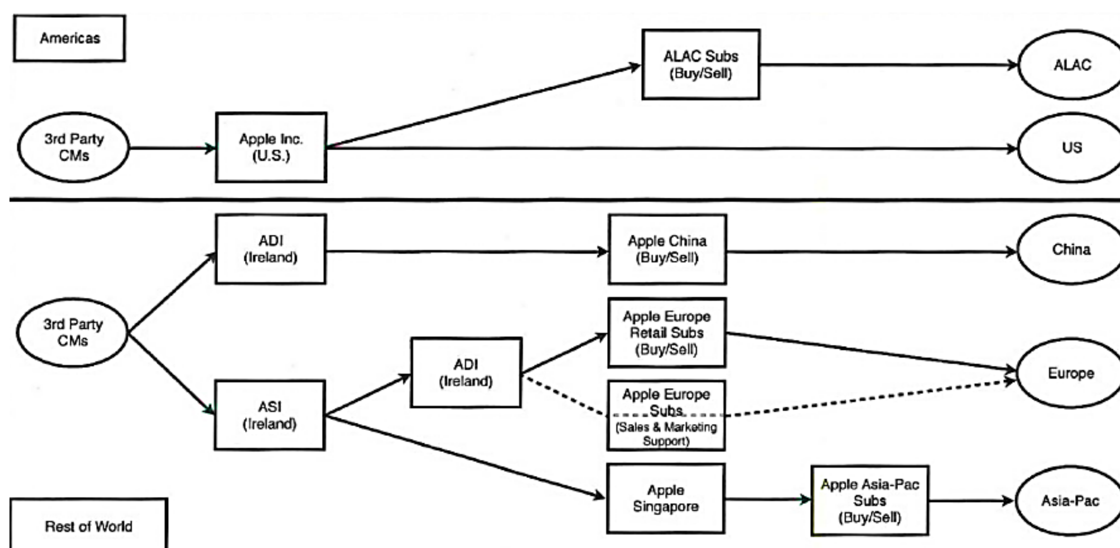
[127] Koutsias M., and Dine J., 2019, The Three Shades of Tax Avoidance of Corporate Groups: Company Law, Ethics and the Multiplicity of Jurisdictions involved, European Business Law Review, 30 (1). pp. 149-182.

12,5%, and the *Double Irish* tax formula that allows companies avoiding to pay taxes, by setting up a subsidiary in the country to allocate there their intellectual property rights. Under Irish law companies are considered tax resident if they are controlled or managed in Ireland. In this way big corporation, such as Apple, establishing a controller of the Irish incorporated company in another country can escape Irish tax residency. As Stewart (2013) affirms some corporations "are tax resident in Ireland for some purposes but are not tax resident for corporate tax payments" [128]. To implement its scheme Apple set up two subsidiaries in Ireland: the first, Apple Operations Europe (AOE) provided services for Apple companies in Europe, the Middle East and Africa (EMEA area); while the second, Apple Sales International (ASI) bought Apple brand products from manufacturers and sold them to companies within the Apple group, so it had a distribution function. AOE owned the 100% of ASI, as shown below in Figure 14, which provides an overview of Apple's Offshore Organizational Structure in 2013. Even if the legal ownership of intellectual property rested with Apple Inc., according to a cost-sharing agreement with the parent, ASI had the economic rights to Apple's intellectual property, so the right to use and sell Apple's intellectual property outside America. Under this agreement the two Irish subsidiaries made annual payments to Apple in the USA to fund R&D conducted on behalf of the Irish companies in the USA, contributing to finance all research to develop Apple's intellectual property worldwide. This was done in order to exploit the Irish law according to which R&D expenses are deducted from the profits recorded by the Irish subsidiaries.
As highlighted by Stewart (2017)[129] and explained in the US Senate Permanent Subcommittee on Investigations[130], ASI contracted with a firm in China to produce finished products, which were then shipped directly from China to the final market. As reported in US Senate report: "Once ASI took initial title of the finished goods, it resold the goods to the appropriate distribution entity, in most cases without taking physical possession of the goods in Ireland"[131]. In addition, the investigation led to the discover of seven subsidiaries in Ireland and was find out that Apple Sales International had no employees, but in 2011 earns income for $22bn (64 % of group income) but paid just $10m. For this reason, Apple Ireland is described as the headquarters of Apple European operations. The US Senate Report states that "Ireland has essentially functioned as a tax haven for Apple, providing it with minimal income tax rates

[128] Stewart J., 2013, Is Ireland a Tax Haven?, IIIS Discussion Paper No. 430 Jim Associate Professor in Finance School of Business, Trinity College, Dublin, p.6.
[129] Stewart J., 2017, MNE tax strategies and Ireland, CPOIB 14,4, School of Business, Trinity College, Dublin, Ireland, pp.338-360.
[130] United States Senate, 2013, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Carl Levin, Chairman John McCain, Ranking Minority Member, E X H I B I T S: Hearing On Offshore Profit Shifting and the U.S. Tax Code Part 2 (Apple Inc.) May 21, 2013, Washington.
[131] Ibid, p.27.

approaching zero”[132]. ASI was not a resident of Ireland, because its central management and control was in the USA, but neither a resident of the USA[133] because not incorporated there. Being stateless, the two subsidiaries were treated as a branch in Ireland, and they were subject to tax only on the trading income attributable to that branch. Moreover, AOE and ASI enjoyed two tax rulings, through which taxable income and internal allocation of profits were determined. The first issued by Irish authorities in 1997 set its net profit at 12.5% of branch operating costs, and in the second (2007, until 2014) profits were deemed to be 8-18% of branch operating costs. The Irish authorities agreed that the majority of ASI’s profits should be allocated to its head office. The problem was, as discovered by the Commission, that the head office (AOI) existed only on paper (no country, no employees, no premises, just occasional board meeting) and could not have generated such sums. In this way, just a minimum part of all EMEA profits, that shift to ASI were taxed, while the main part remained simply untaxed. Thanks to this complex scheme and advantageous tax rulings, in 2003 Apple paid on ASI profits just a corporate tax rate of 1%, decreased to 0,005% in 2014. When in 2014 the European Commission open its investigation about the allocation of profits between the two subsidiaries, found that the artificial allocation of profits and the intra-group transaction scheme was not reflective of the arm’s length principle and therefore they constituted unlawful state aid, meaning that Irish authorities had substantially and artificially lowered the tax paid by Apple. In addition, as reported by the Official Journal of European Union the advantage provided to AOE and ASI was selective, because it involved just Apple Inc companies, putting them in a more favourable position than other comparable undertakings.

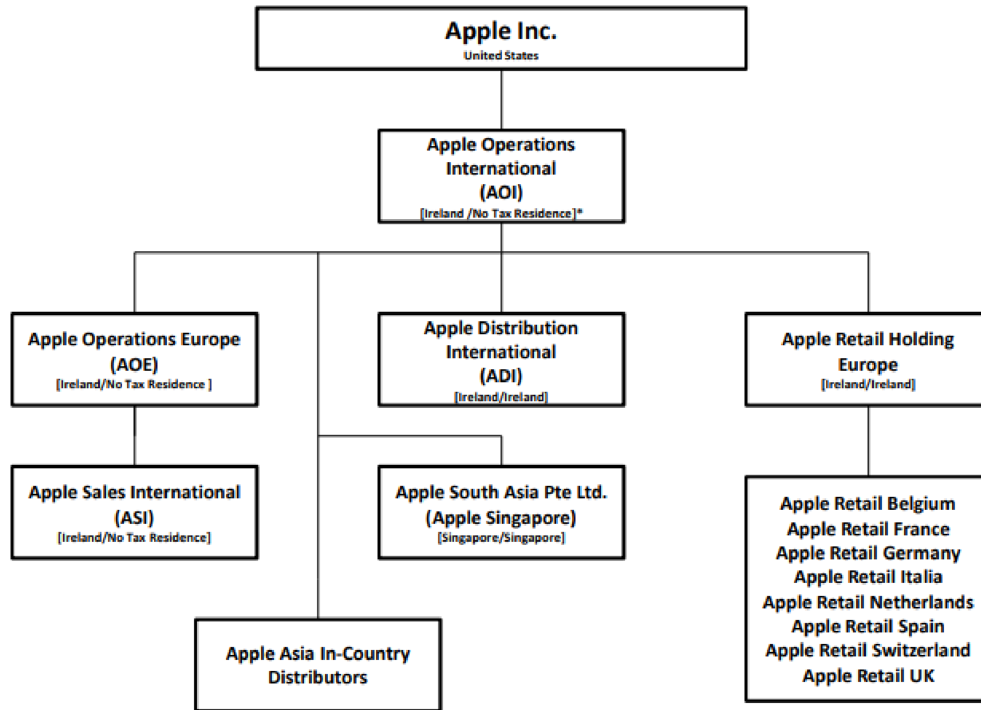
Figure 13- Apple Inc.’s Offshore operating structure



[132] Ibid, p.21.

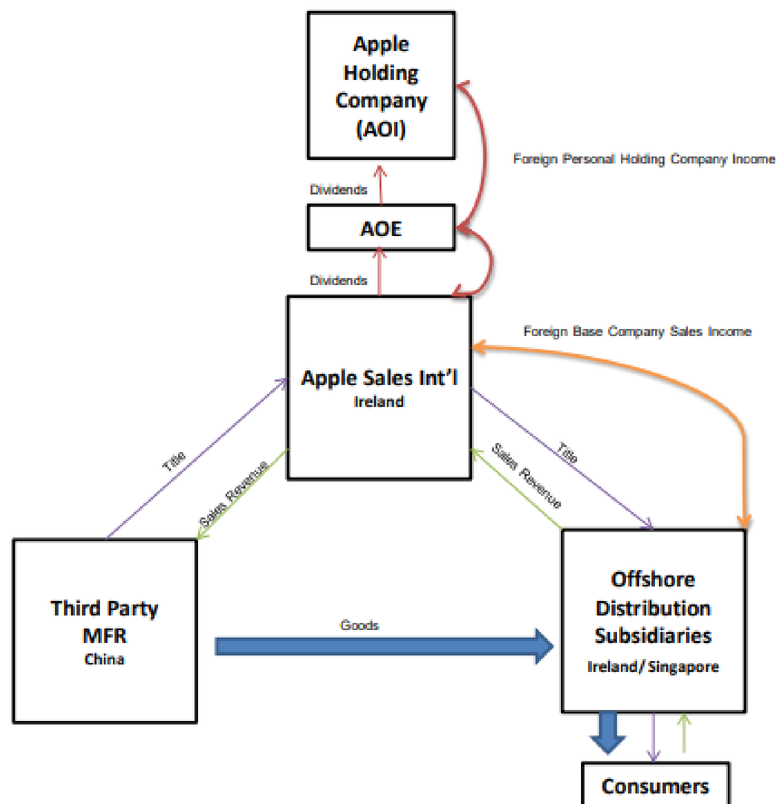
[133] In the USA a company to be resident must be incorporated in the country, regardless its management or control.

Figure 14-Apple Inc.'s Offshore Organogram



** Listed countries indicate country of incorporation and country of tax residence, respectively.*

Figure 15- Apple's Offshore Distribution Structure



Source: provided by Apple Inc. and prepared by the Permanent Subcommittee on Investigations of United States Senate Carl Levin, Chairman John McCain, Ranking Minority Member, E X H I B I T S, Hearing on Offshore Profit Shifting and the U.S. Tax Code Part 2 (Apple Inc.) May 21, 2013, Washington, pp.20. Available at: https://info.publicintelligence.net/HSGAC-AppleOffshore.pdf

2.3.2.2. Google LLC case

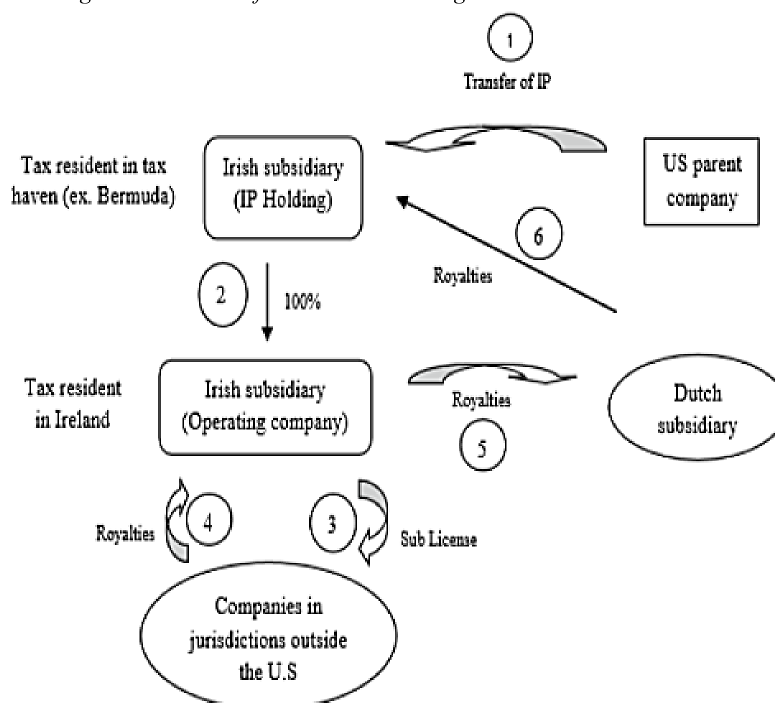
Google case has been defined many times as the best-known example of *Double Irish Dutch Sandwich*, thank to which its legal residence was in one state, but for tax purposes was located in another. This very widespread scheme is a popular way to shift profits between subsidiaries to exploit the low or no tax rate of advantageous jurisdictions. In Google's case the subsidiaries were located in Ireland and Netherlands, in particular it involved two Irish affiliates and a Dutch shell company.

In 2003 before Google's initial public offering, Google US decided to move part of its intellectual property (specifically the search and advertisement technologies) to Google Holdings, a subsidiary incorporated in Ireland, but controlled and managed by another Google company in Bermuda. Therefore, as explained before, it is not a tax resident of Ireland, but of Bermuda, where the corporate tax is at 0%. From the Irish/Bermuda hybrid was set up another Irish subsidiary named Ireland Limited, which owned the license of Google's technologies. The new subsidiary granted licenses of Google's intellectual property to all Google affiliates in EMEA area, in return each Google company in these regions paid royalties to Ireland Limited to have the right to use the company's intangibles. In this way all EMEA profits were taxable in Ireland only, at a tax rate of 12.5%. Last step was about transferring profit from Ireland to Bermuda, through a royalty payment. The problem was that, according to Irish tax law a tax must be imposed on royalty payments from the homeland to Bermuda. To escape this tax, a detour by the Netherlands was necessary. Hence, Ireland Limited paid royalties to Google BV, a shell company set up in Netherlands, in this way the payment was free of tax charge since both countries are EU MS. The Dutch shell then paid back everything to Google Ireland Holdings because again, the incorporation was in Ireland even though managed in Bermuda, so the royalty payment was tax-free.

Through this very complicated scheme Google also exploit the loopholes of US CFC rules. For USA, Ireland Limited and Google BV were not companies, but divisions of Google Ireland Holding, which was perceived by USA as tax resident in Ireland and, by Ireland, resident in Bermuda. Also, in this case the company resulted as stateless, so not subjected to any taxation. Exploiting this strategy, between 2006 and 2011, Google paid just $16 million of the $18 billion of sales generated in UK, equally the 0,1%. The Public Accounts Committee stated (2013): "Google defends its tax position by claiming that its sales of advertising space to UK clients take place in Ireland – an argument which we find deeply unconvincing on the basis of evidence that, despite sales being billed from Ireland, most sales revenue is generated by staff in the

UK"[134]. The Committee, in front of the clear proof that sales to UK clients were the primary purpose, responsibility and result of its UK operation, claimed that Google Ireland had no purpose other than to avoid UK corporation tax. The same situation occurred again in 2012, when Google paid only £11.6 million to the UK Treasury, despite earning amount of £3.4 billion. This scandal undermined Google's reputation in UK, but also the confidence in the effectiveness of HMRC. In 2014, Irish Government, also because of the strong pressure of EU, banned the Double Irish Dutch Sandwich, giving multinational group, which were exploiting the scheme, 5 years to stop. Google persisted in its elusive practice, transferring, in 2016, $19.2 billion to Bermuda, avoiding $3.7 billion in taxes. The same year Google was fined £130 million to compensate UK avoided taxes.

Figure 16-Process of Double Irish Arrangement with Dutch Sandwich



Source: Anggraeni (2015) by Perera, 2021, Tax avoidance strategies of multinational companies, pp. 71-87.

2.3.2.3. IKEA case

IKEA is one of the companies that were included in the blacklist of corporate tax avoiders presented by the European Parliament in 2015, and its name appear also among the Luxembourg Leaks scandal. Evertsson (2016)[135] provides an image of IKEA structure that is visible below in Figure 17. The Stichting INGKA Foundation is the umbrella organization of

[134] House of Commons Committee of Public Accounts, 2013, Tax Avoidance–Google Ninth Report of Session 2013–14, Report, together with formal minutes, oral and written evidence Ordered by the House of Commons, House of Commons London, The Stationery Office Limited p.5.

[135] Evertsson N., 2016, Corporate tax avoidance: a crime of globalization, Springer Science+Business Media Dordrecht 2016, Crime Law Soc Change, pp.199–216.

the group and has been defined also 'the philanthropic arm of the group'. It is the parent of three other foundations and one holding company. It was established in 1982 and is located in Leiden, Netherlands. INGKA Holding B.V. is the parent of the IKEA Group, both located in Netherlands. The IKEA Group is responsible for the whole chain of value (strategy, design and production, distribution, and retail) as well as for the Group's legal issues, human resources, IT, compliance, and sustainability. The IKEA Group is in turn the parent of IKEA Koncernen, which is a company that administers the IKEA franchises around the world. The Interogo Foundation was established in 1989 in Liechtenstein, and owns the Inter IKEA Holding S.A. located in Luxembourg, which in turn controls the intellectual property rights of the products and stores and controls the finances of the entire conglomerate. In particular, Inter IKEA Systems B.V. (Netherlands) is the company that holds the intellectual property rights to the IKEA products and the IKEA brand. Vastint Holding B.V. (Amsterdam, Netherlands) owns the intellectual property rights to the IKEA stores and is responsible for the management of portfolio properties and the development of commercial real estate. Inter IKEA Finance S.A. (Luxembourg) is responsible for guaranteeing liquidity to Inter IKEA Holding S.A. and the IKEA Group by means of intercompany loans.

From its study Evertsson finds out that IKEA transformation from company to foundation, and the relocation from Sweden to Netherlands and Liechtenstein, has three main purposes, completely different from the one provided by the owner Ingvar Kamprad (2011), which justifies his choice as an operation to "support individual IKEA retailers experiencing financial difficulties and for philanthropic purposes […] I did not want IKEA to be become dependent on financial institutions"[136]. Evertsson explains that the transformation was an attempt to escape Sweden's corporate income tax rate of 57,8%, indeed by contrast foundation are exempted from tax in Netherlands. Moreover, in this way also Sweden's inheritance tax (65% to direct descendants of family firms) can be replaced by Netherlands 0%. Lastly, Liechtenstein foundations are charged with a capital tax rate of just 1% of total assets. So working through franchising, IKEA does not have ownership of the stores, so its total asset are very low. This arrangement made by IKEA in 1982 was a perfect free tax scheme.

Chenoweth (2014)[137] explains how from 2002 to 2013, IKEA Pty Ltd. owner of the IKEA stores' franchise in Australia, reported a turnover of AU$ 4.76 billion, but only AU$ 103 million were listed as pre-tax profit. The scheme of payments applied is the following: IKEA Pty Ltd. paid to Inter IKEA Finance S.A. in Luxembourg AU$ 532 million, of which AU$ 259 million

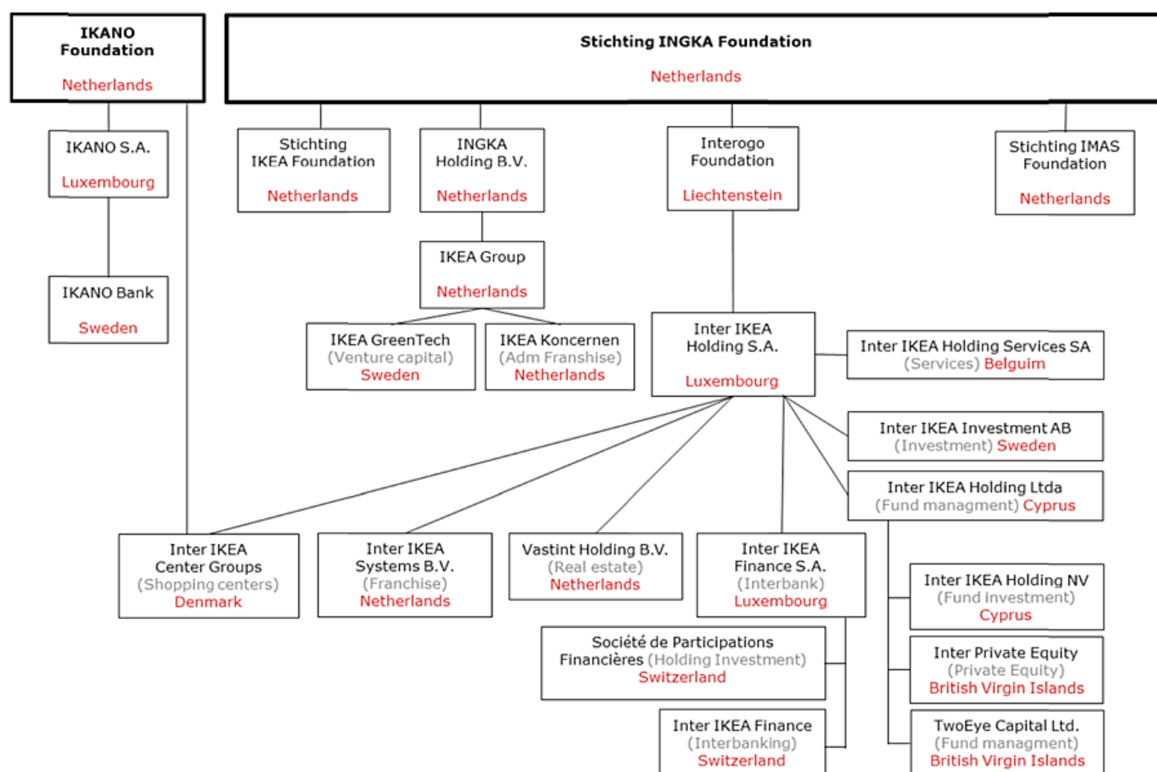
[136] Kamprad I., 2011, Ingvar Kamprad comments.
Available at: http://www.ikea.com/at/de/about_ikea/newsitem/
[137] Chenoweth N., 2014, Why IKEA's profits are mostly tax free, The Australian Financial Reviewer. Available at: http:// www.afr.com/news/policy/tax/why-ikeas-profits-are-mostly-tax-free-20141105-11ho0k

was in risk agreement fees, AU$ 114 million was in interest, and AU$ 159 million was in franchise fees. Additionally, IKEA Pty Ltd. paid to the IKEA Group in the Netherlands AU$ 3.042 billion, to cover the costs of the products and for manufacturing profit. Another payment of AU$ 1.01 billion has been made, but Chenoweth could not find information.

What is clear is that IKEA applied different strategy to reduce its tax liability: profit shifting, paying for intangibles, intercompany loans. From the investigation was discovered that IKEA made use also of hybrid entities to create investment companies setting up incorporated subsidiaries in tax haven countries, such as British Virgin Island and Switzerland, for a global investment portfolio that benefits of total exemption. Another practice was the use of countries, such as Cyprus, as conduit to invest in Russia.

As reported by Evertsson, in 2014 IKEA Group reported taxes for €801 million in the Netherlands, while an estimation of the amount of tax avoided in Luxembourg is €3.524 billion. After decades of tax avoidance, the loss to society is incalculable.

Figure 17- IKEA's ownership structure



Source: elaboration of Evertsson (2016) in 'Corporate tax avoidance: a crime of globalization', Springer, adapted from Administration des contributions directes.

2.3.3. Last investigations: OpenLux and Pandora Papers

Paolo Gentiloni, the 22nd of December 2021, during the opening remarks at the press conference on the proposal to prevent the misuse of shell entities claimed: "Recent investigations such as OpenLux or the Pandora papers were another reminder of the injustices that characterize our economic system today"[138].

In February 2021, the French journal 'Le Monde' along with ten media partners published *OpenLux*[139], the results of its investigation into Luxembourg's beneficial ownership register. This inquiry revealed 55 000 offshore companies managing assets worth at least 6 trillion euros, which means that more than a half of the companies registered in Luxembourg had not declared their beneficial owners on the public register, while others had given contradictory information. Furthermore, it found out that approximately 90% of the companies in the register were owned by non-residents in Luxembourg, and that approximately 33% of these companies were participation or holding companies that were used by very wealthy individuals to structure their assets and investments, to benefit from a favourable tax regime. Among the 157 nationalities represented, the French stand out with 17 000 shell companies involving brand such asYves Rocher, Chanel, JCDecaux and Decathlon. As reported by 'Le Monde', Luxembourg acts as a magnet for the wealth of the world, indeed these ghost companies without offices or employees were created by billionaires, multinationals, sportsmen, artists, high-ranking politicians, and even royal families. Among the hundreds of multinationals involved, LVMH, Kering, Altice, Pfizer, Amazon have opened financial subsidiaries. Even worst is the revelation that part of the funds are suspected to be originated in criminal activity or linked to criminals targeted by judicial investigations, as in case of Italian Mafia, the 'Ndrangheta, the Russian underworld, La Lega[140], and people close to the Venezuelan regime.

OpenLux confirmed that Luxembourg facilitates money laundering and encourages tax evasion. After *LuxLeaks*[141] revelations in November 2014, another new investigation sustained that Luxembourg, contrary to what its own authorities claim, is *de facto* a tax haven, even if, in 2019, was declared 'largely compliant' with the international standard of transparency and exchange of information on request by OECD. 'Le Monde' defines it as a veritable offshore

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[138] European Commission, 22 December 2021, Opening remarks by Commissioner Gentiloni at the press conference on the implementation of the OECD agreement on a global minimum level of taxation and on an initiative to prevent the misuse of shell entities (Speech), Brussels, available at: https://ec.europa.eu/commission/presscorner/detail/en/speech_21_7085

[139] Le Monde, OpenLux. Available at: https://www.lemonde.fr/les-decodeurs/visuel/2021/02/08/openlux-enquete-sur-le-luxembourg-coffre-fort-de-l-europe_6069132_4355770.html

[140] Italian party.

[141] International Consortium of Investive Journalists, 2014, Luxembourg Leaks: Global Companies' Secrets Exposed. Available at: https://www.icij.org/investigations/luxembourg-leaks/explore-documents-luxembourg-leaks-database/

centre, halfway between the City of London and the British Virgin Islands.

As pieced together by Pantazatou (2022)[142], some European Union measures ware fundamental to collect this data:

"The fourth Anti-Money Laundering directive (4th AMLD[143]) required all Member States to establish beneficial ownership registers by June 2017. The directive was followed by the 5th AMLD[144] according to which, Member States should ensure that the information on the beneficial ownership is accessible in all cases to:

(a) competent authorities and Financial Intelligence Units (FIUs), without any restriction

(b) obliged entities, within the framework of customer due diligence

(c) any member of the general public.

Luxembourg applied the 4th AMLD in March 2019, and the 5th one year later."[145]

Moreover, the State has put in place a system of sanction and its public prosecutor's office, and the DAC 6 as complementary. Pantazatou identifies as determinants of Luxembourg situation an enforcement problem, suggesting that no sanction have been imposed, facilitating non-compliance and problems in the definition of beneficial owners, that can bring to the co-existence of two different concept within the same state, one for intra-EU situation and the other for offshore cases.

For what concern the one third of entities discovered as merely holding or with no substance in Luxembourg, the author highlights the notable problem about substance definition and requirements, reiterating the attractiveness of Luxembourg for this kind of scheme. This is due to its jurisdiction, according to which entities that have their registered office or their central administration in Luxembourg are subject to corporate income tax, which apply only on profits in Luxembourg, and a very broad tax treaty network. Even if Luxembourg over time, also under EU pressure, introduced some limitations and safeguards (the beneficial ownership clause in tax treaties, the EU tax directive in respect of passive income, CFC MLI GAAR rules and PPT test) to limit as much as possible tax avoidance practise, OpenLux criticize the lack of substance of these ghost companies. As Pantazatou observed: "The substance requirement is another requirement to curb abusive practices, yet it is difficult to be defined" adding that in many circumstances of CJEU case-law "substance becomes of less significant, in particular because it does not constitute a sufficient factor to prove anti abuse practices"[146].

[142] Pantazatou K., 2021, The "OpenLux revelations": Who is to be blamed?, Cahiers de fiscalité luxembourgeoise et européenne.

[143] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

[144] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing

[145] Pantazatou (2021), p.4.

[146] Pantazatou, p.5.

According to 'Le Monde', "There are various reasons for choosing Luxembourg: a central position in the European Union, high-quality financial engineering, financial regulations tailored to business, direct access to the country's institutions, and political stability. But let there be no mistake: the first reasons are taxation and discretion. They are the result of political choices dating back to the time of former Prime Minister, Jean-Claude Juncker (1995-2013), who later became President of the European Commission." [147] Moreover, the French journal highlights that the Grand Duchy is for sure insufficiently equipped to guarantee an effective control over all the flows it handles. Its trade register has only 59 employees to enforce the legal obligation to declare the actual beneficiaries of more than 100.000 entities and to carry out an initial control of the declarations, while are only 900 the employees of the Financial Sector Supervisory Commission (CSSF), even though a quarter of the state's economy is based in the financial sector.

OpenLux preceded the much larger revelations named *Pandora Papers*[148] that disclosed the hidden wealth of very rich people offshore. *Pandora Papers* is a global investigation launched in October 2021, by the International Consortium of Investigative Journalists (ICIJ), with the purpose of seeking to know the veiled world of offshore finance, a system often used to hide wealth from tax authorities, creditors, and criminal investigations. What differentiate *Pandora Papers* from *Panama Papers* (2016)[149] investigation, is the dimension (more than 11.9 million confidential files), indeed Pandora Papers gathered information on more than 27,000 companies and 29,000 so-called ultimate beneficial owners from 14 offshore providers, more than twice the number of beneficial owners identified in the *Panama Papers*. In addition, Pandora Papers connected offshore activity to more than twice as many politicians and public officials as did the Panama Papers, which investigated on the files of a single offshore services provider: the Panamanian law firm Mossack Fonseca. The ICIJ confirmed: "The leaked records reveal that many of the power players who could help bring an end to the offshore system instead benefit from it – stashing assets in covert companies and trusts while their governments do little to slow a global stream of illicit money that enriches criminals and impoverishes nations"[150].

The Pandora Papers demonstrate that the offshore financial system is active throughout the world, including in the biggest democracies. Elite organizations with headquarters in the US and Europe, such as international banks, legal companies, and accounting firms, are among the

[147] Le Monde, Baruch J., Ferrer M., Vaudano M. et Michel A., 8th February 2021, OpenLux: the secrets of Luxembourg, a tax haven at the heart of Europe.

[148] International Consortium of Investigative Journalists (ICIJ), 2021, Pandora Papers: Offshore havens and hidden riches of world leaders and billionaires exposed in unprecedented leak. Available at: https://www.icij.org/investigations/pandora-papers/global-investigation-tax-havens-offshore/

[149] International Consortium of Investigative Journalists (ICIJ), 2016, The Panama Papers: Exposing The Rogue Offshore Finance Industry. Available at: https://www.icij.org/investigations/panama-papers/

[150] https://www.icij.org/investigations/pandora-papers/global-investigation-tax-havens-offshore/

system's major actors. Below are provided some Pandora Papers data[151] about politicians and countries involved.

Figure 18-Top 5 jurisdictions used by politicians in the Pandora Papers

Figure 19-Where are the politicians in the Pandora Papers from?

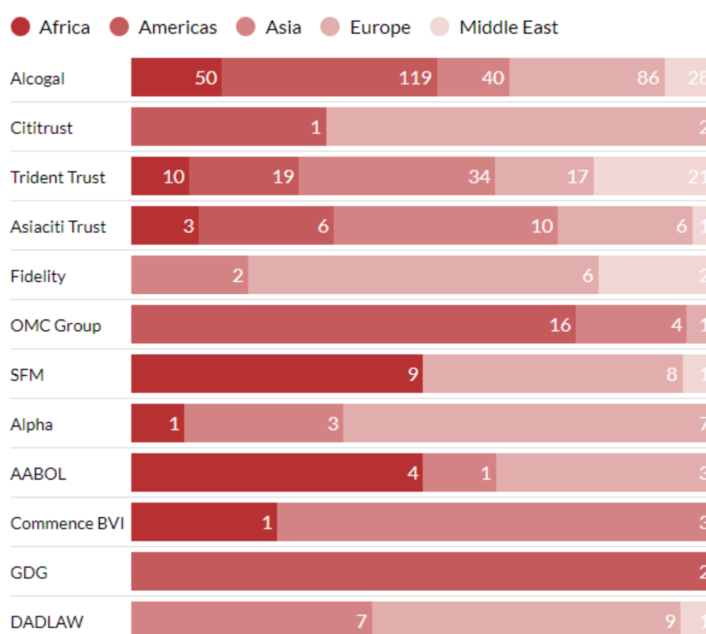
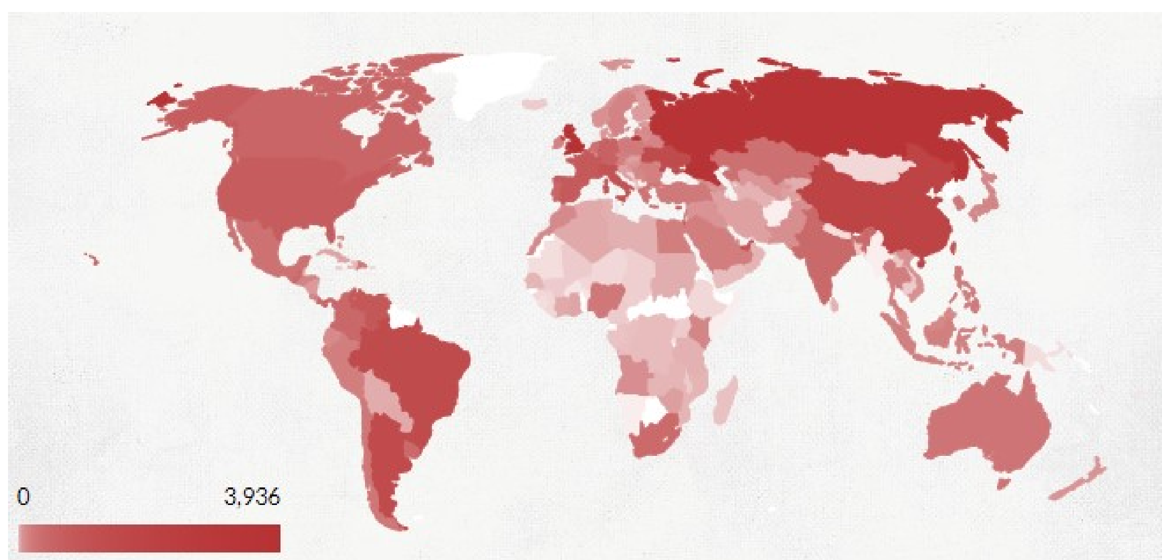


Figure 20-Where are the beneficial owners revealed in the Pandora Papers from?



Source: Pandora Papers via CIJ. Available at https://projects.icij.org/investigations/pandora-papers/charts/

[151] Data provided by ICIJ at: https://projects.icij.org/investigations/pandora-papers/charts/

These last two investigation shows that the huge problem of shell companies' exploitation is not something so far from EU, but it involved in big measure companies and wealthy people in industrialized country. It is also clear that shell entities are set up to hide the identity of who put in place mechanism of money laundering, tax evasion and tax avoidance, corruption, bribery, financial crimes. Moreover, as asserted by Evertsson the current anti-tax avoidance measures are not sufficient to tackle the abusive practices of shell companies, and concept like substance and beneficial ownership, remain hard to be defined and accordingly, easy to be circumvented. For all these reasons EU justified the need of ATAD III.

CHAPTER 3

THE UNSHELL DIRECTIVE

3.1. The proposal

On 22nd of December 2021, the European Commission, with the COM (2021) 565 final, made a 'Proposal for a COUNCIL DIRECTIVE laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU[152]'. This proposal is one of the short-term targeted initiatives born from the COM (2021) 251 final, '*Business Taxation for the 21st Century',* deepened in chapter 1. It aims at improving the current tax system with a focus on ensuring fair and effective taxation, trying to improve the unfair tax burden distribution, and aggressive tax competition environment. As reported in the proposal: "While important progress has been made in this area in the last years, especially with the adoption of the anti-tax avoidance directive (ATAD) and the expansion of scope of the directive on administrative cooperation (DAC) , legal entities with no minimal substance and economic activity continue to pose a risk of being used for improper tax purposes, such as tax evasion and avoidance, as confirmed by recent massive media revelations[153]. While there can be valid reasons for the use of such entities, there is a need for further action to tackle situations where taxpayers evade their obligations under tax law or act against the actual purpose of tax law by misusing undertakings that do not perform any actual economic activity. The outcome of such situations is to lower the taxpayers' overall tax liability.[154]" The EU hereby recognizes the presence of these entities and the possible damage they create at the expenses of honest citizens. Until now, despite the awareness about the risk that these conduits arise in the single market, no explicit provisions that directly tackle the specific shell entity problem has been put in place by the EU. As claimed before, MSs were required to adopt GAARs in their domestic legislation, but only in accordance with the goals of the internal market and the four fundamental freedoms. Many Member States have enacted targeted restrictions establishing substance requirements; nevertheless, the majority have implemented general anti-abuse laws that typically apply on a case-by-case basis. As illustrated by the various multinationals' schemes included in the previous chapter, what differentiate abuses implemented through shell entities from abuse of tax law in general is the involvement of several MS tax systems. This makes impossible to handle the problem at the individual level, because one MS could be impacted by an arrangement which include a shell entity located in another MS. The already existing

[152] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation (DAC).
[153] Reference to OpenLux and Pandora Papers investigations.
[154] COM(2021) 565 final, p.1.

fragmentation combined with MSs' individual policy brings to further inefficiencies and distortions. For this reason, the EU Commission asserts that a coordinated effort and a centralized approach at the EU level are the most appropriate options to separate the substance requirements from general abuse, guaranteeing legal certainty, reducing compliance costs, and furthermore complying with the principle of subsidiarity.

3.1.1. The subject and the scope of the *Unshell Directive*

The Article 2 of the Directive states: "This Directive applies to all *undertakings* that are considered tax resident and are eligible to receive a tax residency certificate in a Member State." The European Commission defines as *undertaking* any entity engaged in an economic activity, regardless of its legal form, that is a tax resident in a Member State. Whatever their legal form or status, all EU undertakings, that are subject to taxation in a Member State, are covered by the directive as long as they have their tax residence there and are qualified to apply for a certificate of tax residence in that Member State.

"This Directive, which aims to discourage the use of shell entities established in the Union for tax purposes, has a broader scope than the Directive on a minimum level of taxation, as it encompasses all entities and legal arrangements resident for tax purposes in the Union, without any threshold based on revenues.[155]" The European Commission highlights the will to fight shell entities through new provisions aiming at introducing new and better-defined substance requirements and tax treatment rules for those entities which do not meet them. Moreover, while the legal framework on the minimum level of taxation[156] applies only to MNEs and large-scale domestic groups with combined revenues that exceed EUR 750 mln, ATAD III applies to all kind of entities, with no revenue limits, to avoid unequal treatment against smaller-sized groups' shell entities. Another difference between the two initiatives is that while Pillar 2 exclusively pertains to the rate, this directive looks at the potentially harmful features of the tax base, examining whether an entity possesses sufficient substance to carry out the activity that it is supposed to.

The *Unshell Directive* does not prescribe a full harmonization of MSs tax systems, but just a minimum protection, laying down a *substance test* which aims at helping Member States to identify manifest cases of shell entities misuse for tax purposes in a coordinated and common manner. Obviously domestic rules remain effective as a complement in case the test fail. The proposal also includes the consequences for shell entities, taking into consideration the agreements and conventions in place between Member States and third countries for the

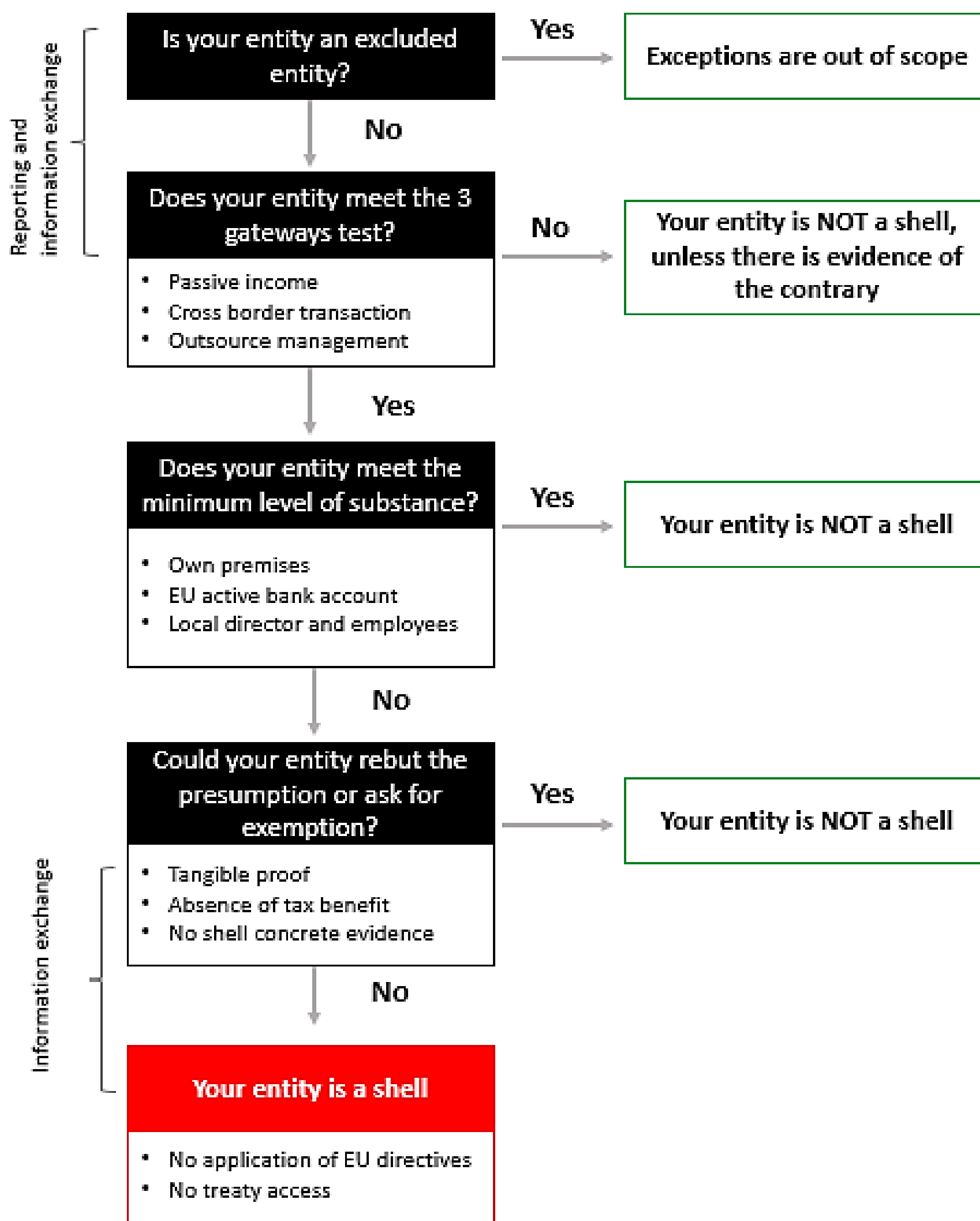
[155] COM(2021) 565 final, p.2.
[156] Pillar 2.

elimination of double taxation of income, and capital, remaining compliant with the proportionality principle.

3.1.2. The contents of the Directive

The structure of the Unshell Directive traces the logical sequence of each step of the substance test. Below a summary scheme of the directive and its explanation are provided.

Figure 21-Unshell Directive step-by-step



Source: own elaboration of Baker McKenzie, 2022, ATAD III: Between fair objectives and uncertain outcome.

3.1.2.1. Undertakings that should report

The first phase aims at dividing the undertakings at risk from the ones at low risk. An entity is considered at risk when it meets some specific features commonly showed up by companies with no substance, namely the passive-income gateway, the cross-border transaction gateway and the outsource gateway[157]. Low risk companies are those that do not pass the gateways, so irrelevant for the purpose of the Directive. It is highlighted that also certain specific types of undertakings are viewed from the start as at low-risk and irrelevant, so they are specifically excluded for tax purposes. Just the undertakings considered at risk proceed to the second phase.

3.1.2.2. Reporting

In their tax returns, the undertakings at risk are asked to report on their substance, providing specific information, in order to facilitate the assessment of their activity and the verification of the truthfulness of the information by the tax authorities. Article 7 identify three main elements that are extremely significant as indicators of minimum substance:

a) the undertaking has own premises in the Member State, or premises for its exclusive use;
b) the undertaking has at least one own and active bank account in the Union;
c) at least one director resident close (distance compatible with the proper performance of its duties) to the undertaking, qualified and authorised to take decisions in relation to the activities that generate relevant income, and not employed in an enterprise that is not an associated enterprise[158], or, alternatively, a sufficient number of employees that are engaged with its core income generating activities being resident close to the undertaking.

In paragraph 2 the Directive highlights that the reporting must be accompanied by satisfactory documentary evidence, which shall include address and type of premises; amount of gross revenue and type thereof; amount of business expenses and type thereof; type of business activities performed to generate the relevant income; the 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 and their qualifications, their place of residence for tax purposes; outsourced business activities; bank account number, any mandates granted to access the bank account and to use or issue payment instructions and evidence of the account's activity. All these information is needed to verify that the entity owns the necessary resources, employee and spaces and really runs the

[157] Deepened below in paragraph 3.1.3.
[158] Article 5 of the COM(2021) 565 final defines 'associated enterprise' as a person who is related to another person in any of the following ways: (a) a person participates in the management of another person by being in a position to exercise a significant influence over the other person; (b) a person participates in the control of another person through a holding that exceeds 25 % of the voting rights; (c) a person participates in the capital of another person through a right of ownership that, directly or indirectly, exceeds 25 % of the capital; (d) a person is entitled to 25 % or more of the profits of another person. (For further details see p.24)

business in the MS where it is resident or that a real nexus between the incomes and the MS exists. To guarantee fiscal certainty its fundamental to set a common framework of rules about the contents required in the income returns.

3.1.2.3. Presumption of lack of minimal substance

During this phase the collected information is properly reviewed, qualifying at first sight the undertaking. If an undertaking meets all the indicators of minimum substance, and have provided the satisfactory supporting documentary evidence, shall be presumed to have minimum substance. An undertaking, which has passed the gateway and whose reporting reveals that it is missing at least one relevant component of substance, should be assumed to be at risk, so to be a *shell* for the purposes of the Directive, meaning that it is used improperly for taxation. In the case in which the entity passed the gateway, but the reporting does not confirm a lack of substance (meets all the indicators) according to the directive point of view, may still be consider by the tax administration as a shell, because the information provided does not confirm the information reported, or is not substantial under the domestic rules, or is not the beneficial owner.

3.1.2.4. Possibility of rebuttal

Being the test based on some indicators it is difficult to capture the specific facts and circumstances of each individual case. For this reason, Article 9 gives to the undertaking considered as a shell entity, for the purpose of the directive, the right to prove its substance, or that it is not used for illicit purposes. In order to refute the assumption of shell, the taxpayers are required to provide tangible proof of the actions they take and how they are taken. Among these can be mentioned:

a) a document allowing to ascertain the commercial rationale behind the establishment of the undertaking;

b) information about the employee profiles, including the level of their experience, their decision-making power in the overall organisation, role and position in the organisation chart, the type of their employment contract, their qualifications and duration of employment;

c) concrete evidence that decision-making concerning the activity generating the relevant income is taking place in the Member State of the undertaking.

The undertaking is free to provide furthered details.

The tax administration of the undertaking's State of tax residence should then evaluate this information. Where it is satisfied that an undertaking refutes the presumption that it is a shell for the purposes of the Directive, the tax administration shall be able to certify the results of the

rebuttal process for the applicable tax year[159]. Since the rebuttal process creates a burden, it will be possible to extend the validity of the rebuttal for another 5 years, provided that the legal and factual circumstances established by the undertaking do not change. Beyond this time frame the undertaking will need to renew the process.

3.1.2.5. Exemption for lack of tax motives

Article 10 provide the possibility of exemption for those undertakings that meet the gateways, but have been put in place for real activity, providing sufficient and objective evidence that its interposition does not lead to a tax advantage for themselves, for the group or for the beneficial owner. In this specific case the entity has the right to demonstrate in any moment its position and ask for exemption from the obligations of the directive. To do so, the undertaking would provide elements that allow to compare the amount of the tax liability considering the undertakings into the group structure and the tax due excluding the undertaking's interposition from the organization. As in the case of rebuttal, is the tax administration of the state of residence that assesses the proof provided by the entity. If the tax administration is satisfied, meaning that the interposition of the undertakings does not have any impact on the group taxation, it must certify that the entity is not at risk. The exemption, after being obtained for one year, could be extended for other 5 years, provided that the circumstances do not change, and after that term the process must be repeated.

3.1.2.6. Tax consequences

When an undertaking is considered a *shell entity* at the sense of the Directive, and does not rebut that presumption, as a consequence, Article 11 provides for the full neutralization of any tax benefit or advantage obtained, or that could be obtained, through agreements or conventions in force with the Member State of the undertaking for the elimination of double taxation, or relevant EU directives benefits (Parent-Subsidiary directive[160], Interest and Royalties directive[161]).

Since to obtain that kind of benefit a certificate of residence is needed, the European Commission, in Article 12, states that the MS, where the undertaking is resident for tax purposes, should deny issuing a certificate of tax residence. Alternatively, that Member State can issue such certificate with a warning statement. This measure does not set aside the national rules of the Member State of the undertaking with regard to the tax residence and relevant

[159] 'Tax year' means a tax year, calendar year or any other appropriate period for tax purposes.
[160] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.
[161] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

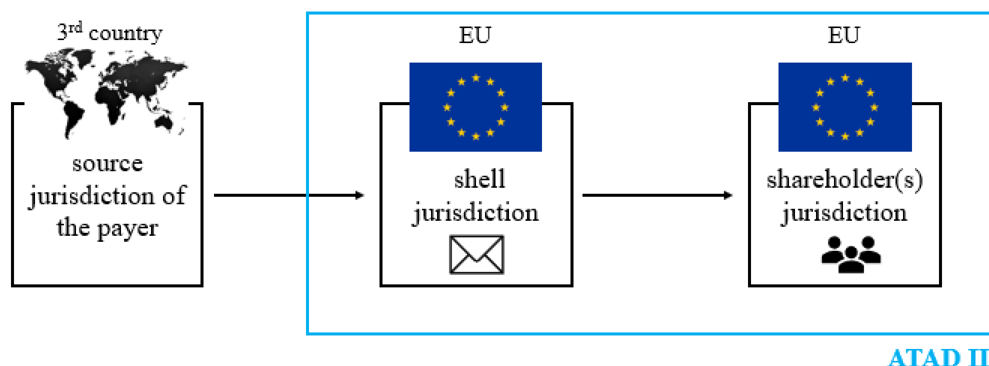
obligations, but it represents a tool to inform the source (another MS or third country) that benefits, reliefs or refund should not be granted with regard to transactions involving this undertaking.

After the abrogation of tax benefits for non-substantial undertakings, the Directive addresses the issue about how the income flowing to or from undertakings should be taxed, to ensure fair taxation in the internal market and tax certainty.

First of all, should be determined which jurisdiction should have the right to tax such income flows and/or assets of the shell entity. The tax that may be levied at shell level is unaffected by this; in fact, the shell's residence state is still free to continue treating it as a resident for tax purposes and to apply national tax legislation to the relevant income flows. Only MS are impacted by the allocation of taxation rights because, in contrast with third countries, MS are bound by ATAD III. Naturally, circumstances involving third parties arise frequently, thus agreements for the avoidance of double taxation between a Member State and a third party should be properly observed as well as the distribution of taxing rights.

The Directive identify four main scenarios[162]:

1) Source: 3rd country – Shell: EU – Shareholder(s): EU



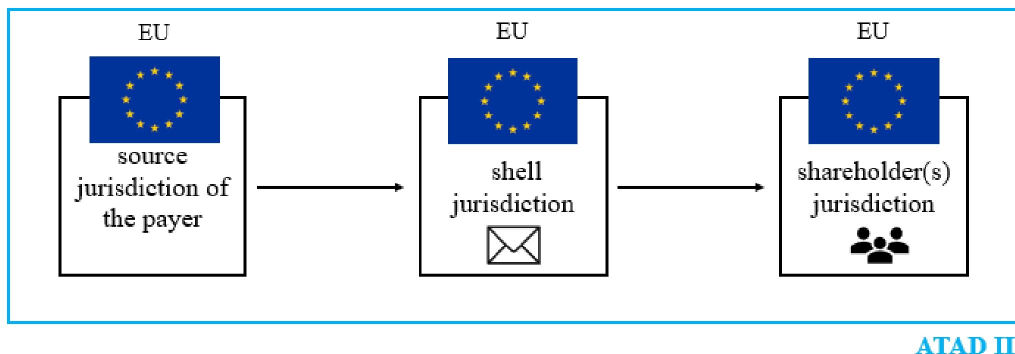
In this case just the shell and the shareholders jurisdiction fall in the scope of the Directive.

Third country source/payer is not bound by the directive, so it may apply national tax on the outbound payment or may apply the treaty in effect with EU shareholder jurisdiction. EU shell will continue to be consider resident for tax purposes in its MS and have to fulfil relevant obligations addressed by domestic law, reporting the payment received. Moreover, it may be able to provide evidence of the tax applied on the payment.

EU shareholder(s) shall include the payment received by the shell undertaking in its taxable income, according to national law and may be able to claim relief for any tax paid at source, applying treaty with third country source jurisdiction, and if provided, deduct any tax paid by the shell.

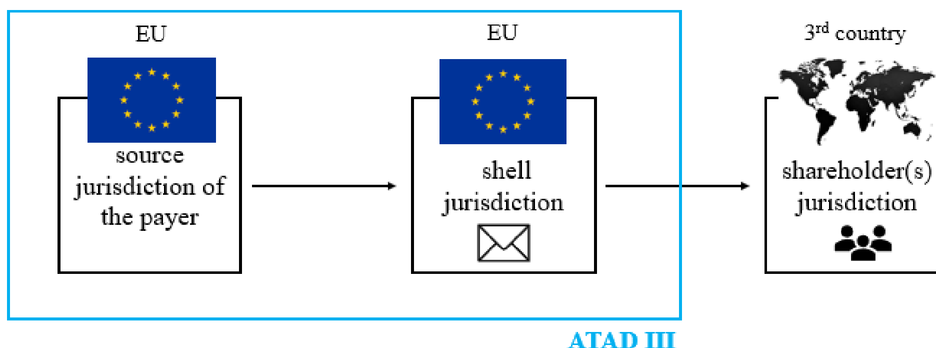
[162] The images used are an own representation of the text in order to make in clearer.

2) Source: EU – Shell: EU – Shareholder(s): EU



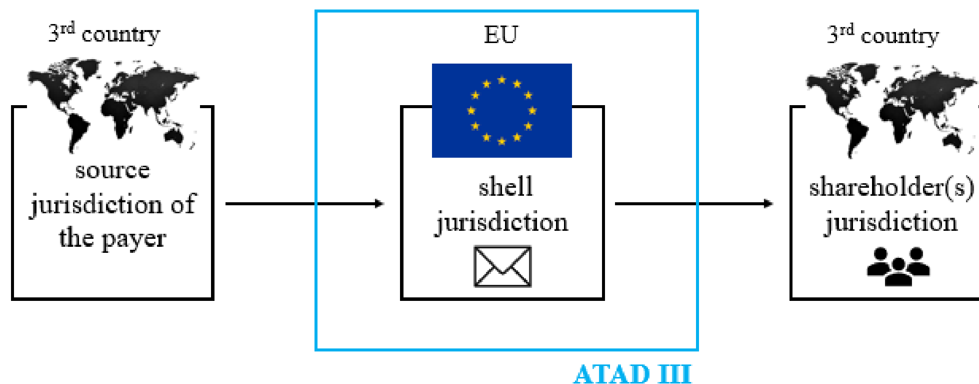
In this situation, the Directive is applicable to all jurisdictions, and they are all required to abide by it. The source will not have the authority to tax the payment but may do so if it cannot determine whether the shareholder(s) of the undertaking are located in the EU. EU shell will continue to be a resident for tax purposes in the relevant Member State and must comply with all applicable legal requirements, including the reporting of income received and possibly the documentation of the tax that was levied on it. According to national legislation, the EU shareholder(s) will include the payment made to the shell undertaking in its taxable income and may be eligible for a tax credit for any tax paid at source, and for a deduction of any tax that the shell may have paid.

3) Source: EU – Shell: EU – Shareholder(s): 3rd country



In this scenario, the Directive solely affects the source jurisdiction and the shell jurisdiction. The source will tax the outgoing payment in line with any applicable treaties with the shareholder(s)' home countries or, in the absence of such agreements, according to its own domestic law. The shell will continue to be tax resident in the MS, as in the previous cases. The shareholder(s)' third-country jurisdiction is not obligated to apply any consequence, but it may be asked to apply a tax treaty in force with the source MS, to provide relief.

4) Source: 3rd country – Shell: EU – Shareholder(s): 3rd country



In the last case, just the shell falls in ATAD III, so the source has the option of applying local tax on the outgoing payment or a tax treaty in force with the shareholder(s)' home country. The shell will continue to be a resident of a Member State for tax purposes. While the third country shareholder jurisdiction may just give relief under an active treaty with the source jurisdiction.

Summing up, the Directive does not apply in situations where shell undertakings are located outside of the EU. The income is taxable in the Member State where the undertaking's shareholder(s) resides, just as if it had been paid to that shareholder(s) directly. Tax paid on such income in the shell's MS should be taken into account and subtracted from the tax due in the Member State of the undertaking's shareholder(s) in order to reduce the possibility of double taxation. If the undertaking's shareholders reside in 3rd country, income should be taxed where the payer resides, as if paid directly to the undertaking's shareholder.

3.1.2.7. Exchange of information

Article 13 introduces some amendments to Directive 2011/16/EU. Information on EU shells will be available to all Member States at any times '<u>without prior request</u>'. To this end, when an undertaking is identified as being at risk for the purposes of this Directive, information will be shared across Member States from the very beginning. The information will be exchanged automatically through a central directory, deploying the existing mechanism of administrative cooperation in tax matters, namely the Common Communication Network (CCN), and within 30 days from receipt of that information. Automatic exchange will also be applicable when a Member State's tax administration certifies that a certain undertaking has rebutted the presumption of being shell or should be exempt from the obligations under the Directive. Additionally, to achieve effectiveness of the provisions, incentivising adequate compliance across the Union, and taking into account the cross-border dimension of the issue, any Member State has the right to ask to another Member State to conduct tax audits of undertakings at risk, if the tax administration has reason to believe they may not have the necessary minimal substance for the Directive's purposes (Article 15). Regardless of the outcome, the results must

be shared within 30 days from the date when the outcome of the audit becomes definitive. Article 13 specifies which information each MS has to include regarding each undertakings: the tax identification number (TIN); the VAT number; the identification of the undertaking's shareholders and the beneficial owner(s) of the undertaking; the identification of the other Member States; the identification of any person in the other Member States likely to be affected by the reporting of the undertaking; the declaration provided by the undertaking; summary of the evidence provided by the undertaking. To facilitate the exchange of information the Commission shall adopt practical arrangement, including measures to standardise the communication of the information.[163]

3.1.2.8. Sanctions

During the impact assessment carried out to prepare the proposal, four policy options have been examined. The first option considered the expansion of the Code of Conduct (Business Taxation), an existing peer review instrument, in order to pursue soft law action, or as an alternative, the adoption of a recommendation to Member States. The problem with soft law is that it has a limited impact on issue such as the exploitation of shell firms for tax reasons, for this reason other options have been taken into consideration. Options 2, 3 and 4 were regulatory and prescribed a set of rules that should be put in place in all Member States, differing just on the extent to which coordination is sought. As reported in the Impact Assessment (p.6):
"Option 2 envisaged coordination of the criteria and processes to identify shell entities as well as coordination on their treatment. Option 3 includes, in addition to Option 2, a mechanism for automatic exchange of information. Option 4 adds to Option 3 a prescription of sanctions against non-compliant entities." Comparing the options based on significant indicators (the effectiveness in reducing the misuse of shell entities, tax gains for public finances, compliance costs for businesses, compliance costs for tax administrations, indirect effects on the single market, competition, EU competitiveness, social impacts and coherence) option 4 appears to be the most suitable to tackle the problem, ensuring the highest level of compliance by the entities in scope, remaining at the same time coherent with the current EU agenda on fighting tax avoidance and evasion.
Since hard law was preferred to soft law, in Article 14, the Directive leaves to MS the power to lay down penalties applicable against the violation of the reporting obligations and infringements of national provisions produced by the transposition of the directive. Moreover, MS have to take all necessary measure to guarantee the correct implementation of the law and ensure an effective, proportionate and dissuasive system of sanction. In the case in which an

[163] For further detail see Article 13, COM (2021) 565 final, p.34-35.

entity required to report fails to do so for a tax year within the prescribed deadline or makes a false statement in the tax return, the MS must impose an administrative pecuniary sanction equal to at least 5% of the undertaking's turnover in the relevant tax year.
As part of the final execution, the European Commission will monitor the correct implementation and enforcement of the directive, on the other hand the MSs have to communicate to the Commission specific information and statistics on the measures adopted.

3.1.2.9. Monitoring and entry into force

For each tax year, Article 16 requires to MS to report to the Commission the number of undertakings, penalties for non-compliance, number of undertakings presumed not have minimum substance, number of rebuttals and exemptions, number of audits requested and received, number of requests for exchange of information. All this information will be taken into accounting for the report that the Commission shall present by 31 December 2028. With Article 18 the Commission sets a deadline (30 June 2023) for Member States to adopt and publish, the laws, regulations and administrative provisions necessary to comply with the Directive, which shall be applied from1 January 2024. Moreover, the text of the main provisions must be communicated to the Commission. As stated in Article 19: "The Directive shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union."

3.1.3. Gateways

In order to restrict the Directive scope to the undertakings that really run the risk of being found to have minimal substance and used with the primary intention of obtaining a tax advantage, the European Commission establishes a gateway criterion, in the form of a set of three cumulative, indicative conditions. In accordance with Article 6 of the *Unshell* Directive:
"*Member States shall require that undertakings meeting the following criteria to report to the competent authorities of Member States in accordance with Article 7:*

(a) *more than **75%** of the revenues accruing to the undertaking in the preceding two tax years is **relevant income***

Since it is typically more difficult to determine the location where operations are really carried out, a first step should make it possible to identify businesses that are presumably engaged primarily in geographically mobile economic activities. Such actions typically result in significant passive income flows, which often result as primary source of income, satisfying this requirement. Moreover, it should be remembered that organizations keeping assets for private use, such as real estate, yachts, aircraft, artwork, or equity alone, may run for longer periods without receiving an income, but they still get large tax benefits from having those

assets. Article 4 specifies which categories fall under 'relevant income': 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.

(b) *the undertaking is engaged in* ***cross-border activity*** *on any of the following grounds: (i) more than* ***60% of the book value*** *of the undertaking's assets that fall within the scope of Article 4, points (e) and (f), was located outside the Member State of the undertaking in the preceding two tax years; (ii) at least* ***60% of the undertaking's relevant income*** *is earned or paid out via cross-border transactions*

A second condition should apply to businesses that engage in cross-border activities since circumstances that are strictly domestic do not threaten the single market and are best handled locally. Given that entities that only hold assets for private, without running a business, may not engage in transactions for a significant amount of time, it is important to consider the nature of the undertaking operations as well as its property when determining whether to engage in cross-border activities. Paragraph two of Article 6 specifies to which 'regulated undertakings[164]' this condition shall be applied

(c) *in the preceding two tax years, the undertaking* ***outsourced the administration*** *of day-to-day operations and the decision-making on significant functions"*

The third requirement should highlight those businesses that lack sufficient or appropriate internal resources to carry out fundamental management tasks. To maintain a legal and tax presence, undertakings that do not have adequate own resources frequently contract with third parties for administration, management, correspondence, and legal compliance services, or they enter into agreements with related businesses for the supply of such services. This phenomenon may not be sufficient to satisfy the condition, e.g., when just some auxiliary services, such as bookkeeping, are outsourced, while the core activities are still carried out by the enterprise. Even if these suppliers of services are regulated, this may not be sufficient to reduce the danger

[164] Credit institutions; investment firms; alternative investment fund manager (AIFM); alternative investment fund manager (AIFM); insurance and reinsurance undertakings; pension institutions operating pension schemes which are considered to be social security schemes; a central counterparty; a central securities depository; an insurance or reinsurance special purpose vehicle; an insurance holding company; a payment institution; an electronic money institution; a crowdfunding service; a crypto-asset service provider. For further details see Article 6 paragraph 2, COM(2021) 565 final, p.26-27-28.

that they will aid the creation and upkeep of business aimed at tax avoidance and evasion practice.

The Directive, in the second paragraph of Article 6, provides for some exceptions, specifying which are the categories[165] that are not subject to reporting. The reason is that these activities are subject to an adequate level of transparency, so they do not present a risk of lacking substance for tax purposes. Among the entities that could be excluded from the purpose of the Directive can be mentioned companies with transferable securities admitted to trading or listed on regulated markets or multilateral trading facilities, as well as specific financial undertakings, since are heavily directly and indirectly regulated in the Union, as well as subject to more stringent transparency requirements and supervision. Another category which is not in the position of benefits from tax advantage is the one of pure holding undertakings that are located in the same country as the operating subsidiary and their beneficial owner(s) are also unlikely to be beneficial. The same reasoning can apply to sub-holding companies that are in the same country as their shareholder or ultimate parent company. For the purpose of legal certainty, also businesses that employ a sufficient number of people, full-time, and solely to carry out their operations should be excluded.

It is important to notice that in this set of gateways examined to identify potential letterbox companies is always present the formula "*in the preceding two tax year*", which means that the retroactive effect applies as of 1st January 2022.

3.2. Doubts and opinions on the Unshell Directive Proposal

Meuwissen (2022)[166], in his paper "The European Commission's Unshell Proposal: Substantive or Not?", claims: "Comparing this proposal with earlier directives, it stands out as much more aggressive by requiring that shell companies be fully disregarded and providing a minimum penalty for noncompliance"[167]. However, he argues that the substance requirements are not particularly onerous, so countries with experience in this area might believe that the directive needs more stringent regulations. Additionally, he asserts that being the substance requirements not particularly onerous, the proposal targets shell companies in its entirety.

[165] These are: "companies which have a transferable security admitted to trading or listed on a regulated market or multilateral trading facility; 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; undertakings with at least five own full-time equivalent employees or members of staff exclusively carrying out the activities generating the relevant income".

[166] Meuwissen R., 2022, The European Commission's Unshell Proposal: Substantive or Not?, Tax Notes International, volume 105, p.1255-1261.

[167] Ibid, p.1255.

Roumen et al. (2022)[168] highlight that the directive does not provide a standard definition of shell entity, since its aim is not necessarily to discourage the use of shell entities but to deny certain tax benefits to them, trying at the same time to introduce a minimum level of harmonization, but still allowing MS to apply their domestic rules. So ATAD III does not prohibit the use of shell entities, but just aims at reducing their benefits. According to authors, among the three gateway criteria, "the outsource gateway is the pivotal one". It must be investigated to determine whether tax benefits can remain available once the Unshell Directive comes into force. Since outsourcing in not just confined to third party situations, but includes also intragroup ones, they raise the issue that in the particular case in which "one director is employed by a shell and the other one is not, neither the provisions nor the recital 5 of the preamble, provides any direct guidance on how to deal with a partial outsourcing to a third-party trust director". Moreover, according to the directive, services of an auxiliary nature are allowed to remain outsourced, but neither recital 5 of the Preamble, nor the provisions, give details about when services can be considered auxiliary.

Also, Tolman and Molenaars (2022)[169] report that the directive does not provide any guidance on how to interpret gateways, especially the outsource one, which is also the one that raises the highest number of questions. However, it is not clear whether, for instance, outsourcing administration to another EU group entity, or even a group entity in the same MS, would also qualify. The concept of outsourcing is not fully explained, but it appears to target entities that depend on reputable third-party service providers. Furthermore, it is unclear whether outsourcing only administration, and not the decision-making fulfils this requirement. Reading literally the directive text should lead to confirm that the latter should not be the case.

Offermanns (2022)[170] highlights another interesting point regarding the broad definition of relevant incomes. What is surprising, according to the author, is the inclusion of immovable property, in particular gains from the sale of real estate, because it is difficult to see how it may be used to improve cash flow since it is always subject to taxation in the situs state. A similar observation has been made by Meuwissen, indeed, according to him, the inclusion of immovable property, which is by definition not mobile, is at odds with the fact that the directive aims to target businesses who participate in geographically mobile cross-border activity. In addition, the authority to tax income and capital gains from the sale of real estate is also being swiftly transferred to the nations where the property is located. The author highlights that these

[168] Roumen R., Drijer H., Pancham S., 2022, The Draft EU ATAD 3 Directive: No Tax Benefits for International Shell Companies, Tax Notes International, volume 105, p.1517-1526.

[169] Tolman C., Molenaars M., 2022, The Unshell Directive and Its Impact On Dutch Holding Structures, Tan Notes International, volume 106, p.99-105.

[170] Offermanns R., 2022, The Proposed Unshell Directive – The Luxembourg and Netherlands Approach, European Taxation, 2022 (Volume 62), No. 6.

elements seem to lend credence to the idea that the directive may have also another scope: "preventing the concealment of ownership of specific types of assets". The same is true for high-value properties, which are typically taxed in the nation where the corporation has its tax residency and does not have any cross-border components.

The lack of guidance for the interpretation of minimum substance indicators is also noteworthy. For instance, it is unclear what exactly is meant by "*having its own premises or premises for its own use*" or whether it is permitted for numerous companies to share the same premises when they are all based in the same MS. Regarding the resident director, it is also unclear whether a director would be regarded as qualified and how this would be determined. Another crucial consideration is that, to ensure a level playing field, Member States should preferably coordinate their interpretation of the rules. For this reasons Tolman and Molenaars asserts that the Unshell guideline should provide greater information on the gateways and substance indications, ideally with examples and cases.

The two-year lookback principle is another remarkable topic on which Roumen et al. and, Tolman and Molenaars express their views. Given that the European Commission has set January 1, 2023, as the deadline for transposing the Unshell Directive into national legislation and has specified January 1, 2024, as the effective date, thus far it is unclear how will implement the lookback concept and when the appropriate organization should register or disclose it. According to Roumen et al. (2022), the retroactive effect violates the principle of legal certainty and is not justified by the abuse qualification, suggesting the application of the "*two preceding tax years*" starting from 1 January 2024, postponing the starting date to 1 January 2026. Tolman and Molenaars (2022) report as possible unclear situation the following one: "For example, if the entity outsources its administration and decision-making for the first six months of 2022, but not for the remainder of 2022 and 2023, it is unclear whether this means that the third gateway will be immediately satisfied"[171], suggesting that further clarification would be helpful, and, considering the brief period of time between the publication of the directive and the rules being applicable, some indulgence would be acceptable.

Another notable aspect reported by Tolman and Molenaars refers to carveout that the directive applies to certain entities, such as specific regulated financial entities or tax transparent partnership, which are not obliged to reporting. They raise the issue of hybrid entities, since looking at the directive it is not clear if this kind of entities is out of scope or not.

The possibility of exemption, which can be required making a comparison of liabilities with and without considering the conduit, point out the issue about when the evidence resulting from

[171] Tolman and Molenaars, p.100.

the comparison of tax due can be considered ‘objective’. Indeed, it is not clear if objective would mean that the evidence cannot be provided by the company, but a third party is necessary, moreover, in the latter case it would lead to an increase of administrative costs. Furthermore, if this implies that tax profiles from different investors are necessary, it may be very challenging to reach a comparability evaluation (for example, for fund structures). Tax authorities may have varying interpretations of whether the exemption can be satisfied because the evaluation is inherently subjective. Meuwissen (2022) observes that the rationale for exemptions varies.

Indeed, for transferable security (admitted to trading or listed in regulated market) and for regulated financial undertakings the reason is that being subject to financial regulatory provisions there is sufficient transparency in the eyes of the European Commission. On the other hand, for companies whose active subsidiaries and beneficial owners are all residents in the same MS, the reason is the low likeliness to be established to cause tax avoidance. Lastly, in the case of companies with at least five full-time employees, the idea is that they are expected to have sufficient substance. The variety of justifications show that ATAD III has a wide range of objectives and that the integration of all these purposes in a single piece of legislation is confusing.

For what concerns the right of rebuttal, according to the directive companies should be allowed to rebut the presumption of shell proving “that the undertaking has performed and continuously had control over, and borne the risks of, the business activities that generated the relevant income or, in the absence of income, the undertaking’s assets”. Meuvissen observed that this clause appears to permit an economic assessment of the company's position within the group. The problem is that a corporation may face the risks associated with the dividends, interest, and royalties it has earned and choose on its own whether to continue distributing the profit or reinvest it. This key element is difficult to demonstrate via content requirements, so it is very difficult to stablish if tax officials will accept that defence.

Since the right of rebuttal can be exercise only by submitting a tax return, which is typically done at least a few months after the end of an entity's tax year, a big issue may rise. Given that a few more months may pass until the authorities evaluate the response, the entity will go through a long period of uncertainty. In this time laps the entity would be subject to the tax repercussions, such as unnecessarily withholding taxes, due to the presumption of guilt, until the conclusion of the rebuttal process.

In tax audits, the problem of time rises once again. When a MS requests to another MS to perform a tax audit, the latter has one months’ time to do it, according to the Directive. This could add a significant administrative burden on taxpayers and tax officials, since ATAD III also includes noncompliance sanctions.

For what concerns the consequences provided by the Unshell Directive, when a company at risk is labelled as shell seems that should be ignored by the EU country of the shareholder, as if income had accrued directly to the shareholders, and, the tax that the shell firm paid must be deducted by that state. This increases the possibility of double taxation. The issue is that it is uncertain whether the deduction will be sufficient to neutralize that risk, as limitations may apply. If the shareholder's nation is not in the EU, but in a third country, it is unclear if that nation will offer relief for the tax paid by the shell company. Since the proposal applies only if the shell company is resident in EU MS, the tax residencies of the shareholders and subsidiaries could have different tax consequences.

As provided by the directive, without a residency certificate, company will no longer be entitled to treaty benefits. Many experts raise the question about whether it is lawful to deny benefits under a bilateral convention only because of an EU directive. Meuwissen (2022) argues: "The obligation to disregard a shell company could conflict with a member state's obligations under tax treaties concluded with other Member States. Although secondary EU law such as directives have priority over treaties concluded between Member States, directives cannot directly impose obligations on individuals or companies in the absence of applicable national legislation. That depends on whether a member's constitutional system gives priority to tax treaties over domestic rules (which implement EU directives), as well as whether a principal purpose test is included in the relevant treaty and applies in the case at hand. Tax authorities are likely to argue that the test applies to companies that are affected by the Unshell proposal and that the treaty therefore does not apply, meaning there is no conflict between the national laws and the treaty."[172]

Interesting is the observation shared by Meuwissen at the end of his analysis. The author is surprised that among all the documents supporting the proposal, the European Commission avoided reference to significant case law of the Court of Justice of the European Union, such as the so-called Danish cases of 2019[173], which, according to him, provide an excellent framework for determining substance requirements in cases of treaty shopping. He asserts: "After studying the proposal, I suspect that was intentional as the European Commission attempts to lower the bar set by the CJEU"[174].

The European Commission left ample room for feedback on the proposal, among them the

[172] Meuwissen, p.1256.

[173] Denmark v. T Danmark, joined cases C-116/16 and C-117/16 (CJEU 2019); and N Luxembourg 1 v. Denmark, joined cases C-115/16, C-118/16, C-119/16, and C-299/16 (CJEU 2019). For related analysis, see Roland Meuwissen, 2021, The Dutch Take on Antiabuse Rules and Conduit Companies in the Context of the CJEU's Danish Cases, Tax Notes Int'l, p. 405.

[174] Mauwissen, p.1256-1257.

opinion of the European Economic and Social Committee (EESC)[175] is particularly noteworthy. The EESC fully support the Commission proposal and the idea to create a common framework among MSs to combat shell entities misuse, appreciating the wide public consultation launched by EU. Despite the warming welcome, they highlight some main points about which they are concerned. According to them, "the substance requirements do not recognise the digital side and only emphasise the importance of tangible assets"[176], leading to possible problems in the future. They suggest to the Commission, to issue appropriate guidelines regarding the substance test, inviting to give more detailed meaning of specific terms such as 'residence', 'resident director' and 'premises'. In this way, national discrepancies, and divergent interpretations, which are potentially harmful for the internal market, could be reduced or better addressed. Moreover, the EESC specifically demands that the Commission properly considers new digital business models in this regard. Other important aspects highlighted are the need to accurately justify the list of companies not subject to reporting[177] to ensure that they do not benefit from an inappropriate tax advantage and avoid their use to circumvent the law; and the need of an effective and complete EU list of non-cooperative tax jurisdictions, to implement effective actions to ensure transparent management and exchange of funds and assets between entities inside and outside EU. Another critical point regards the so-called 'professional enablers', which are never mentioned in the proposal, but most of the time manage or collaborate with chains of shell companies favouring criminal activity and tax evasion. According to the criteria outlined by the OECD, the EESC advises that the rules governing the activities of professional enablers must be defined in a different legislation. Therefore, the EESC emphasizes the necessity of pursuing professional enablers who intentionally provide possibilities to use illegal activities that encourage financial and fiscal crime. Other two important aspect that, according to the Committee must be treat, are the establishment of a transfer pricing directive and the possibility to address those shell companies created and used to facilitate undeclared work and avoid social security contributions.

The *Unshell* proposal still needs to be voted on by the EU Council. It is uncertain whether the Commission will be able to obtain 27 votes in favour given the directive wide-ranging effects. The directive will have a strong impact on many European holding structures, even though there are still many unanswered problems, and it is not clear how certain circumstances should be read. Given that the examination of the gateways considers the previous two tax years, it is

[175] European Economic and Social Committee, 2022, Opinion of the European Economic and Social Committee on the Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (COM(2021) 565 final — 2021/0434 (CNS)), Official Journal of the European Union, C 290/45.
[176] Ibid, ph.4.
[177] Article 6 (2), COM (2021) 565 final

crucial for European firms to analyse their organizational structures immediately and determine whether ATAD III would be applicable. As of January 1, what is happening now might already be significant.

3.3. The impact of ATAD III in European Tax Heavens

Despite being premature assess the possible economic impacts of ATAD III, because of data limitations due to lack of definition, the Directive asserts that the hard law option is expected to have a positive impact. The main expected benefit is a future increase in the amount of tax revenues collected and a reduction of shell entities' misuse in EU. Other effective outcomes will be obtained through the exchange of information between Member States, a common sanctions regime at EU level and the regulatory charges due to the sanctions. The initiative will also provide significant indirect benefits; indeed, information collection should lead to a better understand of the phenomenon of shell entities. On the other hand, according to European Commission, these measures will increase tax compliance costs for both businesses and tax administrations, but in a limited manner, due to the limited number of companies in scope and the availability of additional reporting. To administer the new information system, an expansion of tax administration capabilities is necessary, but also an enforcement of the proposed sanctions. A negative aspect is the risks of insufficient capacity and deployment of forces by MSs to deal with the new responsibilities, among which the management of tax rulings.

The Directive will not affect in the same way all European Member States. As reported by the surveys conducted by the European Parliament[178] (2018) and Oxfam[179] (2021), seen before, EU jurisdictions that registered the highest number of shell companies are Luxemburg, Netherlands, Belgium, Ireland, Cyprus, and Malta; so, according to Meuwissen (2022), are them the real subjects of the Directive, since these countries have also the highest amount of FDI. At least for the foreseeable future, the number of passive income entities and the amount of FDIs, especially in European tax havens, would be expected to sharply reduce or even postponed until the final implementation of the Directive. Indeed, the entities that deal with passive income (although may be considered conducting substantive economic activities according to domestic law of the states) will try to avoid the additional compliance costs arising from the ATAD-3, or the possibility of changes in the requirements, also taking into consideration the possibility to find other tax-friendly countries outside EU. The Directive is

[178] European Parliament, European Parliamentary Research Service, authors: Kiendl Krišto I., Thirion E., 2018, An overview of shell companies in European Union, STUDY EPRS, Ex-Post Evaluation Unit and European Added Value Unit, PE 627.129, Brussels.
[179] Oxfam International, 15th February 2021, Time for a real reform to stop tax havens escaping the EU blacklist, available at: https://www.oxfam.org/en/press-releases/time-real-reform-stop-tax-havens-escaping-eu-blacklist

another puzzle piece of the measures drawn on Action 5[180] of OECD BEPS project. What is worth noting is that the EU began imposing economic substance requirements for particular businesses operating in non-tax jurisdictions like the Cayman Islands, Jersey, and Mauritius, with the risk of being added to the EU blacklist. Ironically, the substance standards those nations implement are typically more burdensome than those of the Unshell. The same argument applies to Netherlands and Luxembourg, as explained by Offermanns (2022) in its article 'The Proposed Unshell Directive: The Luxembourg and Netherlands Approach'.

As previously said in Chapter 2, both Luxembourg and Netherlands tax systems are truly attractive locations in which establishing a conduit company. Among their main advantages worth mentioning are no withholding tax on outbound interest and royalties, 15% withholding tax on dividends, a useful treaty network. Nowadays, Luxembourg agreed on 85 tax treaties, while the Netherlands 95, most of which guaranteeing a withholding tax rate on interest and royalties between 0% and 10%, being resident[181] in one of these countries. In both cases interest and royalties can enter at a low rate and be redistributed tax exempt. Another advantageous point is that both countries have a participation exemption under which inbound and outbound dividends are exempt if certain conditions[182] are met. Until few years ago it was so easy to obtain a ruling in these countries. In Luxembourg the situation changed in 2015, after *LuxLeaks,* when tax ruling practice was codified in Article 29a of the Corporate Income Tax. Tax rulings are now granted for a period of maximum 5 years for requests concerning the application of Luxembourg domestic and international tax law to one or more specific transactions that are envisaged by the taxpayer. In this way the legislator aimed to a more transparent practice ensuring, in the event the ruling is denied, no recourse is available. Moreover, tax rulings are

[180] Harmful tax practices, Action 5 Report (OECD, 2015) is one of the four BEPS minimum standards. It involves two distinct aspects: a review of certain preferential tax regimes and substantial activities in no or only nominal tax jurisdictions to ensure they are not harmful, and the transparency framework.

[181] Luxembourg: a company is deemed to be resident if its statutory seat or place of effective management is established there. Such companies are treated as a resident taxpayer in respect of dividends, interest and royalties received even if they have little substance, unless the place of residence is allocated to another state by the tiebreaker rule of a tax treaty. Such a company can obtain a certificate of residence and, as a result, benefit from treaty benefits.
Netherlands: a conduit company is deemed to be resident, for treaty purposes, despite having limited substance if the management takes place there, specifically if at least 50% of the directors are resident there and board meetings are held there.

[182] In the case of Luxembourg, the participation is exempted if a minimum participation of 10% is maintained in a subsidiary or a participation with an acquisition price of at least EUR 1.2 million (EUR 6 million for capital gains) in the capital of the subsidiary, for a period of at least 12 months. The Netherlands grants the participation exemption in respect of inbound dividends, other profit distributions, currency gains (or losses) and capital gains (or losses) upon the disposal of a qualifying participation or part thereof if the recipient Netherlands company retained a 5% shareholding in a domestic or foreign subsidiary. The participation must be held for business reasons and may not be kept as a mere investment and the receiving company or permanent establishment (PE) located in the Netherlands must be fully subject to tax. The exemption also applies when a subsidiary, 50% or more of the assets of which consist in portfolio investments, is taxed in its state of residence at a statutory rate of at least 10%. The participation exemption ensures that Netherlands companies can compete in foreign countries under the same fiscal conditions as resident companies of that country. (Offermanns, 2022)

no more tools to obtain advance certainty on the taxable profits derived from inbound and outbound payments.

For what concerns Netherlands, for decades ruling practice was based on a General Decree and related Decrees[183], but all standard rulings were abolished in 2001. From that moment on tailor-made advance tax rulings and advance pricing agreements could be issued only on a case-by-case basis. In 2019, some changes have been introduced in the rulings field, among the most important features noteworthy is the economic nexus requirement[184]. This requirement means that, to obtain a ruling, conduit companies must be part of a group that operates in the Netherlands on a commercial basis, in addition other elements are taken into consideration, such as the number of employees and the level of operating costs, which have to reflect the functions of the company. Tax administration monitors from which countries the money flows are coming, to which countries the money flows and which activities are carried out in the Netherlands. This new measure marks the end of pure conduit companies established in the Netherlands mainly for tax saving reasons.

Offermanns identifies other significant non-fiscal factors that favour the establishment of conduit entities in European tax haven countries. The main are a reliable (digital) infrastructure, a well-trained workforce, efficient and predictable regulations, legal and political systems that provide security and stability and a large and sound legal infrastructure. Nowadays, in Netherlands, a company can be incorporated rapidly, and its corporate structure can be changed easily. A minimum amount of capital[185] and auditor statements are no longer necessary. Shares may be issued with low nominal values, without profits or voting rights, or even with multiple voting rights. Additionally, it is possible to split the profit and voting privileges associated with shares. Through this approach the voting rights are given to a trust office foundation while the owner of the shares maintains the right to receive dividends and profit. It is also feasible to issue various share classes with various voting rights. Implementing capital changes, including share premium payments, share cancellations, and share repurchases, is comparatively simple. Regarding Luxembourg, its corporate law permits the establishment of a simplified limited liability company with a paid-up capital that must range from EUR 1 to 12 000; however, it may only be used to practice certain liberal professions, as well as the trades of craftsman,

[183] Standard tax rulings addressed issues regarding the consequences of moneylending, which made the Netherlands an attractive conduit country.

[184] The operational activities must be at the expense and risk of the requesting party. An advance tax ruling will not only be denied in the event of insufficient economic nexus with the Netherlands, but also if obtaining a tax savings in the Netherlands or a foreign country is one of the main aims of a transaction or when a low-tax jurisdiction is involved.

[185] Before 2012, the Netherlands required an amount of EUR 18,000.

merchant, and manufacturer. Another interesting aspect is that Luxembourg and the Netherlands have signed 90 investment protection agreements (IPAs).

After having introduce the actual situation in the field of fiscal and non-fiscal advantages of Netherlands and Luxembourg, it is interesting deepen the already existent domestic tax measures affecting shell entities in these two countries and their reaction to the new ATAD III proposal.

3.2.1. Netherlands reaction: 'an indispensable measure'

As a result of the EU Anti-Tax Avoidance Directive and the negative reputation of Netherlands as a conduit, its legislator has taken various measures to reduce its attractiveness to shell entities. These measures are quite similar to those of Luxembourg, but the Netherlands started the process earlier.

Table 7- Netherlands already existent tax measures affecting conduit companies

SUBSTANCE [186]REQUIREMENTS	• at least half of the board members with decision-making authority reside or are established in the same jurisdiction as the recipient of the dividend • these board members must possess the professional capabilities to adequately perform their tasks • there must be qualified staff to execute and register the taxpayers' activities, the dividend recipient must incur salary costs of at least €100,000 • the board decisions must be taken in the Netherlands • the key bank accounts must be held in the Netherlands • the accounting records must be kept in the Netherlands • the address of the taxpayer must be in the Netherlands • the taxpayer must, to his knowledge, be a tax resident of another country • the taxpayer must assume real risks as regards the loans or royalty/rental/lease agreements • the taxpayer must hold an amount of equity commensurate with the real risk he runs • the dividend recipient's books are managed in its jurisdiction of establishment
ANTI-ABUSE CONCEPT	Under the Netherlands anti-abuse provisions, artificial or simulated transactions are ignored based on a determination of the actual facts of the case. The "just levy" principle included in article 31 of the General Tax Act allows the tax authorities to ignore legal acts for tax purposes with the prior approval of the Ministry of Finance, but this provision, however, is not currently applied. Instead, the abuse of law principle (fraus legis) developed under the case law is used. This principle applies to artificial transactions that are predominantly aimed at avoiding taxation and that violate the object and purpose of a tax law. Under this principle, the spirit of the provision matter, not the wording. If the conditions of this principle are met, a transaction is converted into the closest equivalent that does not give rise to abuse. As the fraus legis concept is perceived as working well, the Netherlands has not introduced the ATAD GAAR.

[186] According to the State Secretary for Finance (2012), the substance of companies refers to recognition/visibility on account of ownership, the use of tangible assets, or staff. With regard to agreements or facts, this means "economic reality" as opposed to what appears on paper, similar to the substance-over-form doctrine. Substance refers to the nexus which a company has with the country in which it is established, so the level of connection it has with that country. "Substance poor" means that a company has little nexus with the pertinent country. When a company is "substance rich", it will instead have stronger ties.

CFC LEGISLATION	2019→CFC rules attribute the non-distributed income of an entity or PE that qualifies as a low-taxed CFC to its Netherlands parent company or headquarters, provided that the non-distributed income arises from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. In addition, the CFC legislation is applied to certain types of income, including dividends, interest, royalties, lease payments, benefits from insurance, bank or other financial activities and income from invoicing activities that add little or no economic value. The CFC legislation applies to entities in which a Netherlands parent has a 50% direct (or indirect) participation, ownership interest or entitlement to an interest in voting, capital rights or profits. A CFC is regarded as low-taxed if the corporate income tax rate is lower than 9%. The CFC legislation also applies to countries that are on the EU list of non-cooperative states.
TAX TREATIES	2013→ to reduce the effect of conduit companies, the Netherlands developed a policy to include anti-abuse provisions in its tax treaties. As a result of this policy, the Netherlands approached many developing countries to add such provisions to the existing tax treaties. These clauses mostly take the form of a principal purpose test (PPT), which the Netherlands has also opted for under the MLI. Under this test, tax treaty benefits, such as the treaty withholding tax rates, are denied if the main or one of the main reasons for entering into an arrangement was to obtain treaty benefits. In making this determination, open norms are used, such as the intention behind a structure or arrangement, which should guarantee that real economic activities are not impacted. In addition, treaty benefits will nevertheless be granted if those benefits would have applied even if the relevant structure or transaction had not been put in place. The Netherlands will always consult the other treaty partner before denying treaty benefits based on the PPT
WITHHOLDING TAX MEASURE	• *Withholding tax obligation for holding cooperatives*→ before 2018, cooperatives were often used as an interposed vehicle in the Netherlands because such entities were not obliged to withhold dividend withholding tax. The shares of a Netherlands holding company were often owned by a Netherlands cooperative, in this way dividend distributions to the cooperative were tax exempt in the Netherlands, whereafter the cooperative could redistribute the dividends to a foreign entity without dividend withholding tax becoming due. Since 2018, holding cooperatives, the actual activities of which consist mainly in the holding of participations or the direct or indirect financing of affiliated entities or individuals, are obliged to withhold tax. • *Conditional withholding tax on interest and royalties* → from 2021, the Netherlands Bureau for Economic Policy Analysis has established that a conditional withholding tax should make the Netherlands less attractive to conduit companies. The tax is imposed on interest and royalty payments to related companies established in low-tax jurisdictions with a statutory tax rate of 9% or less or in a country that is on the EU list of non-cooperative states. The Netherlands treaties with Bahrain and the United Arab Emirates do not authorize the Netherlands to impose any withholding tax on interest and royalties, while the treaty with Barbados provides for a 5% withholding tax on royalties, with Oman an 8% and the treaty with Panama a 5% withholding tax on interest and royalties. For Bahrain, Barbados, Oman, Panama and the United Arab Emirates, the conditional withholding tax does not apply until three calendar years after the state is first designated as a low-tax jurisdiction under the applicable ministerial regulations have passed. During this period, the intention is for the Netherlands to renegotiate the treaty. If this does not appear to be possible, the Netherlands may try to invoke the PPT under the MLI. Bahrain, Panama and the United Arab Emirates also have all opted for the PPT under the MLI, which means that this test could by applied by both countries in the event of treaty abuse. Tax can be due even where payments are made in respect of genuine business activities, showing that the efforts being made to diminish the reputation of the Netherlands as a conduit country trump any economic considerations, such as avoiding situations of double taxation.

DAC6	To provide more clarification and certainty on the practical application of the main benefit test and its related hallmarks, the Netherlands tax authorities have issued guidelines and have also created a knowledge database on mandatory disclosure rules/DAC6. This knowledge database indicates that taxpayers may request an advance tax ruling to determine whether or not the main benefit test has been met. What is decisive in applying this test is that the arrangement would not be implemented without the expected tax advantage, or that elements are added to the arrangement that result in a tax advantage. Consequently, it must be investigated whether or not the result of an arrangement would have been the same without the application of the tax rules. In that instance, the arrangement is not tax driven. Whether or not the main benefit test has been satisfied must be assessed on the basis of objective factors. The taxpayer's subjective intention is not relevant here, but the intent of the legislator may be an element to consider when making the assessment.

Source: rework version of the reconstruction provided by Offermanns (2022) in its article 'The Proposed Unshell Directive: The Luxembourg and Netherlands Approach', p.18-25.

As observed by Meuwissen (2022), Netherlands substance requirements, even if stricter, are largely similar with the ones of the Unshell Directive. The most striking difference stays in the directors and employees' requirements, which are much less burdensome in the proposal that asks for only one director to show authority, qualification, and actual use thereof. On the other hand, the Netherlands requires that the majority (at least half) of directors meet the requirements and imposes also the minimum wage. A central element of ATAD III director requirement is "at least one company director may not be an employee of an enterprise not associated with the company". Its purpose is avoiding directorship outsourcing and trust-service providers' administration, delating the need to have local decision-making by in-house directors. The author asserts that this element combined with the third gateway, clearly put in evidence the proposal's risk-based approach: "If the other gateways are met, those companies must report whether they meet the substance requirements. If they have outsourced all directors, they do not meet the substance requirements, with all consequences thereof. […] Outsource one director and you must report that, so it becomes clear whether you have outsourced too many directors."[187] Holding corporations in nations like Ireland, the Netherlands, and Luxembourg will be significantly impacted by this. To assist the directors who are also directors or employees in other firms of the group, trust service providers frequently offer directors for the corporation in such countries. Meuwissen raises the issue about the interpretation of what *functions' outsourcing* actually means for the third gateway. In the case in which service providers give their help with the preparations for taking decisions regarding significant functions but the directors, that are also employed elsewhere in the group, remain responsible of the last say, the directive does not provide a clear solution. Indeed, it is unclear if the outsourcing must be interpreted more broadly to include also outsourcing to group companies or personnel. While the European Commission's direction in this field is uncertain, the Dutch

[187] Meuwissen, p.1260.

content requirements offer some useful guidance on standards for directors, such as the cost of salary requirement. Despite that, it is important to bear in mind that the directive is a minimum standard, which does not limit MS power to impose more stringent requirements.

Another difference can be observed for what concern premises. In Netherlands is required that: "The dividend recipient must have its own office space at its disposal in the jurisdiction of establishment for at least 24 months". This requirement will most likely undergo changes as the Unshell proposal seems more restrictive and closed to exclusivity than the Netherlands, which merely look at availability of premises to the firm, meaning that an office can be shared as long as it is open to the company.

Offermanns (2022) highlights that in reaction to the Ter Haar report[188] (2021), the Netherlands are implementing many measures to combat abuse and indirectly shell entities, among them the conditional withholding tax on interest and royalty payments to low-tax countries; the planned conditional withholding tax on dividends (2024); an increased exchange of information where companies lack substance, a reduction in the EBITDA (from 30% to 20%) with regard to the restriction on the deduction of excessive interest; the tackling of treaty abuse by means of the PPT. It is important to notice that Netherlands already exchanges information about (financial) service companies with a lack of substance, since 2014. Addressed by Committee recommendations, the Netherlands has preferred and continues to prefer multilateral solutions to combat abuse and profit shifting by shell entities. Netherlands supports the new proposal; indeed, they define it as indispensable to create a level playing field and furthers the attractiveness of the Netherlands as investment destination for active companies.

On February 21, the Dutch Ministry of Foreign Affairs submitted its assessment of new Commission proposals, including the draft Unshell directive, to the Dutch House of Representatives. The Dutch government supports the policy goals as laid down in the directive and agrees on the need for an EU approach to effectively prevent the abusive use of shell companies. According to Netherlands, the European Commission has the competence to make such a proposal in order to modify statutory and regulatory laws that have an impact on the functioning of the internal market (this authority is based on article 115 of the TFEU). The new directive also complies with the subsidiarity principle (because conduit abuse cases require EU-level intervention), and with the proportionality conditions, since it clearly defines consequences for shell entities.

[188] Expert Committee established by the Ministry of Finance (Ter Haar Committee) published its report on possible civil and fiscal law changes regarding the taxation of conduit companiesReport of the Ter Haar Committee, October 2021, Towards an acceptable cash flow (traduced from Naar een acceptabele doorstroom). Available at: https://open.overheid.nl/repository/ronl-0816d541-5d35-4413-ae74-f27a7e51a45b/1/pdf/rapport-commissie-doorstroomvennootschappen-op-weg-naar-acceptabele-doorstroom.pdf

Despite its apparent support, the Dutch government expresses its doubts regarding structures involving related companies that are established in third countries. The government thinks that because of the high number of complex actions needed to determine an abuse practice, it may not always be able to exchange information within 30 days. Moreover, it should be ensured that all Member States of associated entities are informed about a structure using a conduit to assure that the proper Member State is levying tax.

Since they perceive the scope of the new directive as very broad, especially in the field of information exchange, with the possibility that it could harm implementation, they suggest that the 30-day information sharing deadline seems impracticable so it should be extended. Taxpayer penalties for non-compliance should be enhanced, and the identification and exchange of information system should be more efficient and better targeted. In addition, a few definitions need to be clarified, namely qualified personnel, the delegation of daily management and decision-making, the participation of personnel in the generation of the relevant income, the implications of the application of tax treaties, and audit requests by other tax administrations on the issuance of residence certificates.

Even if Netherlands government doubts that the Proposed Unshell Directive can be implemented by January 1, 2024, they are optimistic since the proposal ought to improve the Netherlands' international reputation. They expect that ATAD III will generate a strong impact especially on private equity and debt fund structures.

3.2.2. Luxembourg reaction: ‘a disproportionate proposal’

After BEPS project and ATAD I-II, Luxembourg has introduced many domestic tax measures aiming at fighting abuse and conduit companies; among them the legislator increased substance rules, CFC rules, non-deductibility of interest and royalties’ rules, reporting of aggressive planning structures (DAC6).

Table 6- Luxembourg already existent tax measures affecting conduit companies

SUBSTANCE RULES	• the majority of the managing directors that have the power to bind the company towards third persons are resident in Luxembourg. Non-resident managers also qualify if they carry out their professional activity in Luxembourg and are taxed in Luxembourg on at least 50% of their professional income. The manager may also be a company that has its statutory seat and head office in Luxembourg • the directors must have sufficient knowledge to exercise their functions • the majority of the meetings of the board of directors must take place in Luxembourg • a company must have sufficient employees to carry out its activities in Luxembourg, including the execution and registration of company transactions. Auxiliary activities, which do not have a significant impact on risk management, may be outsourced • the important company decisions must be taken in Luxembourg and at least one general shareholders' meeting must be held annually in Luxembourg • the company may not be a tax resident of another country • all substantive documentation, including books must be retained in Luxembourg • books and records (including detailed minutes) must be kept in Luxembourg • signatories to the company's bank accounts must be Luxembourg tax resident directors/persons who are authorized to manage the bank accounts without requiring the approval of non-Luxembourg tax resident directors • the company must have a bank account in Luxembourg • the premises must be owned/leased solely for the company (and associated/group entities) and be appropriately equipped with office furniture and equipment and staffed with adequate personnel
GAAR	Before 2019→ the Luxembourg GAAR allowed, for transactions that were considered fictitious under the simulation principle, to be ignored or reclassified. Therefore, when a legal act or an action was considered simulated, it was ignored for tax purposes. The same approach applied if a transaction was purely tax driven under the abuse of law principle[189]. Under ATAD 1→ the GAAR has been replaced by a new provision, according to which abuse of law occurs if a specific legal route is selected for the main purpose of obtaining a tax advantage, not genuine considering all the relevant facts and circumstances of the case concerned. As a result, the interposition of a conduit company that lacks substance, which aims at mitigating taxes, can be ignored.
CFC LEGISLATION	CFC legislation, introduced in 2019, not specifically to target conduit companies, attributes the non-distributed income of an entity or PE, that qualifies as a low-taxed CFC, to its Luxembourg parent company or headquarters if the non-distributed income arises from non-genuine arrangements that have been put into place for the essential purpose of obtaining a tax advantage. The CFC legislation applies to entities in which a Luxembourg parent holds a 50% direct (or indirect) participation, ownership interest or entitlement in respect of voting, capital rights or profits. A CFC is regarded as low-taxed if the corporate income tax rate is the equivalent of less than 50% of the Luxembourg corporate income tax rate. This is currently 50% of 17%, equals 8.5%. Foreign entities with an accounting profit of less than EUR 750 000 or with accounting profits not exceeding 10% of their operating profits during a taxable period are excluded from the scope of the CFC rules.
I/R	From 1 March 2021→ Interest and royalties paid to or payable to a related enterprise located in a country or territory listed on the EU's list of uncooperative nations and territories are no longer tax deductible.

[189] This principle was included in LU: Tax Adaption law [Steueranpassungsgesetz], art. 6.

DAC 6	25 March 2020→ DAC6 obliges intermediaries or relevant taxpayers to report cross-border aggressive tax planning structures. Reportable structures are listed under certain categories of hallmarks set out in the Directive. Hallmark 3b of this Directive targets schemes that include circular transactions involving funds passing through interposed entities without a primary commercial function or transactions that offset or cancel each other out or have other similar characteristics. This hallmark is implemented by way of an annex to the law and may also target pure conduit companies that are not established for commercial reasons but are mainly interposed for tax savings reasons. In these circumstances, after a favourable tax treatment is obtained, payments return to the Member State of origin. This hallmark applies when a main benefit test is met. Luxembourg administration has announced that the main benefit test is not met when the main benefit obtained from an arrangement is in line with the object and purpose of the legislation or consistent with the intention of the legislator. A structure that, considered as a whole, does not meet this intent, still meets the main benefit test if special features of a tax system are used, or if inconsistencies between two or more tax systems are relied on in order to reduce tax payable. No clarifications have yet been provided, however, in relation to the practical application of any of the hallmarks linked to the main benefit test.

Source: rework version of the reconstruction provided by Offermanns (2022) in its article 'The Proposed Unshell Directive: The Luxembourg and Netherlands Approach', p.15-18.

Offmanns (2020) observes that differently from the substance requirements provided by the proposed Unshell Directive, the Luxembourg's ones results as more onerous, since both the director and the employee requirement must be met, while, under the new directive, these are in the alternative. Moreover, ATAD III does not provide for any bookkeeping requirement and is silent about the organization of board meetings. Yuriko Backes[190] (2022), Luxembourg Minister of Finance, asserted: "Luxembourg generally supports the fight against aggressive tax planning and has proven this over the last few years. In this case, however, we have concerns that the current version of the proposed directive <u>overshoots the mark</u>. Above all, there is the question of the added value of this initiative given the whole range of instruments that have been created in this area over the last few years. These instruments are already being used to combat tax avoidance and the use of company structures for purely tax reasons. Since the criteria of the directive are <u>extremely broad</u> in the current version, there is a <u>problem of proportionality</u>. There is also the risk of new market <u>entry barriers and restrictions</u> that could impair the functioning of the EU internal market. This would then also weaken the competitiveness of the EU compared to third countries. Discussions on this in the Ecofin Council have not yet started. Luxembourg will work towards a solution that is sensible and proportionate. […] Luxembourg has been pro-European from the start and has welcomed EU institutions here. The country has helped shape the EU in many ways and, conversely, has also benefited from the advantages of its membership. There has actually always been a pro-European consensus, which of course also keeps <u>national interests in mind</u>, and the two are not

[190] Ministry of Finance.

fundamentally incompatible."[191] So, despite her support to measures aiming at fighting tax abuse, she reported the idea that the Unshell Directive proposal is disproportionate, highlighting that across all other numerous anti-tax avoidance measures introduced in recent times, ATAD III not seems to offer much added value. Moreover, its scope is overly broad, meaning that it could lead to impediments to enter the Luxembourg market and restrictions that could affect the EU internal market in a negative manner, triggering its competitive capacity with third countries. For these reasons the Minister suggests that Luxembourg would prefer to introduce a more proportionate and useful measure.

Interesting is the feedback sent by the Association of the Luxembourg Fund Industry[192] (ALFI) to the European Commission to share its point of view on the proposed Council Directive. "Past experiences have shown that, the investment fund industry is not always the intended addressee of certain tax measures but that these measures may nevertheless have unintended consequences for the industry. As regards the operational business model of investment funds, having carefully read the text of the Unshell Directive, ALFI considers that it largely disregards the economic reality and the existing operating model of investment funds. By doing so, it indirectly imposes additional requirements to the existing model and additional administrative burdens and costs on the industry that would ultimately translate into increased costs for end investors"[193]. ALFI emphasizes how heavily regulated and subject to mandated EU regulatory frameworks the investment funds sector is. Management companies (including self-managed investment funds) are subject to the authorization and supervision of national competent authorities (NCAs), who demand that their internal structure and core components comply to the legal requirements and specific local NCA standards. Furthermore, in the context of a fund structure, outsourcing and delegation of tasks to organizations sharing the same investment management structure are carried out in line with tight regulatory requirements and are overseen by the management firm or the manager. For these reasons, it would appear inappropriate to assume that the fund structure, especially for companies or SPE, held by an investment fund, lacks substance and adequate own resources. ALFI welcome the Directive's carve out for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIF) as well as to management, but regrets that the same logic was not fully followed through

[191] Ministry of Finance, 10 February 2022, an interview of the Luxembourg Minister of Finance with newsmagazine Telecran, A bunch of advantages (traduced from EinStrauß an Vorteilen). Available at: https://mfin.gouvernement.lu/fr/actualites.gouvernement%2Bde%2Bactualites%2Btoutes_actualites%2Binterviews%2B2022%2B02-fevrier%2B10-backes-telecran.html

[192] ALFI is the representative body of the Luxembourg investment fund community and counts among its members not only investment funds, asset management firms but also a large variety of service providers of the financial sector.

[193] Association of the Luxembourg Fund Industry (ALFI), 2022, Object: Draft Unshell Directive - Fighting the use of shell entities and arrangements for tax purposes Luxembourg, 6 April 2022, p.1.

and that entities held by investment funds were not excluded from the scope of the Unshell Directive, asking inclusion of them into Article 6 carve-out.

In addition, ALFI notes an exponential increase in formalities that will put an unprecedented amount of administrative burden on taxpayers and put tax administrations at risk of having a backlog of assessments due. The enormous administrative burden on both must be weighed against the limited increase in actual tax receipts. ALFI is further worried that the proposed regulations could harm small open economies, which significantly rely on cross-border commercial relationships and structures, and that doing the principle of MSs equality will be violated due to the disproportionate administrative burdens on small MSs.

For what concerns legal certainty, ALFI asks for clarifications on concepts and administrative procedures, such as rebuttal, audits and exemption, to be introduced in the Directive and for ensure harmonized application among EU.

ALFI is also worried about the retrospective clause and the use of a directive as an instrument to combat treaty abuse. Recalling the MLI, which is intended to amend other international treaties, ALFI emphasizes that using a directive that must be transposed into national laws to serve as a legal justification for refusing to apply an international treaty can create complex legal issues that could result in complex cross-border disputes and potential barriers to fundamental EU freedoms. Furthermore, according to ALFI, the Directive creates a competitive disadvantage in relation to third countries, which are not subjected to the same administrative barriers and expenses. Additional expenses have a direct negative effect on the performance of investment fund structures, increasing the cost of doing business in the EU and possibly deterring investment.

Another issue risen is that businesses with sufficient economic substance, which need just a simple tax residence certificate for business-as-usual transactions, may be incur in risks and operating costs because of the lack of responsiveness from the tax authorities, which may lead to legal covenant violations due to time restrictions. ATAD III may create significative competitiveness distortion for EU businesses, since, according to ALFI, it create unnecessary extra barrier to simple non-abusive transactions. Additionally, the sanctions imposed by Articles 11 and 12 of the Directive as currently written and implemented, increase uncertainty regards the access to tax treaties in force with third parties. This, combined with the requirements introduced by ATAD III, could result in facilitating the use of third country entities over EU ones, even when investing in the EU, putting the European Single Market in a clear competitive disadvantage. ALFI fervently urges that any step to address the suspected abuse of corporations lacking proper nexus includes the third country dimension from the outset, or at the very least wait until the measures for non-EU shell firms have been

implemented. “ALFI strongly advocates that any measure to deal with the perceived abuse of companies lacking appropriate nexus should incorporate the third country dimension from the outset, or at least it should not apply until the measures for non-EU shell entities also apply.”[194] In this regard the European Union has already announced in the Q&A session on the Commission’s Proposal, that separate rules will be introduce in order to discourage the use of shell entities located in third countries (ATAD IV), in particular Switzerland, HK, UK, Dubai, Singapore. The EU market will undoubtedly suffer as long as this idea is not driven by the OECD and does not apply to all jurisdictions, including non-EU. The EU entities now covered by ATAD III may decide to relocate outside EU, removing the entities also from EU regulatory oversight.

[194] Ibid, p.5.

CHAPTER 4

FINAL REMARKS

4.1. Take stock of ATAD III

ATAD III represents another puzzle piece that sums to the long list of measures introduced by EU in order to tackle tax avoidance practices. The process, that leads to this new proposal, has been long and still today it is possible to affirm that it is not come to an end.

As deepened in the second chapter, the history of tax avoidance started with the concept of *abus de droit*, developed in French case law under the Civil Code of 1804. The concept becomes a pillar of EU communitarian law, with the power of limiting the unrestricted exercise of fundamental freedoms under the Treaty on the Functioning of the European Union (TFEU).

The critical issue was and still stays in trying to oppose the tax abuse problem, without undermine the four fundamental freedoms and the no discrimination principle. An efficient and fair balance has always been very difficult to achieve and still today raises a lot of complexities. When the European Community was created in the 1950s, the harmonization of direct taxation was not the priority. By contrast indirect taxes represent the main objective to stem the distortion caused by national trade barriers that hindered the formation of the Single Market. Member States maintained their sovereignty in the direct taxation field, leading to the formation of a variety of national tax systems, across which many obstacles, impediments and differences in the definitions and approaches spread. For these reasons, became extremely imperative for EU try to create a common framework especially in the fields of corporate tax base, subsidiaries' taxation, passive investment income's taxation, corporate reorganisations, and anti-abuse rules. Essential was the role of CJEU in addressing many legislative vacuums. Among the established harmonized standards, noteworthy are the Parent–Subsidiary Directive, the Merger Directive, the Savings Directive, the Interest and Royalties Directive, the Mutual Assistance Directive for the Recovery of Taxes, Mutual Assistance Directive for the Exchange of Information. Some fundamental ECJ's cases drove and accompanied this process.

The starting point was the *Emsland-Stärke* case, since in that occasion the ECJ provide for adequate criteria to assess whether abusive behaviour occurs, introducing a two elements test. Other remarkable cases were the *Cadbury Schweppes, Kofoead, Halifax* and *Foggia.* As reconstructed by Panayi*, Zwijnenburg* case led to many doubts about the weather a general principle of abuse of the right was provided by EU. According to De Charette, in *3M Italia Spa* the CJEU confirmed the will to keep separated *abuse of right* doctrines for each taxation field (direct and indirect). Since Member States cannot directly rely on a general principle, they

implement domestic measures to protect themselves from abuse, even if respecting the standard imposed by the CJEU. After that the ECJ clarified that, in unharmonized direct taxation Member States had no obligation to enact measures preventing abusive practices, the trend has shifted towards an obligation imposed on Member States to enact measures preventing abusive tax practices. The turning point came in 2011 with the Financial Transaction Tax (FTT) plan, according to which Member States are not only allowed to take anti-abuse measures, but they are required to do so. This was made further clearer in the second FTT proposal, which included a GAAR. Years of uncertainty and ambiguity ended in 2016, when EU issue the first Anti-Tax Avoidance Directive, which adopted the EU ATAD GAAR.

In spite of the efforts of EU, the complete harmonization is far from here. Many problems are still present, suffice it to know that among MS the definition of tax avoidance, tax evasion, tax abuse have not been standardized and well defined at European level. The lack of harmonized definitions impacts on the treatment of the crime, on who bears the burden of proof, and on how specific tax violations are prosecuted. The result of these chaos is that legislative and juridical authorities share a confused approach. For EU authorities is even more difficult to develop and implement specific instrument to tackle tax avoidance. Moreover, the improper use of the term could violate the legal certainty principle, jeopardizing the accuracy of Court's decisions, and undermining the functioning of the internal market.

Zuckman reminded that the current tax system is still the brainchild of the 1950s. As reported so many times by the literature, in the past years, EU taxation policies had developed in a complex and inconsistent way. Several rules are nowadays outdated and new cooperative solutions, also at global level, need to be found. While corporate income is taxed at national level, business models continue to become even more international, complex, and digital, leading to high compliance costs and double taxation risk.

Globalization and digitalization have completely revolutionized the way of doing business, reshaping economies. Physical presence is no more needed to run a business, and value creation is no more linked to a permanent establishment. Fundamental concepts as tax residence and source on which the international tax system has been based until now, are outdated.

The side effect, born from the globalization and digitalization, is the problem of international tax competition. An issue that in the past, when wealth was anchored to tangible properties, land, and real estate assets, was no warned at all. Nowadays, around the world many countries have started competing to each other to have the lowest rate, contributing to the collective decline of tax rates. In a short-term perspective, MNEs benefit from this low-rate policy since they exploit loopholes between the different tax systems through aggressive tax planning scheme. But, from a long-term perspective, it has a negative development implication for

governments and citizens, undermining trust in institutions and harming the tax system as a whole.

The problem is huge. The European Union computed that every year the compliance gap due to tax abuse in general reach 1 trillion euros. Despite the European Parliament reported a slightly reduction of the gap, suggesting that the fight against tax crime seems, partially, to pay off, the size of shadow economy is still alarming. The problem is exacerbated by the impossibility to really quantify the amount of unpaid revenue, due to the lack of data available. Among the causes of the loss of one trillion euros, we can also include for a sizeable part cross-border tax evasion, especially in corporate tax field. According to the study of Tørsløv and Zucman, EU MSs loose every year the 13% of their CIT due to MNEs artificial profit shifting. Almost 80% of the CIT revenue lost due to artificial profit shifting is in favor of Belgium, Cyprus, Ireland, Luxembourg, Malta and the Netherlands, also called EU tax havens.

To exploit the discrepancies between tax systems, loopholes, advantageous treaties and circumvent obligations, MNEs and wealth people usually implement no-substance entities.

As in tax avoidance case, also the term *shell entity* has not been defined accurately, indeed a general and unique definition is not provided by EU. The term is usually interchangeably used with other term such as letterbox, ghost company, offshore company, paper company, even if they do not denote the same thing. As investigated by the EPRS, three different kind of shell entities can be distinguished: anonymous, letterbox and SPE. Nevertheless, there are a combination of common elements that are shared by all these different definitions: the lack of economic activity in the MS of registration, the ultimate owner residents abroad, few or no employees, little or no production in the host economy, the core business of the enterprise that consists of group financing or holding activities, no bank account. The illegal use of these entities generates three main risks: the anonymity, the treaty abuse (also called treaty shopping), and the circumvention of the Posting of Workers Directive.

Since the data collected by Member States on this phenomenon are scarce, the only sources of information are journalistic investigation and the identification of some fundamental indicators that led to quantify the dimension of the problem. The main indicators investigated in this thesis are the number of foreign owned companies in a MS, the FDI/GDP ratio in EU Member States, the profitability gap between foreign and domestic companies. The results obtained by this analysis are interesting, since the MSs where these indicators are very substantial are Luxembourg, Netherlands, Cyprus, Malta, Belgium, Ireland, confirming which are the countries that benefit from tax avoidance and favour it.

The problem of international tax competition is difficult to eradicate indeed there is no international customary rule prohibiting tax competition between states, moreover a state can

shape its own tax system as it prefers. Another essential aspect is the freedom of establishment, guaranteed by EU and protected by the ECJ case law.

To understand deeply how aggressive tax scheme, such as the Double Irish and Dutch Sandwich, are implemented, and how much conduit countries affect the liabilities due, this thesis investigates the schemes of three important MNEs, namely Apple, Google and IKEA. The first two are an example of how US big IT corporations exploit Ireland shell entities as a conduit for EMEA profit, taking advantage from the lack of withholding tax on outbound interest and royalties, exemption on dividends, a useful treaty network and tax rulings that these states grant to them. On the other hand, IKEA has been selected since its structure is almost totally planned in EU, between Luxembourg, Liechtenstein and Netherlands. The evidence of these studies highlights that European Tax Heavens have been and are still used as conduit for profit shifting, moreover these countries grant a favour treatment to MNE, also through tax aid. What is even more surprising is that, as in the case of Luxembourg, even if DAC6 and other strict anti-tax avoidance measures are in place, the number of tax authorities' employees that should control the registers and illegal practices is too low that is impossible for them implement their function in an efficient way.

In front of these evidence and pushed by the last scandals of *OpenLux* and *Pandora Papers*, European Commission decide to claim the need for an *Unshell Directive*. What differentiate this last ATAD directive from the previous one is that is designed to gather information and create a tool that would apply ex-ante where all the other existing anti-tax avoidance provisions apply ex post. In short, the Directive aims at labelling undertakings as at risk, if they pass the three gateways, otherwise at low risk. To the ones at risk are asked for reporting and a further substance test is applied. To the companies that are qualified with no-substance is given the possibility of rebuttal and exemption. If the company does not exercise these rights, it is considered a shell entity, so consequences and sanctions apply.

With ATAD III, the European Commission has again tried to push the boundaries of its role in matters of direct taxation. For the first time, it plans to enact a legislation that forces Member States to ignore tax treaties they have concluded with other Member States. Despite being positively welcomed as an additional tool in the fight against tax avoidance, many doubts have been raised.

Initially, the directive has been criticised especially because the criteria and its purpose have been considered extremely broad. It does not provide a general definition of shell entities, so in a certain sense it left opens the issue about one standardize definition valid in all MSs. Furthermore, since different substance requirements have been drafted with regard to the different type of entities, many countries ask for more details, in order to clarify to which kind

of shell entities is it address. Specifically, the Directive cannot combat all the types of shell companies, so the scope should be limited regarding the type of entity that EU Commission wants to combat. Another critical point highlighted by Member States and numerous tax law experts, is the lack of guidance to interpret gateways and substance requirements. The gateway that risen the highest amount of perplexity is the outsourced gateway since no details have been disclosed on outsourced auxiliary services and on partial directorship outsourcing. Further details are also needed in the field of relevant incomes since many doubts raised regarding the inclusion of immovable property. This element seems to confirm that ATAD III has more purposes than the declared ones, namely preventing the concealment of ownership of specific types of assets. Other areas from which many questions arisen are minimum substance indicators, carve-outs logic, rebuttal and exemption procedure. Member States are concern about the timeframe that will pass between that exercise of right of rebuttal by a company and its recognition by tax administration. Given that a few more months may pass until the authorities evaluate the response, the entity may go through a long period of uncertainty, tax repercussions and negative covenants. Moreover, moving to ATAD III's consequences, since the directive applies only at EU level, if the shareholder is resident in a third country, it is unclear if that nation will offer relief for the tax paid by the shell company. This creates differences among countries since shareholder and subsidiaries' tax residencies could provide for different tax consequences.

Going beyond the problems of interpretation and the clear need for greater clarity and definition, some issues are given greater weight. First of all, the effective date that the directive set at 1 January 2024, implying that '*the two preceding tax years*' clause is applicable from January 1, 2022. This has created some panic and concern among Member States, as it would mean that the addressees of the directive did not have the time to reschedule or restructure the business before the entry into force of the directive. According to Roumen et al., the retroactive effect violates the principle of legal certainty and is not justified by the abuse qualification, for this reason some indulgence would be acceptable, postponing the effective date to 1 January 2026. Another hot point is the absence of provisions or requirements that recognize the digital side of the economy, since only the importance of tangible assets has been emphasized, confirming that outdated concepts are still in used and perceived as main pillar. Even for this reason European Commission were asked to be more detailed about the meaning of 'residence', 'resident director' and 'premises'. In this way, national discrepancies, and divergent interpretations, which are potentially harmful for the internal market, could be reduced or better addressed. Also, the lack of reference to 'professional enablers' has been noticed.

In the light of these observations, this thesis has tried to assess a possible first impact of the directive. ATAD III measures will not affect all Member States in the same way, as the main recipients are clearly the European tax havens. In these countries, due to the uncertainty regarding the date of application of the retroactive effect, the expected costs, and the foreseen long time it takes for an exemption or rebuttal to be granted, the amount of FDIs is expected to sharply decrease or even postponed until the final implementation of the Directive. On the other hand, to avoid problems or additional compliance costs or the possibility of requirements rearrangements, entities engaged in passive income activities, even if considered as substantive according to domestic law, would choose to find other tax-friendly environments, even outside EU. This will facilitate the movement of shell entities overseas, outside EU, where the directive is not applicable.

Analyzing the reactions of Netherlands and Luxembourg after the issuing of the proposal has been particularly interesting and functional to understand the role of this countries in the international environment. Both countries point out some major unclarities, such as the too broad purpose, and the need of more explicit and detailed guidelines which ensure legal certainty. What is surprising is that these two tax havens already have substance requirements, which are stricter than the one provided by the directive. So, in part they perceived the directive as something too light to add value to the already existing national provisions. Despite that, Netherlands shows to have welcome the proposal in a positive manner, since it ought to improve their international reputation. They expect that ATAD III will affect mostly private equity and debt fund structures. What worries them most are the expected time for the exchange of information (30-days) and the retroactive effect.

On the other hand, the reaction of Luxembourg was particularly negative and mildly argumentative. According to them, the directive overshoots the mark and shows a proportionality problem, moreover it bears the risk to create new market entry barriers and restrictions, jeopardizing EU single market competitive capacity with third countries. Particularly strong has been also the feedback of Association of the Luxembourg Fund Industry, which affirms that the ATAD III largely disregards the economic reality and the existing operating model of investment funds, imposing additional requirements and administrative burdens to an already highly regulated industry. They also recall the MLI, as tool intended to amend other international treaties, emphasizing that the choice to use a directive that must be transposed into national laws to serve as a legal justification for refusing to apply an international treaty can create complex legal issues, cross-border disputes, and potential barriers to fundamental EU freedoms. Furthermore, the Directive creates a competitive disadvantage in relation to third countries, which are not subjected to the same administrative barriers and

expenses. Additional expenses, in fact, have a direct negative effect on the performance of investment fund structures, increasing the cost of doing business in the EU and possibly deterring investment. In conclusion, *Unshell Directive* may create significative competitiveness distortion for EU businesses, facilitating the use of third country entities over EU ones, even when investing inside the EU, putting the European Single Market in a clear competitive disadvantage. Thus, until the same treatment will not be ensured also to non-EU shell entities, EU entities covered by ATAD III may decide to relocate outside, removing the entities also from EU regulatory oversight. In so doing the problem is not effectively tackle, but just moved. In addition to the global dimension of the shell entity problem, other fundamental aspects act as a deterrent for the effective come into force of ATAD III. Since the Unshell proposal still needs to be voted by the EU Council, it is uncertain whether the Commission will be able to obtain 27 votes in favour given the directive wide-ranging effects. Unanimity is difficult to reach in front of 27 Member States, with 27 different domestic legal systems and divergent interests. Once again unanimity can heavily undermine any attempt by the European Union to eradicate shell entities.

4.2. Where are we going?

ATAD 3 is expression of an issue that cannot be delated in today's framework. It is an illustrative example of the failure of ATAD, due to reiterative problems of EU approximation process, which confirm that the fight against tax avoidance cannot be won with the tools and the approach that have been implemented so far.
Recalling Chapter 1[195], in the field of direct taxation, EU provides for approximation of the law. It differs from harmonization[196], applied in the indirect tax field, since just single parts of the legislation need to be harmonized, not the entire framework. In the case of Anti-Tax Avoidance policies, the choice fell upon directive[197] since it is the only tool to issue approximation. A directive is a legislative act that sets out a goal that all EU countries must achieve. However, after being issued, to become legally binding, it must be implemented in the national legal systems, and it is up to the individual countries to devise their own laws on how to reach these goals. The MSs are in general free to choose how they implement it, as long as the measures are qualified to achieve the purpose prescribed by EU. The directive, indeed, enables the introduction of complex legislative changes, which would be hardly achieved if the regulation

[195] Paragraph 1.1.1. The role of European Union in direct and indirect taxation.
[196] Harmonization in the sense of European law can be defined as “a process of replacing diverse national rules with common rules for a common market”
[197] The directive is regulated in Art. 288 (3) TFEU stating that it “shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.”

would be directly binding. From one point of view, allowing Member States to develop a plan to meet the directive's objectives independently, protects their sovereignty, since the directive enables them to select the action that interferes least with their domestic law system, minimizing potential problems. Moreover, the European lawmaker can focus simply on the chosen area, without having to adjust the proposal taking into account the entire context. The drawback is that, since MSs are free to choose how to implement the directives, differences and discrepancies will arise. Being the European Union composed by 27 Member States with 27 different legal traditions and practices[198], it is inevitable to have different techniques for implementing a European directive in the national legal system. Logically, this variety of methods produced a wide array of complex legal problems. In the light of this, it is evident that continuing undeterred on the path of approximation makes impossible to achieve a real harmonization of the different legal systems, leading to the creation of large gaps across nations, providing the perfect environment for the settlement of tax avoidance practices.

These discrepancies between one system and another arise due to a substantial limit, intrinsic in the communication system itself. Indeed, when the text of the directive is interpreted literally, it can contrast what the legislator really intends with that provision, creating tensions between the letter and the spirit of the law, posing the immense and ancient problem of its interpretation. Since legal harmonization gives to Member States a broad discretionary power, they can determine the scope and the degree of the harmonization. The so-called option clauses are one of the many tools that the European legislation provides to give them some wiggle room. The Member State is enabled to select from a number of options in the specific directive, which precisely define the exception in terms of the Member State's implementation. These alternatives are frequently the last chance for the parties involved in the negotiations to come to an agreement. In addition, directives do not always provide solely detailed regulations, but they often include general clauses which left an ample room for interpretation.

What is essential is that European terminology must be interpreted autonomously from the national definitions. In some cases, the Member States are permitted to concretize the general clauses for themselves if there is no indication in European law to interpret it independently. This leads to legal uncertainty since the different national legal systems do not allow a uniform interpretation in the whole European Union as the approaches are too diverging.

Outside of directive’s scope, the Member States can lay down their own regulations and could possibly expand the scope to even more circumstances as long as this does not break European primary or secondary law. The problem is that different implementation techniques lead to new

[198] Art. 67 (3) and Art. 82 (2) TFEU emphasise that the approximation of national criminal law must be “necessary” and at the same time, respectful for the “legal systems and traditions of the Member States.”

problems.

The failure of the *Unshell Directive* delineates another weakness of approximation: the unanimity issue. While in many areas, the Council decides by qualified majority[199]; in the Treaties, unanimity[200] is always provided for crucial matters considered to be the most politically sensitive, such as common foreign and security policy, citizenship[201], EU membership, EU finances, etc. Among them is included also taxation, on which all states must agree.

In practice, MSs are willing to hand over part of their power as long as they are guaranteed the ability to stop the implementation of decisions they disagree with. The problem is that unanimity slows down the decision-making process of the Union and fiscal veto is often used by one Member State to "blackmail" others or as trade goods. Each Member State has the right to defend its national point of view and interest, however, it is a widespread practice to use veto as a bargaining chip on issues that have nothing to do with the decision to be taken. As asserted by Elgström and Jönsson (2000), “The bargaining orientation is based on the assumption that all participants will pursue their individual self-interest, and that agreement will only be reached if each party expects an outcome which is no worse than the status quo. The existence of a veto will preclude any other type of agreement. In such a system, it will obviously be very difficult to obtain major changes; in fact, there is a strong inclination to preserve existing rules”[202].

Since EU decisions are binding, MSs government are prone to be sure that the directive is not in conflict with their national interests. Therefore, they fight vigorously for their positions, since no MS has any incentive to agree to a policy decision which is below its Best Alternative to a Negotiated Agreement (BATNA)[203]. Hence, in an environment where the veto seems to encourage the promotion of self-interests and these interests are divergent, one MS will always have the power to impede the come into effect of new measures. In this light, as long as the national logic prevails, firmly defended by unanimous voting, it is difficult to progress.

The reason why, after decades, no significantly effective steps against tax avoidance have been taken, is that applying the unanimity principle the risk that existing policies will continue to

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[199] Also called Double Majority, consists in 15 out of 27 countries which must be in favour and represent at least 65% of the total EU population. An abstention is considered a vote against. The blocking minority must include at least four countries, which represent over 35% of the EU population.

[200] The current Treaties already provide for the possibility of proceeding by qualified majority even in these areas in which unanimous decisions must be taken, but to do so it is necessary that all 27 Member States agree. Indeed, according to the Passerelle Clauses, unanimity is needed in order to not apply unanimity. So, the process is articulated, and the application of majority is not simple to achieve.

[201] the granting of new rights to EU citizens.

[202] lgström O., Jönsson C., 2000, Negotiation in the European Union: bargaining or problem-solving?, Journal of European Public Policy, pp.686.

[203] For a better explanation of this concept developed by Fisher and Ury (1981) see lgström O., Jönsson C., 2000, Negotiation in the European Union: bargaining or problem-solving?, Journal of European Public Policy, pp.690.

remain into force even when circumstances changed is meaningful.
ATAD III, like many other proposals, risks to not be adopted at all. MSs who have more interests to stop new measures are the European Tax Heaven.
Indeed, low-tax jurisdiction countries benefit from the favorable taxation policies they guarantee, basing their economic growth on attracting MNEs and FDI. This strategy, for small countries such as Luxembourg, Netherlands, Cyprus, Ireland, implies collecting an amount of tax revenue so much consistent than the mere one they would receive from the sole domestic economy. Consequently, it is logical that, being direct taxation the most substantial source of revenues, these countries are on the front line to block directives that could be harmful to their business and that would decrease or stave off foreign investment in their territory.
The EU's lack of harmony in corporate taxation has paved the way for the development of harmful tax competition, revealing a break in solidarity between Member States of European Union. On one hand there are the states that benefit from this competition and are protective of their sovereign right to tax multinationals as best they can grow. On the other hand, other states that are in favor of the dismantling of harmful tax systems and are contrary to the unanimity rule of the Treaties on the decisions of the Tax Council.
Nowadays, a purely national approach to taxation no longer works and unanimity is neither a practical nor an effective way of decision-making. National and common interests must be intertwined, since globalization and digitalization have created common challenges that need common solutions. The introduction of qualified majority voting in specific fields of taxation would lead to less distortion and fragmentation between Member States in their tax regimes, helping to reach objectives more effectively. However, taking such actions at the EU level will not be feasible without more flexibility in decision-making to enable the introduction of crucial fiscal instruments and market-based procedures to achieve shared goals.
In this context the fight against tax avoidance is strongly slowed down by many obstacles and dynamics that have been going on for decades with no way out. In this timeframe, EU has never applied a leader's logic in the fight since it has never adopted a propositional approach in order to propose its own anti-elusive policy. It has always been a follower of the policies suggested by the OECD in the BEPS project, as happened with ATAD III, shaped from BEPS action 5, and triggered by BEPS Two-Pillar solution. As demonstration of this fact, many times ATAD package has been defined as the European twin of BEPS Project.
The results of this approach are minimal. As confirmed by Enriques[204], harmonization has achieved little in terms of law uniformity, especially in corporate tax area, and in the current

[204] Enriques L., 2017, A Harmonized European Company Law: Are We There Already?, 66 International and Comparative Law Quarterly 763-777 (2017), Oxford Legal Studies Research Paper No. 5/2017, p.5.

conditions, that outcome is simply impossible to achieve, due to interest group resistance and the variety in national meta-rules[205].

Despite the number and volume of green papers[206], action plans, reflection groups' reports and advisory groups' studies, the results are modest and trivial, and divergence is thus still there.

The asymmetries and loopholes might be reduced in the future when EU will have one unique legal system, centralized authority and one common harmonized tax legislation. Until that moment the problem of tax avoidance and shell entities is going to persist.

[205] Meta-rules have been defined by Pierre Legrand as 'the rules developed by a legal system to help it manage its body of rules'. These rules also include any practice or convention that may entrust individuals, groups or institutions allocate with the power to provide interpretations of the law that are held to be reliable by affected parties. National meta-rules may lead courts inadvertently to give divergent interpretations of harmonized rules, simply because a given outcome, which might be what best corresponds to the EU legislator's purposes, is plainly impossible to conceive of under national meta-rules, making it harder for national lawyers and courts to perceive that a violation of the obligation of harmonious interpretation has taken place.

[206] Green papers are documents published by the European Commission to stimulate discussion on given topics at European Union level.

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