Lidija O. Živković*

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THE UNSHELL DIRECTIVE PROPOSAL IN A NUTSHELL: OPEN QUESTIONS**

Abstract

The paper analyses the recent European Commission's Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, commonly referred to as the Unshell Directive Proposal. The author firstly identifies the features of the existing EU legislative framework contributing to the widespread utilization of shell entities for tax avoidance purposes and clarifies the policy context in which the Unshell Directive Proposal was drafted. She further provides a detailed analysis of the anti-avoidance mechanism introduced thereby and discusses a number of questions which the said mechanism raises. In addition, the author assesses its effects on Serbian corporate taxpayers. She concludes that the envisaged anti-avoidance mechanism deserves further refinement, not least in regards to its interaction with Member States' general anti-avoidance measures, as well as with respect to the economic substance indicators on which it is based.

Keywords: *Unshell Directive, Misuse of Shell Entities, Economic Substance, Tax Avoidance, Wholly Artificial Arrangements.*

1. Introduction

During the last decade, the legislative activity of the European Union (hereinafter: EU) in the field of direct taxation has been predominantly focused on the introduction of measures directed at the prevention of tax avoidance – the so-called anti-tax avoidance measures. Two main factors contributing to such a state of affairs can be identified.

* MA, Assistant, Faculty of Law, University of Belgrade, Serbia
E-mail: *lidija.zivkovic@ius.bg.ac.rs*
ORCID: *https://orcid.org/0000-0003-2113-2566*

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Firstly, the Union's legislative competences in the field of direct taxation are fairly limited. Art. 115 of the Treaty on the Functioning of the EU (hereinafter: TFEU) – being the only provision of the founding treaties that provides a legal basis for legislating in the domain of direct taxation – presupposes the application of a special legislative procedure and enables issuance of directives only, under condition that they are needed for the approximation of Member States' laws directly affecting the establishment or functioning of the internal market. As the special legislative procedure requires that all the Member States agree unanimously on the relevant proposal, the enlargement of the Union has made it increasingly difficult to go forward with positive integration in matters relating to direct taxation. As a result, in the field of direct taxation there are only a handful of directives, which are confined to regulating rather narrow aspects of predominantly corporate income taxation.[1]

Secondly, the 2008 economic crisis instigated a change in the public's perception of tax avoidance. Encouraged by the public outcry to curb tax avoidance practices and in an attempt to collect revenues needed to remedy the economic consequences of the crisis, policy makers around the globe began on strengthening the existing legislative framework against tax avoidance. In that sense, the introduction of numerous anti-avoidance measures in secondary EU law was a manifestation of a global trend, which was initiated and promoted primarily by the Organisation for Economic Co-operation and Development.

The last one in the series of European Commission's initiatives directed against tax avoidance practices is 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, commonly referred to as the Unshell Directive Proposal.[2] The Proposal was published on 22 December 2021. Its provisions are expected

[1] Direct tax matters that are covered by Union secondary law are the following: 1) cross-border distribution of dividends (Council Directive (EU) 2011/96, known as *the Parent-Subsidiary Directive*, 2) tax treatment of cross-border reorganizations (Council Directive (EC) 2009/133, known as *the Merger Directive*), 3) cross-border interest and royalties payments between associated enterprises (Council Directive 2003/49/EC, known as *the Interest and Royalties Directive*), 4) exchange of information between the competent authorities of Member States (Council Directive 2011/16/EU, known as the *Directive on Administrative Cooperation – DAC 1*, and the subsequent amendments), 5) mutual assistance in the recovery of tax claims (Council Directive (EU) 2010/24, known as *the Recovery Assistance Directive*), 6) measures directed at the prevention of tax avoidance and aggressive tax planning (Council Directive (EU) 2016/1164, known as *the Anti-Tax Avoidance Directive – ATAD1*; Council Directive (EU) 2017/952 amending Directive (EU) 2016/1164, known as *the ATAD2*), as well as 7) resolution of tax treaty disputes (Council Directive (EU) 2017/1852, known as *the Dispute Resolution Mechanisms Directive*).

[2] The proposed Directive is also referred to as the ATAD 3, as it represents the third EU hard law instrument which is entirely dedicated to the fight against tax avoidance practices.

to be transposed into Member States' national tax legislation until 30 June 2023, provided that the Proposal is unanimously agreed upon. In this paper, the author firstly identifies the issue that the Unshell Directive Proposal is intended to address and clarifies the policy context within which the Proposal was drafted. She then provides an in-depth analysis of the provisions of the Proposal and assesses whether the anti-avoidance mechanism established thereby is capable of addressing the issue of shell entity abuse within the internal market. After setting forth the crucial shortcomings of the said mechanism, the author addresses the relevance of the said Proposal for Serbia.

2. The Misuse of Shell Entities within the Internal Market

2.1. Shell Entity as a Tool for Tax Avoidance

Terms "shell entity" and "shell company" generally have a negative connotation, regardless of the context in which they are used. It should, however, be kept in mind that the stated terms tend to be used in several different contexts, for which reason their meaning may accordingly differ to a certain degree. Regardless of the context in which the term is used, a common feature of entities which are referred to as "shell entities" is the absence of real economic activity in the jurisdiction in which they are established. In other words, the entities in question have no employees, assets or physical presence in the jurisdiction in which they are established (Krišto, Thirion, 2018, p. 12). Shell entities may serve various purposes, some of which are straight up illegal (such as tax evasion, money laundering or terrorism financing), while some are, strictly speaking, legal, but illegitimate (such as tax avoidance). The focus of this paper is the utilization of shell entities for tax avoidance purposes.

2.2. Existing Legislative Framework Facilitating the Misuse of Shell Entities for Tax Purposes

On the one hand, intra-EU payments of passive income (*e.g.* dividends, interest, royalties) are not subject to withholding tax (hereinafter: WHT), owing to the provisions of EU secondary law, more precisely: the Parent Subsidiary Directive (hereinafter: PSD) and the Interest and Royalties Directive (hereinafter: IRD). As a result, intra-EU flow of passive income is tax free. On the other hand, passive income payments "exiting" the internal market are generally taxable. More importantly, WHT rates charged on payments to residents of third (non-EU) countries are

not harmonized at the level of the EU. Member States are therefore free to decide what rate of WHT to charge on passive income payments, and whether to levy WHT at all. Consequently, several Member States provide for very low or no WHT on payments of passive income to residents of third-countries.[3]

The interplay between the two described groups of provisions provides fertile ground for the misuse of shell entities for tax purposes. The basic example of the said practice is the following. Instead of passive income being paid out directly by a payor resident of a Member State A to a recipient (shareholder) resident in a third-country, a shell entity is interposed in Member State B, whose national legislation provides for low or no WHT on payments of passive income to residents of non-EU countries. In this way, the payment of passive income is split in two parts: (1) the first one is the payment made by the initial payor resident of Member State A to the shell entity resident in Member State B, (2) the second one is the payment made by the shell entity resident in Member State B to the recipient resident in the third-country. Having been paid out by a resident of one Member State to a resident of another Member State, the first payment will benefit from the provisions of EU directives (provided that all the preconditions stipulated therein are fulfilled) and will accordingly be freed from WHT. The second payment will be subject to low or no WHT, in line with the national tax legislation of Member State B, in which the shell entity is resident. The described practice is generally referred to as directive shopping. The result is tax free or low taxed repatriation of profits from the EU to a third-country.

The described legislative framework has resulted in several EU Member States becoming notorious as cash-flow hubs. According to a study of the expert committee established by the Dutch Ministry of Finance, in 2019 there were more than 12 thousand shell companies in the Netherlands, with a balance sheet total more than five times larger than the Dutch gross domestic product. At the same time, the inbound and outbound flow of passive income were virtually of the same magnitude, implying that the investment did not actually remain in the country, but was mostly channelled out of it, in the majority of cases – to tax havens (Commissie Doorstroomvennootschappen, 2021, p. 10). Similar patterns with respect to the extent of shell entity misuse have been identified in several other Member States as well, *e.g.* Luxembourg, Ireland, Malta and Cyprus (Krišto, Thirion, 2018, p. 13-26).

[3] *E.g.* Luxembourg does not levy WHT in the case of interest and royalty payments to residents of third- countries (IBFD Tax Research Platform, 2022, para. 7.3.4.2 and 7.3.4.3). Similarly, the Netherlands applies no WHT on the payments of interest and royalties to residents of third-countries, provided that the country in question is not considered to be a tax haven (IBFD Tax Research Platform, 2022, para. 7.3.3.3.).

3. The Unshell Directive Proposal

3.1. The Goal and Scope

The Unshell Directive Proposal is intended to remedy the described issue by introducing a measure specifically targeted against legal entities without substance (European Commission, 2021a, p. 1). The supposed added value of the anti-avoidance mechanism introduced by the Proposal is its preventative character, as opposed to the existing anti-avoidance measures, both legislative and judicial, that are curative in nature. The introduced anti-avoidance mechanism represents a minimum standard. Therefore, the Member States are free to adopt measures that are more stringent (but not more lenient) towards taxpayers.

The introduction of a common set of rules establishing minimum substance for tax purposes within the internal market can be said to build upon the case law of the Court of Justice of the EU (hereinafter: CJEU). The seminal case in this respect is the *Cadbury Schweppes* case, which set the basis for the doctrine on the prohibition of abuse of law in the field of direct taxation (Vanistendael, 2006, p. 194). According to the reasoning of the CJEU in the said case, the interposition of a wholly artificial entity with the aim of obtaining tax benefits in a cross-border scenario is abusive. Whether an entity can be regarded as wholly artificial is to be assessed on the basis of objective factors ascertainable by third parties, in particular: whether it has staff, premises and equipment in the jurisdiction in which it is established (Cadbury Schweppes, 2006, paras. 67, 75). Wholly artificial entity is, by nature, not involved in the pursuit of genuine economic activity and cannot, as a result, contribute to the fulfilment of the aims of the EU fundamental freedoms (Cadbury Schweppes, 2006, paras. 53-54).

The personal scope of the Proposal is quite wide. Pursuant to its Arts. 2 and 3, it encompasses all undertakings, regardless of their legal form, provided that they can be considered to be tax residents of a Member State and are eligible to receive a tax residency certificate in that Member State. As for the territorial scope, the Proposal applies only to undertakings operating cross-border.

In short, the Proposal identifies undertakings that are considered to be "at risk" from being misused for tax purposes. It does so by stipulating the so-called gateway criteria, which are based on features commonly present in undertakings that lack economic substance and that are involved in tax avoidance (and evasion) practices. Undertakings that have the specified features are regarded as being "at risk" and are required to report on their economic substance. Undertakings that fail to document the presence of the so-called substance indicators are presumed to be shell entitles. Unless they succeed in rebutting this presumption,

or manage to benefit from an exemption, such entities are subjected to severe tax consequences. The following paragraphs provide an in-depth analysis of each of these steps.

3.2. The Gateway Criteria

Art. 6 of the Proposal stipulates three gateway criteria, *i.e.* preconditions on the basis of which the risk posed by a specific undertaking is to be assessed.[4] The first criterion deals with the question of how the revenue was generated. This precondition is fulfilled if more than 75% of the undertaking's revenue consists of so-called relevant income. The term "relevant income" is specifically defined in Art. 4 of the Proposal to include several categories of passive income, such as interest, royalties, dividends, income from the disposal of shares, income from financial leasing, etc. The second criterion is based on the cross-border nature of the undertaking's activity. An undertaking is considered to be engaged in cross-border activity provided that: (a) more than 60% of the book value of its assets is situated in a jurisdiction other than its Member State of residence, or (b) at least 60% of its relevant income stems from or is paid out through cross-border transactions. The third criterion questions whether the undertaking relies on other entities for its own administration. More specifically, the precondition is that the undertaking outsources the administration of its day-to-day operations, as well as the decision-making on significant functions. The time frame within which each of the three criteria is to be assessed is two tax years preceding the moment in which the tax return is to be filed.

3.3. Carve-outs

The Proposal excludes from its scope certain categories of undertakings, which are *prima facie* considered not to be "at risk" from being misused for tax purposes. Consequently, these entities are not subject to reporting obligations, even if they meet all the described gateway criteria. The carve-out applies to listed undertakings, as well as specifically enumerated regulated financial undertakings, such as credit institutions, investment firms, alternative investment fund managers, insurance undertakings, etc. The reasoning behind the exclusion of such entities from the scope is that they are already subjected to stringent regulatory requirements and are, as a result, considered to be sufficiently transparent (Hoor, O'Donnell & Schmitz, 2022, p. 233). Moreover, the carve-out also covers undertakings which would anyway not meet the gateway criteria, *e.g.*

[4] Assessment is conducted by the undertaking itself.

undertakings whose beneficial owners and operational businesses are located in the same Member State in which they are resident, or undertakings that have at least five full-time employees or staff members exclusively carrying out the activities generating the relevant income. Although it may be questionable whether the latter group of exclusions is actually needed, the justification for their stipulation, as per the Explanatory Memorandum, is to ensure tax certainty (European Commission 2021a, p. 9).

3.4. Reporting on Substance Indicators

Undertakings that fulfil all of the described gateway criteria are considered to be "at risk" and are subject to stringent reporting obligations. Pursuant to Art. 7 of the Proposal, they are required to declare in their annual tax return whether they meet the so-called "indicators of minimum substance" and to provide documentary evidence for their claims. The Proposal specifies the following indicators of minimum substance, which are subject to reporting. Firstly, the undertaking is expected to has its own premises, or premises for its exclusive use, in the Member State where it is considered to be tax resident. Secondly, the undertaking is expected to own at least one active bank account in the EU. The last substance indicator is related to the staff of the undertaking – its directors or employees. It is required that the substance indicator is met in respect to either only directors or only employees. Namely, at least one director needs to: (a) be a tax resident of the same Member State in which the undertaking is resident, or a resident in another jurisdiction, provided that the distance from the Member State of the undertaking is compatible with the proper performance of his/her duties, (b) possess qualifications and authorisation needed to make decisions in relation to the activities that result in relevant income for the undertaking, (c) exercise such authorisation actively and independently. Additionally, the respective director must not be an employee of another, non-associated undertaking, nor can he/she act as a director thereof. Alternatively, the same preconditions relating to tax residence and qualifications need to be fulfilled in the case of the majority of undertaking's employees.

3.5. Presumption of Abuse and the Right to a Rebuttal

Art. 8, para. 2 of the Proposal stipulates that if an undertaking fails to provide sufficient documentary evidence that it meets the described substance indicators, it will be presumed to be a shell. The presumption introduced by the Proposal is, however, rebuttable. The Member State of undertaking's residence is required, pursuant to Art. 9 of the Proposal, to allow the presumed shell entity to rebut

this presumption by providing additional (explicitly specified) supporting evidence that it does have substance, or is not misused for tax purposes. In an attempt to minimize the compliance burden for taxpayers, the Proposal allows Member States to consider the rebuttal of the presumption valid for a period of five years, provided that the factual and legal circumstances of the case remain unchanged.

3.6. Exemption

The Proposal contains an exemption from obligations introduced thereby for undertakings that were presumed to be shells, even if the rebuttal of this presumption was unsuccessful. The exemption, contained in Art. 10 of the Proposal, acknowledges the fact that the establishment of entities with low economic substance could, in certain cases, be motivated by legitimate commercial reasons (Popa, 2022, p. 167). In order to benefit from the exemption, the undertaking needs to provide evidence that its interposition does not lead to a reduction of the tax liability of its beneficial owner or of the group of which it is a member. In particular, the evidence provided should enable a comparison between the overall level of taxation without the interposition of the presumed shell and the level of taxation with the presumed shell interposed. As with the rebuttal of the presumption, the Proposal allows Member States to extend the granting of the exemption for a period of five years, provided that the factual and legal circumstances of the undertaking, as well as of the beneficial owner and the group as a whole, remain unchanged.

3.7. Tax Consequences for Shell Entities

An undertaking that fails to rebut the presumption and is not able to benefit from the aforementioned exemption will be subject to tax consequences, as stipulated in Arts. 11-12 of the Proposal. Tax consequences differ viewed from the perspective of (a) the Member State of shell entity's residence, and (b) the Member States where the payer of income and the shareholder (*i.e.* the final recipient of income) are residents.

On the one hand, shell entity will be subject to tax obligations in line with the national law of its Member State of residence. In other words, no "look through" approach will be applied. On the other hand, the same Member State is required to either not issue a tax residence certificate to the shell entity, or issue a tax residence certificate explicitly specifying that the undertaking is not entitled to the benefits of double tax treaties and the PSD and the IRD. Tax residence certificate represents evidence that a certain taxpayer is a resident of a specific tax jurisdiction. As such, it is a formal precondition for a taxpayer to be able to enjoy benefits

contained in double tax treaties, as well as in directives applicable to the case in question. Without being able to obtain a tax residence certificate, the shell entity is effectively prevented from benefitting in other jurisdictions from preferential tax treatment stipulated in the directives and double tax treaties (*e.g.* exemption from WHT, or low WHT rates).

As for the tax consequences in the other two jurisdictions involved (the non-shell jurisdictions), income passing through the shell entity will be regarded as having been paid directly by the payer to the shareholder, and any applicable double tax treaties, as well as the PSD and IRD will be disregarded.[5] In other words, the look-through approach is applied. More specifically, for outbound payments (payments exiting the EU): the Member State of the payor is obliged to apply WHT to the payment that is channelled through the shell entity to a third-country shareholder/final income recipient. For inbound payments (payments entering the EU): the Member State of the shareholder is required to tax the payment channelled through the shell in line with its national tax legislation, as if it were directly paid to it by the third-country resident payor. Finally, the real estate owned by the shell entity will be taxed in the jurisdiction where it is located, as if it were owned directly and not via the shell entity.

3.8. Enforcement

The Proposal envisages in its Arts. 14-16 several mechanisms intended to facilitate the enforcement of the anti-avoidance measure introduced thereby. Firstly, it imposes an administrative pecuniary sanction on shell entities that fail to assess whether they pass the gateway criteria or make false declaration in their tax returns. The penalty amounts to 5% of the entity's turnover for the relevant tax year. Secondly, any Member State that suspects that an undertaking of another Member State is not compliant with the requirements introduced by the Proposal, may request that Member State to conduct an audit of the undertaking in question. The requested Member State is obliged to initiate the audit within one month after request is received, as well as to provide feedback to the requesting Member State within one month after the outcome of the audit is known. Finally, Member States are required to report on a regular basis to the European Commission information explicitly specified in the Proposal, so as to enable adequate monitoring of its implementation and enforcement, as well as to provide solid basis for a better understanding of the phenomenon of shell entities utilized for tax purposes (European Commission, 2021a, p. 7).

[5] Naturally, since the Directive can introduce obligations only for EU Member States, the provisions of double taxation treaties concluded by third-countries will need to be honoured.

Finally, the Proposal presupposes an amendment of the Directive on Administrative Cooperation, by introducing an obligation for Member States' competent authorities to automatically exchange a rather comprehensive set of information regarding the shell entity. The automatic exchange of information is supposed to take place every time an undertaking passes the gateway criteria, as well as in each case in which the tax authorities accept the rebuttal of the presumption or allow for an exemption. The time span within which the exchange must take place is 30 days, counting from the moment tax return was received, or from the moment the rebuttal/exemption was certified by the tax authorities.

4. Issues and Open Questions

The first question to be raised in regards to the proposed Directive is whether there is actually a need for yet another anti-avoidance mechanism in EU law. Not long ago, the Anti-Tax Avoidance Directive (hereinafter: ATAD) introduced in its Art. 6 an obligation for Member States to adopt in their national tax legislation a general anti-avoidance rule (hereinafter: GAAR).[6] As an anti-avoidance measure of a general scope, the said provision is intended to address any form of corporate tax avoidance potentially arising in the future in a particular jurisdiction. As such, it is supposed to complement the existing specific anti-avoidance rules (hereinafter: SAARs), whose narrow scope of application targets only the widespread, *ex ante* identified, tax avoidance practices. The Preamble of the ATAD confirms this position in para. 11 by clarifying that GAARs "feature in tax systems to tackle abusive tax practices that have not yet been dealt with through specifically targeted provisions" and as such have a "function aimed to fill in gaps" in the existing legislative framework against tax avoidance. Therefore, GAARs transposed into Member States' national laws should, by definition, be capable of addressing the misuse of shell entities for tax purposes. After all, the wording of the GAAR itself specifies that it is directed at non-genuine arrangements, *i.e.* arrangements that "are not put into place for valid commercial reasons which reflect economic reality".

One of the crucial supposed benefits of the introduction of a GAAR is that it eliminates or, at the very least, diminishes the need for the subsequent adoption of SAARs (Athanasaki, 2021, p. 20) and thus keeps the complexity of the tax legislation in check (Duff, 2020, p. 588). It could, nevertheless, be argued that there is a justification for the introduction of a new SAAR in a particular tax system which

[6] The Member States were required to transpose the provision in question into their national legislation by 31 December 2018.

already presupposes a GAAR, to the extent that the GAAR is not successful in addressing a specific widespread form of tax avoidance. However, the stated justification does not seem to be valid in the case of the specific anti-avoidance mechanism devised by the Unshell Directive Proposal. As the European Commission itself admitted, the impact of the exiting anti-avoidance measures, most importantly Member States' GAARs, on the utilization of shell entities for tax purposes has not yet been assessed (Hoor, O'Donnell & Schmitz, 2022, p. 246). Consequently, the question on the necessity of the newly introduced specific anti-avoidance mechanism remains open.

Even if we were to accept the position put forward by the European Commission, according to which the existing anti-avoidance framework is not sufficient to adequately address the misuse of shell entities within the Union, the question of interaction between national GAARs and the newly presented anti-shell mechanism remains. At the core of this question is the interaction between a GAAR and various SAARs applicable in a particular jurisdiction. Generally speaking, this question is not unequivocally resolved across jurisdictions (Arnold, 2017, p. 726). Whereas in some tax systems the fact that there is a SAAR applicable to the relevant case precludes the subsequent application of a GAAR to the same set of facts, there are also tax systems in which the GAAR could apply to a specific case, even if the said case potentially falls within the scope of an existing SAAR (Drüen, 2008, pp. 33-34). In this sense, it remains unclear whether taxpayers who are able to prove the existence of an adequate level of economic substance or that they are not misused for tax purposes, will be safe from the subsequent application of a GAAR.

According to the preamble of the Proposal, the fact that the undertaking was found to have sufficient substance on the basis of the anti-avoidance mechanism contained in the Proposal "should not prevent the Member States from continuing to operate anti-tax avoidance and evasion rules, provided that these are consistent with Union law" (European Commission, 2021, p. 17). On the other hand, the ATAD in para. 11 of its preamble only notes that, being a provision whose function is "to fill in gaps", a GAAR "should not affect the applicability of SAARs". Apart from the fact that the latter clarification says very little (if anything) about the interaction between the two types of anti-avoidance rules, it refers only to the anti-avoidance rules (the GAAR and four SAARs, *i.e.* interest limitation rule, exit taxation, controlled foreign company rule and hybrid mismatch rule) introduced by the ATAD. Consequently, it could very well be expected that taxpayers would face differing approaches of various Member States *vis-à-vis* the potential applicability of a GAAR on top of the anti-avoidance mechanism introduced by the Proposal.

Another issue relating to the compatibility of the proposed anti-avoidance mechanism with the established EU tax law framework is the presumption of abuse which it introduces. According to the long-settled case law of the CJEU, when determining whether the principal objective (or one of the principal objectives) of a taxpayer's operation is tax evasion or tax avoidance, national tax authorities are not allowed to rely solely on "predetermined general criteria but must subject each particular case to a general examination" (*Leur-Bloem* 1997, para. 41-42; *Euro Park Service* 2017, para. 55). As a result, a general tax measure which automatically excludes certain categories of taxpayers from the tax advantage is considered disproportionate. As the CJEU underlined in *Eqiom and Enka* (2017, para. 36) and a little later in *Deister Holding* (2017, para. 61), anti-avoidance measures that do not require tax authorities to provide at least *prima facie* evidence of abuse would go further than is necessary for preventing abuse. However, the Proposal shifts the burden of proof to the taxpayer before the tax authorities have provided any evidence on the abusiveness of the taxpayer's arrangement. The fact that the abusiveness of the taxpayer's arrangement (*i.e.* the lack of involvement in genuine economic activity) is presumed on the basis of general criteria laid down in the Proposal seems to be in direct contradiction to the case law of the CJEU.

Moreover, the period of time that would need to pass between the moment the presumption of abuse arises and the moment in which the tax authorities accept (or reject) the taxpayer's rebuttal will normally be quite substantial. First of all, the presumption arises on the basis of information declared in a corporate income tax return, which is usually required to be filed months (often as late as six months, or more) after the end of the relevant tax year.[7] Furthermore, the taxpayer may actually attempt to rebut the presumption only after the tax authorities provide feedback that the evidence submitted does not suffice to satisfy the substance requirements, for which reason the taxpayer is presumed to be a shell. It may also be expected that the assessment of the taxpayer's rebuttal by the tax authorities will take quite some time, not least because the Proposal fails to prescribe a deadline for them.[8] Finally, the Proposal does not presuppose suspending the legal consequences of the presumption during the review of the rebuttal. As a result, the described dynamic would lead not only to taxpayers being faced with prolonged legal uncertainty, but would also result in them suffering adverse tax consequences before the tax authorities' decision on rebuttal is finalized (Tolman & Molenaars, 2022, p. 102).

[7] *E.g.* the deadline for the submission of a corporate income tax return is: 31st July in Germany (*Abgabenordnung*, Art. 149), 25th July in Spain (*Ley del Impuesto sobre Sociedades*, Art. 124), 30th June in Austria (*Bundesabgabenordnung*, Art. 134).

[8] The same is the case in respect to tax authorities' assessment of whether the taxpayer can benefit from the exemption, as stipulated under Art. 10 of the Proposal.

Finally, the criteria used by the Proposal to identify shell entities raise a myriad of questions. It is questionable whether it is reasonable to utilize the same set of criteria for the identification of shell entities regardless of the industry in which they operate. After all, the level of substance an entity is supposed to have in order to be considered as conducting genuine economic activity within the internal market should depend on the type of economic activity supposedly performed in each specific case. CJEU case law, which insists on a case-by-case analysis in each specific case, supports this view. Moreover, the choice of substance indicators seems to suggest that the Proposal adheres to a perception of business reality which is already outdated. Namely, it makes little sense to require that the entity's employees/directors reside close enough to the entity so as to be able to adequately perform their duties. The effects of the pandemic have taught us that a vast array of employee/director's functions can actually be performed remotely. Analogous reasoning could apply to the requirement that the shell owns or exclusively uses premises in its Member State of residence. In addition, having in mind that the free movement of capital contained in Art. 63 of TFEU applies *vis-à-vis* third-countries as well, requiring an undertaking to have a bank account within the EU could easily amount to a breach thereof.

5. The Unshell Directive Proposal from the Perspective of Serbia

For the time being, shell entities having their tax residence in Serbia will be safe from tax consequences stipulated by the Proposal, since its personal scope does not cover undertakings resident in non-EU jurisdictions. Considering the share of foreign investment in Serbia originating from the EU (Radenković, 2016, pp. 58-59; Vržina, 2017, p. 95), Serbia will, in the majority of transactions involving the use of EU-resident shell entities, assume the role of the source jurisdiction of the so-called relevant income.

Assuming that the payment of relevant income was made by a Serbian resident entity, *via* a shell entity resident in Member State A, to a shareholder/final recipient of income resident in Member State B, the tax consequences would be as follows. Being a non-EU country, Serbia would be free to apply its domestic WHT rate on the outbound payment of relevant income. As it is not obliged to treat the payment as being paid directly to the shareholder/final recipient, Serbia is not required to grant benefits of the double tax treaty which it has with the Member State B (residence country of the shareholder/final recipient).[9] On the other hand, in line with Art. 12 of the Proposal, the competent authorities of Member State A would refuse to issue a tax residence certificate for the shell entity, for which

[9] The only EU Member State with which Serbia does not have a double tax treaty is Portugal.

reason the entity in question would not be able to obtain preferential WHT rate under the double tax treaty concluded between Serbia and Member State A, nor would it be able to benefit from a WHT exemption under EU directives on payments channelled to the shareholder resident in Member State B. At the same time, shell entity would be subject to the national tax law of the Member State A and would bear the tax burden accordingly. Finally, Member State B would apply the look-through approach and tax the payment received by the shareholder/final recipient as if it were paid directly by the payor resident in Serbia. Member State B would, however, grant a deduction for the tax paid by the shell entity in Member State A, in accordance with Art. 11, para. 2 of the Proposal.

Nevertheless, it should be noted that, at the same time with the publication of the Unshell Directive Proposal, the European Commission announced that by the end of 2022 it will present a new initiative to address the challenges posed by non-EU shell entities (European Commission, 2021b, p. 2). This would imply introducing substance requirements *vis-à-vis* third-country resident undertakings. In this context, it might be worrisome that, according to some estimates (Brakočević, 2021), 29.7% of all undertakings registered at the Serbian Business Registry Agency have no employees. Although this does not necessarily mean that all such entities would fall within the scope of the European Commission's future initiative (*e.g.* because a substantial share thereof is not involved in cross-border transactions), it underlines the relevance of the issue of economic substance for Serbian corporate taxpayers and tax policy makers. This is especially the case since, under the Unshell Directive Proposal, the look-back period for the assessment of the criteria implying that an undertaking is "at risk" is two years. Assuming that the future European Commission's initiative directed at non-EU shells would follow the same approach, Serbian corporate taxpayers should already be made aware of the need to initiate an assessment of their economic substance and implement changes into the manner in which their operations are organized, so as to be able to escape the tax consequences of being identified as a shell.

6. Concluding Remarks

Although various studies have shown that the extent of shell entity misuse for tax purposes within the EU is considerable, these findings predate the introduction (and subsequent application) of national GAARs based on Art. 6 of the ATAD. The European Commission's own acknowledgement of the lack of data on the effectiveness of national GAARs *vis-à-vis* tax avoidance practices involving shell entities implies that the Proposal was published as an answer to the pressure of the

public (especially following the reports of investigative journalists, most recently the ones relating to the Open Lux scandal), rather than on the basis of an up-to-date assessment of its necessity. Moreover, the question of how the newly introduced anti-avoidance mechanism is supposed to interact with the existing framework of legislative, as well as judicial measures against tax avoidance applicable in the EU context has not been given much thought. Even if we were to leave aside the issue of compatibility of the anti-avoidance mechanism introduced by the Proposal with the established case law of the CJEU, as well as the controversial aspect of its interaction with the ATAD GAAR transposed into national laws of Member States, serious doubts remain with respect to the choice of substance indicators which are at the core of the new anti-avoidance mechanism: they do not take into account the specific type of economic activity the undertaking is involved in, some of them make little sense in view of the currently widespread remote work arrangements, while some are potentially in contradiction with the fundamental freedoms. At the same time, the Proposal not only substantially increases corporate taxpayers' compliance burden, but it also imposes significant administrative burden on Member States' tax authorities, not least by introducing rather short deadlines for the exchange of information and initiation of audits. It would therefore seem preferable if the European Commission were to put the Proposal on hold until relevant evidence is gathered on the deficiencies of the existing anti-tax avoidance framework in the EU, and sufficient consideration is given to the above questions.

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Lidija O. Živković
Master, asistent, Pravni fakultet Univerziteta u Beogradu, Srbija
E-mail: *lidija.zivkovic@ius.bg.ac.rs*
ORCID: *https://orcid.org/0000-0003-2113-2566*

O REŠENJIMA KOJE DONOSI PREDLOG *UNSHELL* DIREKTIVE

Sažetak

Predmet rada je nedavno objavljeni Predlog direktive o utvrđivanju pravila za sprečavanje zloupotrebe shell entiteta u poreske svrhe i izmeni Direktive 2011/16/EU – tzv. Predlog unshell direktive. Autorka najpre identifikuje elemente postojećeg legislativnog okvira EU koji su doprineli rasprostranjenoj upotrebi shell entiteta sa ciljem izbegavanja poreza u okvirima jedinstvenog tržišta i objašnjava kontekst u kome je Predlog formulisan. Srž rada predstavlja detaljna analiza anti-abuzivnog mehanizma predviđenog Predlogom, kao i razmatranje osnovnih problema koji se u vezi sa njegovim funkcionisanjem mogu očekivati. Takođe, u radu se ispituju efekti Predloga na srpske obveznike poreza na dobit pravnih lica. Autorka zaključuje da Predlog zaslužuje određene izmene, odnosno preciziranja, pre svega u pogledu načina regulisanja interakcije sa postojećim opštim antiabuzivnim merama sadržanim u nacionalnim zakonodavstvima država-članica, kao i u pogledu odabira indikatora supstance na kojima se zasniva funkcionisanje antiabuzivnog mehanizma koji se njime uvodi.

Ključne reči: Unshell direktiva, zloupotreba shell entiteta, ekonomska suština, izbegavanje poreza, potpuno artificijelni aranžmani.

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