



## Luxembourg News

### February 2022

### ATAD 3 DIRECTIVE: SOME CLARITY AS TO “ECONOMIC SUBSTANCE”?

The dynamism of the EU Commission in the field of combating tax evasion seems to be limitless, after the recent initiatives culminating with ATAD (Anti-Tax Avoidance Directive) 1 and 2. On 22nd December 2021, the Commission published a draft Directive (2021/0434) directly targeting the so-called “*shell companies*” that “*do not perform any actual economic activity*” and that “*can be misused for tax avoidance or evasion purposes*”.

Once adopted and implemented, “*shell companies*” so identified will be denied treaty protection, and access to EU Directives, more specifically the Parent-Subsidiary Directive. Practically, no certificate of residence will be issued for such companies.

One may observe that the Specific Anti-Abuse Provision inserted in the Parent-Subsidiary Directive, and the General Anti-Abuse Rule provided for by ATAD 2 Directive, already targeted artificial arrangements in the form of interposed companies, but the new suggested legislation will also introduce new reporting obligations for eligible entities.

The new legislation is a welcome addition as it provides guidance in the minefield of economic substance requirements and may help interpreting the GAAR as applied to foreign-held companies engaged in cross-border transactions.

#### “In scope” companies

Cumulative criteria determine “*in scope*” shell companies:

- Shareholders residing in other jurisdictions;
- 75% of passive income (irrespective of the amount) consisting in dividends, capital gains on shares, IP income or interests, income from financial assets (including crypto-assets), financial leasing, insurance, banking and financial activities, real estate and movable assets with a book value of more than 1M € or income from services outsourced to other associated enterprises.
- Significant daily-management and decision-making outsourced to “*professional third party service providers*” or equivalents.

Reunion of these criteria create a rebuttable presumption that the company is “*at risk*” of being used for tax evasion, and must be identified as such by way of self-reporting in its yearly CIT return on:

- Its premises for exclusive use in the member State;
- The existence of at least one bank account in the EU;
- One or more local exclusive director(s) with effective management function, and majority of local staff.

#### Rebuttal of the presumption

Undertakings falling within the scope of the presumption shall have the possibility to provide evidence of the true commercial rationale of the establishment of the company, concrete evidence of the decision-making process taking place in the Member State of establishment, and information as to the employees’ profile and qualification, and risks allocation.

#### Exceptions

Even in case all the above conditions are fulfilled, the following entities fall out of the scope of the new Directive:

- Entities listed on a market in financial instruments<sup>1</sup>;
- Regulated financial undertakings;
- Entities holding shares in operational businesses in the same Member State while their beneficial owners are also resident in the same Member State;
- Entities the shareholders of which are tax resident of the same Member State;
- Undertakings employing at least five FTE employees or members of staff carrying the considered activities.

#### Tax consequences

If a company falling within the scope of the presumption fails to provide adequate information for the purposes of rebutting the presumption, it shall be denied the benefits of the EU Directives and Tax Treaties. No certificate of residence shall be issued by its local tax authorities and information will automatically be exchanged with foreign (EU) tax authorities under DAC Directives.

<sup>1</sup> Directive 2014/65/EU.



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### Entry into force

The draft Directive (to be unanimously adopted by all Member States) provides for an implementation deadline of 30th June 2023, and entry into force on 1st January 2024.

It is therefore advised to examine carefully existing structures established in different Member States to ascertain whether they meet the soon-to-be introduced economic substance requirements in order to secure the continued benefits of EU Directives and Double Taxation Treaties.

Strelia will monitor the next steps of the legislative process attentively and provide continued information by the same channels.



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