Brussels, 6 April 2022

EFAMA COMMENTS ON THE EUROPEAN COMMISSION'S UN-SHELL ENTITIES PROPOSAL - FIGHTING THE USE OF SHELL ENTITIES AND ARRANGEMENTS FOR TAX PURPOSES

Our response

EFAMA fully supports the Commission's initiatives to fight tax avoidance and aggressive tax planning. **The work of the technical teams that acknowledged our industry's special requirements and the proposal of carve-out rules to protect investment structures and end-investors are**, to a certain extent, **to be welcomed**.

As a principle**,** this proposal should not have an impact on any of the "regulated financial undertakings" exempted under Article 6 (2)(b) of this draft Directive. **Notwithstanding**, after a first review of the legal text, as well as of the Commission's working documents, **EFAMA is concerned with the unintended consequences that will be imposed on some entities, commonly used by investment funds (both UCITSs, AIFs and others), for commercial and regulatory purposes, that may not be covered by these carved out rules, as they stand.**

EFAMA is calling for:

- **A broader exemption:** The exemption rules should cover all undertakings held directly/indirectly by the fund. The scope of the exempt regulated financial undertakings should match with the OECD Pillar Two definitions. The exemption should be globally applicable to the overall fund structure (the Management Company (ManCo) substance requirements could be used by the entities/structures below).

- **Modification of the Gateway tests ensuring that clear and industry-relevant definitions and notions of "outsourcing", "premises", "bank account", "directors", "full-time equivalent employees" be employed:** Considering the challenges that will arise from the flexibility that is being granted to Member States on the interpretation of this proposal, EFAMA would welcome if these definitions could be clarified upfront and allowances made to extend substance within investment managers to the underlying investment entities they operate.

- **Enhanced legal certainty through clear and predictable procedures,** such as for the rebuttal of the presumption, the exemption and the tax audits, included in the Un-shell proposal that requires a clarification of concepts and a harmonised approach on the application of procedures.

- **A period of assessment:** EFAMA calls for the introduction of a transitional period for the implementation of the new rules allowing entities to review, adapt and comply with the new measures.

- **Caution with tax competition issues:** If the Commission is planning to expand this proposal to non-EU countries we highly recommend Member States to suspend these negotiations allowing the approval of all un-shell measures at the same time (measures to be enforced at an EU and non-EU level should be included within the same legal text and enter into force at the same time).

The substance of investment funds' structures.

Why is EFAMA calling for a broader exemption?

The approach taken by the Un-shell proposal generally **relies on an assessment of the substance at the level of each entity individually**. This approach **does not fit the actual functioning of investment funds' structures that operate within a wider context.**

From a regulatory perspective, management companies and managers of investment funds are responsible for the management of funds and their assets towards investors. This includes any entities directly or indirectly held by a fund and implemented with the view to fulfil its investment policy objectives.

Outsourcing and delegation of functions by management companies or funds to other entities belonging to the wider investment management infrastructure and may themselves be subject to regulatory authorisation and supervision, such as asset managers, depositaries or distributors, are part of their ordinary functioning and implemented in accordance with strict regulatory rules. Unlike multinational operating businesses, Investment funds, and the entities they utilise, are by their very nature, designed to delegate substance and the responsibilities associated with it back to the investment manager who operates the fund.

This is a hallmark of almost all investment funds and is **to ensure they provide the highest levels of investor protection** in collective investment. It is **a regulatory gold standard and a model in compartmentation, risk management and governance that the Commission promotes across the Union.**

This substance is however not hidden nor 'out-sourced' in a 'shell' context, rather the substance is reflected within the manager (likely an AIFM, a regulated financial undertaking) and allows the fund to remain a pool for collective investment uncontaminated from the obligations typically associated in operating businesses with employees (human resources considerations, employment law and local income tax and social security issues, etc), own premises (office leases, building maintenance, etc) or other general commercial concerns.

On that basis, it logically follows that **the substance of an investment fund's platform is to be found at the management company or the manager level.**

EFAMA calls for a broader exemption for all fund structures (e.g., the rules should cover not only the regulated fund entities but also any structures, arrangements, entities that are beneath the fund entities and **that do not pose risks of being used for tax avoidance and aggressive tax planning**).

How to preserve the tax neutrality of investment structures?

As already discussed with TAXUD ahead of the proposal's release, **for sake of clarity and consistency in the way our industry needs are addressed, the Un-shell proposal should leverage on the Pillar Two approach to investment entities to preserve the tax neutrality that should be granted to all investment structures that do not pose tax avoidance and aggressive tax planning risks.**

The OECD Pillar Two Blueprint generally sees entities held by investment funds and created to implement and execute the fund's investment policy *"as part of the infrastructure of the fund itself and should be treated as part of the Excluded Entity"*.[1]

The carve-out for investment funds should therefore be extended to cover entities held directly or indirectly by investment funds also in the context of the draft Directive.

As mentioned in our reply to the public consultation, **as a matter of EU public policy investment entities are highly regulated tax neutral structures and do not pose the risks identified by the Commission**. The OECD recognises that when tax is paid at the investor level of a structure there is no avoidance or evasion risk and **we should not penalise fund structures by creating additional levels of taxation (ultimately penalising end-investors).** This tax neutrality principle has also been explicitly recognised and catered for in the recently published international rules on minimum taxes (OECD's Pillar Two) agreed by jurisdictions in the Inclusive Framework including EU Member States.

Failing the recognition of the investment industry specific features and the extension of the carve-out to entities held directly or indirectly by investment funds, **additional requirements would be imposed on the current operational model of investment funds**. **This would also impose additional administrative burdens and related costs on the industry and ultimately on investors** in investment funds.

We feel the use of the OECD Pillar Two approach will help futureproof the Directive should it later be expanded, in some form, to third countries which will not manufacture non-EU investment funds in the same way and will not be subject to and thus exempted by either the UCITS or AIF regulatory carve-out.

As acknowledged in the preamble to the draft Directive, it aims to facilitate the identification of manifest cases of misuse of shell entities and therefore **the carve out definitions seek to cover those entities which are considered low-risk or would be determined as such or irrelevant at a later step** (e.g. because – given the activities or purpose of the entities – the presumption of lack of substance is expected to be rebutted or it is expected that the use of the shell entity is not to reduce the tax liabilities of relevant beneficial owners).

Investment funds, and entities within the underlying investment structure, should clearly fall into either or both categories **and it is counter to the draft Directive's stated aim to have tax authorities focussed on low risk cases, not to mention the concern over available resources, to require such entities to report as to their substance and/or go through the process of rebutting the 'no substance' presumption or proving its non-tax related purpose.**

Over EUR 20 trillion worth of investment is structured through European funds and **tweaking the exemption would have the welcome effect of preventing the vast majority of this capital being categorised as 'shells', reducing unnecessary costs and burdens on both governments and investment funds where reporting will not identify instances of tax avoidance or aggressive tax planning, rather than risking a patchwork of exemptions applying to investment funds but not the underlying entities associated with them.**

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[1] Paragraph 82 of the OECD Pillar Two Blueprint: *"The final part of the definition recognises that an Investment Fund may use special purpose vehicles to hold assets or to make certain investments. Such entities or arrangements essentially function as part of the infrastructure of the fund itself, and should be treated as part of the Excluded Entity. The exclusion for special purpose vehicles does not extend to entities that carry on or otherwise have responsibility for managing a trade or business of the MNE Group itself. The definition also provides for cases where the entity or arrangement is held by more than one separate Investment Fund, or by one or more Investment Funds together with another Excluded Entity such as a pension fund. The definition also accommodates cases where, for regulatory or commercial reasons, the fund manager may be required to hold a de minimis shareholding in the entity or arrangement."*

What is at risk?

Without robust carve-out and modified Gateway test rules, there is a heightened risk that investors stop investing in funds with structures that (e.g., due to too narrow carve-out rules) would fall in the scope of the draft Directive for qualifying as "shell-entities" (structures that exist and are operating for valid reasons). This will constrain the EU's prospects as an important investment centre, including its efforts in regards to the Capital Markets Union (CMU) integration project.

Applying substance only at an entity level, any investment entities unable to benefit from an exclusion as part of Article 6(2) would likely fail to meet the Article 7 tests and so we strongly urge that this substance issue is addressed **before the Directive is finalised**. Investment entities should not be required to fall back on either the *Exemption for lack of tax motives* or the *Rebuttal* procedures.

There however remains a risk that not every type of investment product can be catered for and inevitably some of will pass through the tests of Article 7. This could be because the fund would not qualify as a UCITS or AIF, or the entity in question may not be wholly owned by a regulated financial undertaking (for instance, applying the OECD's Pillar Two Investment Entities' provisions).

While we believe it highly likely that investment entities would be able to prove one or both of conditions, having to do so will lead to unnecessary compliance cost and exhaust tax administrations. Moreover, it may create temporary operational, and in some instances, permanent barriers to collective investment, including in a CMU context.

Also, as a general remark, **the principle of legal certainty requires that administrative procedures are clear and predictable without the burden of proof being practically impossible or excessively difficult for the taxpayer or for the tax authorities**.

Common interpretations of certain concepts and a harmonised application of administrative procedures, in particular those applicable to the rebuttal of the presumption, the exemption, the access to Double Tax Treaties and/or EU Directives and the implementation of tax audits, are essential to avoid taxpayers being confronted with divergent interpretations across the EU, which would increase legal uncertainty and the administrative burden. These clarifications of concepts and of administrative procedures should be to be introduced in the draft Directive.

As an example, application for a Certificate of Residence (CoR) will usually require attestation by the manager, on behalf of the investment entity, that the investment entity is entitled to treaty benefits for the jurisdiction they are applying.

We anticipate instances where this attestation will be delayed until such time as the tax authority can authenticate the commercial rationale under the rebuttal procedure. This will cause the investment entity to have to, wrongly, forego treaty entitlement until such time as CoR is issued. This is unfair to fund investors.

Needless distortions such as these would only limit investment opportunities within the EU and exacerbate the success of the EU's CMU initiative. In order to reflect this core design feature of how investment funds are structured, **we suggest that the mechanics of the Gateways tests are modified so investment entities can apply substance across an investment structure, including within the investment manager, and not be limited only at the entity itself.**

In this respect it is worth reading the following points made by the Commission in the impact assessment report where EFAMA's previous comments were acknowledged [2] [3]:

- *"For the sake of clarity, it is worth stressing that* ***the problem to be addressed is not the existence of shell entities per se****. Indeed, the latter can serve several valid and fully legitimate commercial and business purposes."*

- *"****Just to provide some examples obtained via the public consultation on this initiative [input received from EFAMA], shell entities can be used [for legitimate reasons] (…) shell entities as such are not the problem****."*

- *"Therefore,* ***it would not be appropriate to distinguish between legitimate and problematic shell entities****: rather,* ***the issue is about*** *distinguishing between the legitimate and problematic* ***uses of shell entities****. As other technologies or forms of innovation and organisation,* ***shell entities can be exploited or rather serve broader economic and social goals****."*

EFAMA is raising its voice aiming to protect our industry from any adverse effects of this initiative on investment activities, especially to protect the entities that are not yet covered by the proposed carve-out rules. In addition, we believe the Directive's Gateway tests should be modified to consider the substance of the manager's activities, as delegated by the investment entities, to reflect industry practice and regulation. We believe there is room to improve and robust them, also to align EU/OECD positions in this respect.

We also want to mitigate unnecessary mismatches where the UNSHELL Directive risks conflicting with the design or intention of Minimum Corporate Tax Directive, or does wider damage to the UCITS and AIFM Directives and the EU's own CMU.

Where should we focus?

The number of structures/arrangements the Commission expects to fall in the scope of this Directive is unknown (ranging from 29.000 to 75.000, from what we can read on EC's staff working document - SWD (2021) 578 final). We suspect that investment entities may not have been included in this figure and, if so, they might constitute a large portion of such reporting, albeit for no useful purpose and at undue costs.

We agree with the Commission that it is not appropriate to distinguish between legitimate and "problematic" entities, rather **the focus should be on the <u>use</u> of the entities**. This raises an obvious concern that if only 0.3% of European companies will be subject to additional reporting, then this Directive succeeds only in burdening the remaining majority with additional and on-going costs to comply with the regime for no ultimate benefit to them.

This element of proportionality should not be underestimated. Not all these structures/arrangements should be seen as "problematic" and tax authorities may not have the means to go through the thousands of investment entities that would fall in the scope of the Directive if implemented as it stands.

EFAMA believes that it should be incumbent on the Commission to provide for **a robust and broader carve-out, plus Gateway rule modifications, which would allow tax authorities to better focus (in many cases limited) resources on the entities that pose real 'shell' risks.**

[2] EFAMA's reply to EC's public consultation - available here.
[3] EC's staff working document - SWD(2021) 578 final - available here.

We also take the opportunity to highlight the **European tax competition issues that will arise if the draft Directive is implemented as it stands**. It is expected that by the mid-2022 EU Member States may be called upon to make these rules applicable to third countries.

In case the carve-out rules are not amended in line with our proposal, there is also a risk that some investment structures/entities will be relocated to third countries jurisdictions outside the EU.[4]

EFAMA reiterates that the adoption of the Un-shell proposal may be premature, as **the effectiveness of existing tools (tax transparency packages, administrative cooperation tools, other anti-avoidance measures e.g., DAC's, ATADs) was not fully explored by Member States and the Commission, and all of which are placing a greater and greater compliance burden on taxpayers and strain on tax authorities' resources.**

When commenting on the public consultation, EFAMA stated clearly that rather than exploring new legislative measures (risking imposing additional costs and unintended consequences on end-investors) **Member States and the Commission should focus on making more effective use of the existing EU legal framework to tackle tax avoidance and aggressive tax planning**.

We understand the Commission is aiming to implement a new set of rules that would allow an *ex-ante* assessment of the substance requirements of the shell entities. In the impact assessment documents we can also read as follows: *"[a]s the problems of tax avoidance and tax evasion persist,* ***it is important that shell entities are addressed in a targeted, specific manner, providing tax administrations with the information they need to prevent (rather than to react ex-post) tax avoidance and tax evasion"*** **-** SWD (2021 578 final page 8).

One can say, however, that the current measures operate *ex-post* i.e., after an assessment of the information reported, and are subject to the discretion of the tax authorities and therefore may be seen as compatible with the existing legal framework (i.e., the un-shell rules can be seen as complementary). Notwithstanding, **there are areas where the proposed measures may be seen as an overlap/duplication of the rules already implemented** (e.g., DACs, ATADs), including the proposed penalties, **and EFAMA calls Member States to review the compatibility of the proposal with the existing legal framework**.

Otherwise, there is a concern that – counter to the expressed intention – the un-shell rules will not be targeted to address the specific risks posed by the misuse of shell entities and simply add another layer of complexity for all through over-disclosure.

Detailed recommendations

EFAMA is taking the opportunity to comment on the fundamentals, but also the details of the proposed rules. Please refer to **Appendix I** where you will find **EFAMA's detailed comments, concerns and recommendations on the text of the proposal**, with **practical examples of situations that could be fixed with robust exemption rules**.

This comment paper is being shared with the Commission and with all Fiscal Attachés/Ministers of Finance of the 27 EU Member States. **EFAMA stands ready to assist and discuss the issues raised in this document** with the technical teams of the relevant stakeholders that will work in the upcoming negotiations of this proposal.

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[4] Not to mention the impact of these measures on EU Member States tax collection as the denial of a tax residency certificate in the EU could increase the level of tax incurred at source (outside of the EU) which may erode the tax base coming into the EU and undermine the investment strategies made to have parts (if not all) of the operations/structures within the EU.

Appendix I

#	Un-shell proposal	EFAMA's Comments
#0	**Relevant income** Article 4 *"For the purposes of Chapters II and III 'relevant income' shall mean income falling under any of the following categories:* *[…]* *~~(d) income from financial leasing;~~* *~~(e) income from immovable property;~~* *(f) 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.* *~~(g) income from insurance, banking and other financial activities;~~* *(h) income from services which the undertaking has outsourced to other associated enterprises."*	**Concerns** • The scope of "Relevant Income" is not limited to passive income, but also includes income from business activities. This is the case for financial services but also for income from financial leasing and income from immovable property. • We do not understand why the income which is generated from the trading activity of certain businesses would be in scope of Article 4. This creates a distortion between different economic sectors for which we see no justification. **Recommendation** • EFAMA recommends removing from definition of "Relevant Income" all income which is derived from a commercial or industrial activity.
#1	**Period of assessment Preceding two tax years** Article 6.1 (a), (b) (i), (c) *"more than 75% of the revenues accruing to the undertaking in the preceding two tax years is relevant income"* *" 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".* *"in the preceding two tax years, the undertaking outsourced the administration of day-to-day operations and the decision making on significant functions"*	**Concerns** • Is the Commission aiming for the *de facto* retrospective application of the proposed measures? • Consequently, would the current status of the undertaking (entity) already be in scope for the assessment, even in the absence of a clear and comprehensive framework regarding this assessment as of today? **Recommendation** • EFAMA recommends the introduction of a transitional period for the implementation of the new rules allowing entities to review, adapt and comply with the new measures. • As an alternative, in the absence of a transitional period, the proposal should not revert to an earlier date than the one of the approval of the Directive and related guidance.

#2 Clarification of the notion of outsourcing

Article 6.1 (c)

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

Concerns

- Would the test be based on the number of independent/internal directors?
- Would the assessment be done at the group level? Or on an entity basis? Or more globally on a jurisdiction basis?
- Does it mean that outsourcing of administrative functions within the same fund structure would be targeted?
- How is this to be combined with the indicators of minimum substance for tax purposes related to the directorships to be included in the tax returns (i.e., same criteria or different requirements)?

Recommendation

- EFAMA would welcome the clarification of the notion of "outsourcing" and the confirmation that one local director (external or internal) is sufficient to fall out of this criteria or, as the case may be, that this is the case in presence of part-time employees.
- As reflected in the AIFMD and other regulations applicable to our industry, the fund's structure substance is to be found at the ManCo level, therefore the outsourcing to the AIF Manager should not be considered when applying these criteria.
- EFAMA would also be in favour of the introduction of an "outsourcing threshold" whereby if a certain level of costs would be incurred at the level of the shell entity that would demonstrate sufficient business activities. The outsourcing of administrative activities and specialist activities is common in the investment fund industry.

#3 Exemption for undertaking with holding activities

Article 6.2, first subparagraph, (d)

"undertakings with holding activities that are resident for tax purposes in the same Member State as the undertaking's shareholder or the ultimate parent entity as defined in Section I, point 7, of Annex III to Directive 2011/16/EU"

Concerns

- Does the exemption included in article 6.2 (d) aim at covering subsidiaries of a fund qualifying as a *regulated financial undertakings* under article 6.2 (b), located in the same jurisdiction as the fund?

Recommendation

- EFAMA calls for a broader exemption to cover all undertakings held directly/indirectly by a fund (not taking into account holdings of investors in the fund). The scope of the exempt regulated financial undertakings should at least follow the OECD Pillar Two approach as detailed above.
- Designed specifically to shield investment structures from the wider Pillar Two rules and protect their internally accepted tax neutrality, the Un-shell Directive should extend exemption to cover underlying entities, which are wholly or almost wholly owned by other financial undertakings stipulated under the Directive.

#4 Exemption in presence of sufficient employees members of staff

Article 6.2, first subparagraph, (e)

"undertakings with at least five own full-time equivalent employees or members of staff exclusively carrying out the activities generating the relevant income"

Concerns

- It is not market practice to have 5 full-time employees working in each entity within a fund structure (and not even applicable for operational groups).
- Do these criteria apply on an entity per entity basis?
- Or does this criteria apply at the group/fund structure level?
- It may be very difficult to prove which employees or members of staff carry out exclusively the activities that generate the relevant income of the entity; this analysis should be based only on the number of employees/members of staff.
- "Own" employees or members of staff: are employees seconded to the entity included?

Recommendation

- EFAMA recommends revisiting the individual entity-centric approach adopted by the Un-shell proposal with regard to substance requirements in the context of investment fund structures in order to ensure that proportionate requirements for employees and staff apply.[5]

#5 Definition of premises[6]

Article 7. 1. (a)

"the undertaking has own premises or premises for its exclusive use "

Concerns

Lack of proper and clear definition:

- Is a rental agreement sufficient?
- Does the word "own" mean that premises rented at a trusted company are not compliant with this criteria?
- Is it possible that several entities of the same group share the same address?

Recommendation

- EFAMA calls for a clear definition of premises and would like to see confirmed that at least rented offices are accepted. If possible, the confirmation that sub-licensed offices within a group (shared premises) are accepted to be in line with market practice would also be welcomed.

[5] As mentioned above, requirements should be met solely at the level of Master HoldCo / equivalent entity within the fund structure / the Manco to apply globally this exemption to the overall fund structure.
[6] Please refer to our previous comments on the substance requirements. Again, the scope of the carve-out rules should be broader, and the substance of investment funds' structures is to be found at the level of management company, of the manager or the service providers responsible for their day-to-day operations.

#6 Definition of directors

Article 7. 1. (c) (i)

"(i) One or more directors of the undertaking:

(1) are resident for tax purposes in the Member State of the undertaking, or at no greater distance from that Member State insofar as such distance is compatible with the proper performance of their duties;

(2) are qualified and authorised to take decisions in relation to the activities that generate relevant income for the undertaking or in relation to the undertaking's assets;

(3) actively and independently use the authorisation referred to in point (2) on a regular basis;

(4) are not employees of an enterprise that is not an associated enterprise and do not perform the function of director or equivalent of other enterprises that are not associated enterprises".

Concerns

- Is one (independent/local) director sufficient?
- Absence of metrics to assess the notion "at no greater distance from that Member State insofar as such distance is compatible with the proper performance of duties".
- Lack of proper and clear definition of "qualified and authorised" and "actively and independently use the authorisation (…) on a regular basis".
- Does point (4) mean that the director of the undertaking can only have one mandate within the group? Or even only one mandate towards non-related companies?
- The requirement provided for in point (1) may result in a restriction to workers' freedom of movement within the EU.
- This is a critical element for the industry. We believe that if an AIFM is the appointed manager for more than one AIFs and has [investment] management control of all the entities held by each fund respectively , it is reasonably fair to say the AIFM substance requirements could be used by each of the AIFs and critically any investment structures held by those AIFs for which it is the appointed manager.

Recommendation

- EFAMA would like to see confirmed that (4) is not to be interpreted strictly, i.e. directors can have other mandates with third parties (when they are independent) or at least with other affiliates (when they act within the group). This is important considering that EU/ Member States' regulators are seeking to ensure that a fund's directors act in the best interests of fund holders and have the requisite knowledge and experience to do so. Limiting directors/ ManCo employees to one entity would be contrary to such view and harm the interests of fund investors.
- EFAMA is calling for clarity in the interpretation of this element (associated enterprises) for all the AIFs that have the same ManCo managing their operations or their investments. The Commission reveals that it has no issues with regulated entities per se and if we look into the proposed rules as they are, even if these entities would get caught in the first gateway, they would be waived in the third one by rebutting the presumption. The EC is not targeting these entities (including those with cross-border activity) and for sake of clarity and certainty this interpretation should be clarified upfront by ensuring the carveout covers such entities.

#7 Definition of full-time equivalent employees

Article 7. 1. (c) (ii)

"(ii) the majority of the full-time equivalent employees of the undertaking are resident for tax purposes in the Member State of the undertaking, or at no greater distance from that Member States insofar as such distance is compatible with the proper performance of their duties, and such employees are qualified to carry out the activities that generate relevant income for the undertaking".

Concerns

- Is it possible to have these full-time employees on the payroll of one entity (e.g., Master HoldCo in a fund structure) with recharge to the other entities of the structure? Or through a global employment contract?
- Similar comments as for the directors regarding the concept of "no greater distance from that Member State".

Recommendation

- EFAMA would like to see confirmed that such recharge mechanism/global employment contracts are accepted to fit market practice.

#8 Evidence / documentation supporting the rebuttal

Article 9.2. (a), (b), (c)

(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.

9.3. A Member State shall treat an undertaking as having rebutted the presumption if the evidence that the undertaking has provided under paragraph 2 proves 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".

Concerns

Lack of proper and clear definition:

- Are the examples given solely of illustrative nature?
- Under which format the rebuttal has to be done?

Recommendation

- For EFAMA the proposal should be clear on the exact process to be followed. This would be critical for sake of the level of certainty that should be granted to the taxpayer on the tax treatment applicable to its annual transactions, e.g. declaration and supporting documentation to be included in the tax returns.
- EFAMA would like to see confirmed that article 9.3. should be interpreted in a transfer pricing context, i.e. that the level of control and risk are borne would depend on the type of activity/industry – e.g. a securitisation vehicle with no or very limited substance should be able to meet this test.

#9 Absence of tax benefit

Article 10 (1), (2)

"1. A Member State shall take the appropriate measures to allow an undertaking that meets the criteria laid down in Article 6(1) to request an exemption from its obligations under this Directive if the existence of the undertaking does not reduce the tax liability of its beneficial owner(s) or the group, as a whole, of which the undertaking is a member.

2. A Member State may grant that exemption for one tax year if the undertaking provides sufficient and objective evidence that its interposition does not lead to a tax benefit for its beneficial owner(s) or the group as a whole, as the case may be".

Concerns

- What methodology should be followed to compare the overall tax liability of the beneficial owner/group with and without the undertaking being interposed?
- Difficult to carry out this assessment in a fund with multiple investors or where investors' particular tax circumstances are not known.
- The application of DTTs in the absence of the shell entity may lead to no/very limited tax benefit.

Recommendation

- EFAMA calls for the introduction of a clear set of assumptions to be made, for which the analysis needs to be carried out (e.g. a minimum threshold test of 25 or 50 per cent, as already included in ATAD) or in terms of the amount of reduction/tax benefit that would be tackled.

#10 Articulation of the tax consequences

Article 11 (2)

"The Member State of the undertaking's shareholder(s) shall tax the relevant income of the undertaking in accordance with its national law as if it had directly accrued to the undertaking's shareholder(s) and deduct any tax paid on such income at the Member State of the undertaking (…)

Where the payer is not resident for tax purposes in a Member State, the Member State of the undertaking's shareholder(s) shall tax the relevant income accruing to the undertaking in accordance with its national law as if it had directly accrued to the undertaking's shareholder(s), without prejudice to any agreement or convention that provides for the elimination of double taxation of income, and where applicable, capital, in force between the Member State of the undertaking's shareholders and the third country jurisdiction of the payer (…)

Where the undertaking's shareholder(s) is not resident for tax purposes in a Member State, the Member State of the payer of this income shall apply withholding tax in accordance with its national law, without prejudice to any agreement or convention that provides for the elimination of double taxation of income, and where applicable, capital, in force with the third country jurisdiction of the undertaking's shareholder(s)".

Concerns

- Lack of coherence concerning the sequence of the tax consequences applicable at the level of the source jurisdiction, the shell and the shareholder's undertaking (even between the content of the explanatory statement and article 11).
- The deduction provided in Article 11(2) should cover any tax paid by the undertaking, also outside its Member State of residence (i.e. withholding tax applied in the Member State of the payer); this approach is in line with the explanatory statement (see page 13, point 1, third bullet point) where it is stated that EU shareholder "**will also take into account and deduct any tax paid by the shell".**

Recommendation

- EFAMA understands that the Commission planning to expand this proposal to non-EU countries and we highly recommend that all measures should be included within the same legal text and enter into force at the same time.

#11 Shareholder's undertaking

Article 3 (6)

"the individuals or entities directly holding shares, interest, stakes, participations, membership rights, entitlement to benefits or any equivalent rights or entitlements in the undertaking and in the case of indirect holdings, those individuals or entities holding interest in the undertaking through on or a chain of undertakings none of which fulfils the indicators of minimum substance set out in Article 7(1) of this Directive".

Concerns

- This key concept in the interpretation of the tax consequences does not specify whether tax transparent entities are included or not in the notion of indirect holdings.
- Are indirect shareholders to be considered when the immediate direct shareholder(s) is/are not fulfilling the indicators of minimum substance (i.e., move up the chain until finding the indirect shareholder which either passes the test or is excluded)?
- How to apply tax consequences where the ultimate shareholder is a regulated fund exempt from the scope of the substance assessment?

Recommendation

- EFAMA calls for clarifications on the concept of "indirect holding" in presence of chains of undertakings that include tax transparent entities (e.g. tax transparent investment funds).

#12 Request for tax audits

Article 15

"Where the competent authority of one Member State has reason to believe that an undertaking which is resident for tax purposes in another Member State has not met its obligations under this Directive, the former Member State may request the competent authority of the latter to conduct a tax audit of the undertaking".

Concerns

- How to assess the concept of "reason to believe"?
- In the absence of a clear definition, this concept may lead to fishing expeditions from Member States, with adverse consequences for the taxpayers from a fairness perspective.

Recommendation

- EFAMA raises awareness on the need to provide a more detailed and comprehensive framework for this new exchange of information tool between the tax authorities of the Member States.
- For EFAMA, the concept of "reason to believe" needs to be interpreted in compliance with the principle of proportionality (i.e., the tax audit would have to be necessary, and the reasons invoked would need to be justified) in line with ECJ cases on the exchange of information.

#13 Exemption for PEPPs

Not covered by the proposal.

Concerns

- Only institutions for occupational retirement provision are currently excluded from the Directive where we cannot find specific exclusion rules for pan-European Pension Products.

Recommendation

- Since PEPPs are subject to supervision and they do not pose a risk of tax abuse, EFAMA recommends Member States to include PEPPs in the list of "regulated financial undertakings" cases on the exchange of information, as follows – possible Article 6.2., second subparagraph, (g-bis) - *"a pan-European Personal Pension Product (PEPP) as defined in Article 2, point (2) of Regulation (EU) 2019/1238 of the European Parliament and of the Council of 20 June 2019".*

ABOUT EFAMA

EFAMA, the voice of the European investment management industry, represents 28 member associations, 58 corporate members and 24 associate members. At end Q1 2021, total net assets of European investment funds reached EUR 19.6 trillion. These assets were managed by more than 34,600 UCITS (Undertakings for Collective Investments in Transferable Securities) and almost 29,600 AIFs (Alternative Investment Funds). At the end of 2020, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 27 trillion.

More information is available at www.efama.org

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