BRUSSELS | 17 JANUARY 2022

EU Tax Policy Report - Semester II - July to December 2021

CFE Tax Advisers Europe has now published its EU Tax Policy Report covering the second semester of 2021. The EU Tax Policy Report is a bi-annual publication which provides a detailed analysis of significant primary law and tax policy developments at both EU and international level that have occurred in the previous six months which would be of interest to European tax advisers. It also includes an overview of selected CJEU case-law and relevant European Commission decisions.

We invite you to read the EU Tax Policy Report and remain available for any questions or comments that you may have.

ECOFIN to Discuss EU Directive on Minimum Tax

At the ECOFIN meeting scheduled to take place tomorrow, 18 January 2022, EU Finance Ministers will hold their first discussions concerning the European Commission proposal for an EU directive on global minimum level of taxation for multinational groups, adopted just prior to Christmas. The French Presidency of the Council of the EU is eager for the Directive to be approved as quickly as possible. Some Member states have already expressed reservations, such as Estonia.

The Directive intends to implement the OECD Pillar 2 agreement into the

European Union, and will become EU law once adopted with unanimous vote of all Member states. The EU proposal follows on from the publication of the OECD Pillar 2 Model, which contains detailed rules to assist governments in the implementation of the minimum 15% tax rate as of 2023.

The EU Pillar 2 Implementation Directive follows the OECD model rules to ensure consistency, with one notable departure: in addition to cross-border operating MNEs, the EU Directive is intended to apply to domestic groups reaching the threshold of €750 million revenue (combined financial revenues per year), with either a parent or a subsidiary situated in an EU Member state. The provision on application of the Directive to domestic entities is unlikely to have significant impact and is intended to ensure consistency with EU law principles, notably the principle of equal treatment (non-discrimination). As consequence, the Under-Taxed Payments Rule will only apply to external transactions, and not on the intra-EU level.

The implementation of the Pillar 2 Directive will affect existing EU tax law provisions (ATAD), specifically for the Controlled Foreign Company (CFC) rules, which could interact with the Income Inclusion Rule, the primary rule of Pillar 2, which merits amendments of ATAD. In practice, ATAD CFC rules will take precedence and any additional taxes paid by a parent company under a CFC legislation in a given fiscal year will be taken into consideration by attributing those to the relevant low-taxed entity for the purpose of computing its (jurisdictional) effective tax rate.

EU Commissioner Paolo Gentiloni said at the time of the proposal being published that hot on the heels of this proposal the Commission is already looking towards the new framework for business taxation in the EU (BEFIT), aimed to streamline corporate taxation rules and create a more business-friendly environment in the Single Market, stating *"We will follow up with a second directive next summer to implement the other pillar of the agreement, on the reallocation of taxing rights, once the related multilateral convention has been signed. The European Commission worked hard to facilitate this deal and I am proud that today we are at the vanguard of its global rollout."*

CFE Tax Advisers Europe Annual Report

CFE Tax Advisers Europe, in cooperation with IBFD, has published its 2021 Annual Report, which can be viewed on the CFE website. The annual report details CFE's technical and policy work and relevant events and publications in the 2021 calendar year. The report also provide a detailed overview of our activities aimed at Member organisations and other external and internal stakeholders.

CFE President Piergiorgio Valente said of the occasion: *"In 2021, the CFE Executive Board together with the Technical Committees and CFE Team continued to work on existing projects and focus on relevant new technical publications and policy developments, in close conjunction with the Member Organisations and in synergy with the work of the EU institutions and the OECD. Spurred on by the limitations on meeting in-person due to the pandemic, CFE also accelerated the implementation of our Digital Strategy, a key part of which is the creation of digital, online content for our members. The silver lining of this crisis has been the opportunity to transfer and deliver content online, allowing us to provide the best experts and speakers, for the benefit of our joint membership. We have been able to deliver content on international and European tax law and policy to all our members. CFE is proud to be a relatively small organisation with a significant impact. With a small technical team but very dedicated volunteers from our Member Organisations and advisers who volunteer to assist the CFE Executive Board, we have made and continue to make significant impact on the development of the tax profession. We work with our members and gather the best professionals across Europe to share their expertise, exchange views, learn from each other, and most importantly, agree on a common European view on tax policy which is then conveyed to the EU, the OECD, UN and the Platform for Collaboration on Tax. The focus on international tax policy continues to evolve and CFE will continue to support our Member Organisations in their educational endeavours for their members. In doing this CFE continues to give continuous,* *high-level participation at EU, OECD, UN level and, thus, ensure that tax professionals have a voice that is heard in matters of international tax policy."*

We invite you to read the publication and remain available for any queries you may have.

EU Shell Entities Directive

Prior to the Christmas break, the European Commission adopted a proposal for a directive on the misuse of shell entities, or unshell legislation in the EU-bubble jargon. The directive aims to enable more tools for tax authorities to detect the misuse of shell entities, by requiring reporting (relevant disclosure) in tax returns and consequently denying benefits of tax treaties and EU tax law.

The Directive does not define shell entities, but requires certain criteria to be fulfilled (gateway principle and substance requirements), to allow the tax administrations to designate an entity as a shell. In practice, the gateway principle will look into activities of the entities based on the income where 75% of an entity’s overall revenue in the previous two tax years does not come from the entity’s trading activity or if more than 75% of its assets are real estate property or other private property of particularly high value. The second gateway element looks at the cross-border element and it is satisfied where the relevant income is received through cross-border transactions or it is passed on to other entities abroad. The final gateway indicator is linked to the corporate management and is aimed to asses whether the administrative operations of the entity are in-house or outsourced. With some exceptions, a company which ticks the boxes for these three indicators will be required to disclose in its tax return information concerning the premises of the company, bank accounts, tax residency of its directors and its employees. If an entity fails at least one of the substance indicators, it will be presumed to be a shell.

As a consequence, where a company is considered to be a shell entity, it will be denied tax treaty and EU tax law benefits, notably arising from the Parent-

Subsidiary and Interest and Royalties Directives. The Member State of residence of such company can either deny to issue a tax residence certificate or the certificate shall state that the entity is a shell company. In addition, payments to third countries will be subject to withholding tax and will not be seen as passing-through the shell for tax purposes, with inbound payments taxed in the state of the shell's shareholder as a result of this targeted tax treatment.

The Commission's impact assessment and public consultation comments from professional associations note that it remains challenging to define what constitutes a shell entity and that assessing lack of substance depends on the facts and circumstances of each specific entity and transaction. Public consultation comments also highlight that taxpayers should always have an effective right to provide evidence of their specific circumstances, particularly concerning structures that are not put in place to obtain tax advantage but for valid commercial reasons, in accordance with settled ECJ case-law. To address some of these concerns, the Commission proposal includes a 'rebuttal of the presumption' provisions, where tax administrations are obliged to allow companies deemed to be a shell to rebut this presumption by providing further evidence of the commercial rationale behind their business activity.

Penalties for non-compliance with the reporting requirements of this directive include administrative sanction of at least 5% of the undertaking's turnover in the relevant tax year, if the undertaking fails to disclose relevant information or if it makes a false declaration in the tax return.

This Directive also requires unanimous support of Member states to be enacted into EU law.

EU Targets Portion of Carbon Tax Revenues & OECD Pillar 1 To Finance Post-Pandemic Recovery

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The European Commission is proposing to Member states that part of the revenue generated by the July 2021 proposal for a carbon border adjustment mechanism and the emissions trading scheme (ETS) goes direct into the EU budget, in order to finance the post-pandemic recovery of the European continent. In addition, EU's own additional resources would come as portion of the residual profits of MNEs within scope of Pillar 1, once the Multilateral Convention negotiated by the BEPS Inclusive Framework and the related EU Directive are both in force, as follows:

- 25% of the revenues generated by EU emissions trading become an own resource for the EU budget,
- 75% of the revenues generated by a carbon border adjustment mechanism become an own resource for the EU budget,
- 15% of the share of the residual profits of the MNEs under Pillar 1.

It is estimated that the package would be worth 17 billion Euros from 2026, as part of the new multi-annual financial framework for the EU. The Commission also aims to create a carbon market for cars and buildings which is opposed at present by France and Spain, as well as a more general opposition towards certain carbon tax measures from the Eastern European Member states who fear these policies are driving energy prices higher up.

The selection of the remitted material has been prepared by: Piergiorgio Valente/ Aleksandar Ivanovski/ Brodie McIntosh/ Filipa Correia