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# The Unshell Directive and Its Impact On Dutch Holding Structures

by Charlotte Tolman and Michael Molenaars

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In this installment of In Step With Stibbe, Tolman and Molenaars examine the European Commission's proposed Unshell directive, which targets the misuse of shell companies, and its potential impact on Dutch holding structures.

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The European Commission presented a legislative proposal for a new EU directive to prevent the misuse of EU shell companies (the Unshell directive) on December 22, 2021, in the context of its ongoing fight against aggressive tax planning.[1] The directive seeks to discourage the use of shell companies within the EU by introducing reporting obligations and possibly denying tax advantages (*inter alia*, the denial of tax benefits under tax treaties and EU directives) to EU companies that are deemed to have no or minimal substance. To determine whether a company falls under this directive, specific "gateways" and "substance indicators" need to be assessed. If adopted, the Unshell directive must be transposed into national law by June 30, 2023, and take effect January 1, 2024.

If adopted, the directive could have an enormous impact on European (holding) structures. Unlike pillar 2, the draft of the Unshell directive is not limited to multinational groups with global revenues exceeding €750 million. It is therefore expected to affect many small and medium-size enterprises with an EU presence. This article examines the most important features of the Unshell directive draft, how it could affect Dutch (holding) structures, and what actions can be taken now by businesses that are likely to face consequences of the directive.

## I. Scope of the Unshell Directive

### A. Step 1: Gateways

Any entity, regardless of its legal form, that is engaged in an economic activity, is considered a tax resident and is eligible to receive a tax residency certificate in a member state will in principle be in scope of the Unshell directive.

To determine whether an EU entity has specific reporting obligations under the directive, it must first be assessed whether the entity can be considered at risk and whether it meets the following cumulative three gateways by having:

- more than 75 percent of its revenues in the preceding two tax years qualify as "relevant income" (that is, passive income, including, *inter alia*, dividends; royalties; or income

[1] European Commission, Proposal for a Council Directive 2021/0434 (CNS), COM(2021) 565 final (Dec. 22, 2021). This proposed directive is also known as the third anti-tax-avoidance directive (ATAD 3).



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from the disposal of shares, financial leasing, immovable property, or financial activities) or, if more than 75 percent of its assets are shares or real estate property, the assets have a book value of more than €1 million;
- at least 60 percent of the entity's relevant income is earned or paid out via cross-border transactions, or more than 60 percent of the book value of immovable property or movable property with a book value exceeding €1 million is located outside the member state of the entity in the preceding two tax years; and
- the administration of day-to-day operations and the decision-making on significant functions were outsourced in the preceding two tax years.[2]

The Unshell directive does not provide any guidance on how to interpret the gateways. The third gateway, looking at whether the administration of day-to-day operations and decision-making is outsourced in the preceding two years, especially leads to many questions. The directive does not explain the concept of outsourcing. It seems to target entities relying on professional third-party service providers, such as trust offices or equivalents, for their own administration and director services. However, it is unclear whether, for example, outsourcing of the administration to another (EU) group entity or even a group entity in the same member state would also qualify. It is also not clear whether outsourcing only its administration, and not the decision-making, would satisfy this gateway. Based on the literal reading of the Unshell directive, the latter should not be the case. A further clarification of the outsourcing concept would be helpful.

Another notable aspect is the gateways' two-year lookback principle. Given that the European Commission aims to have the Unshell directive transposed into national law by June 30, 2023, and to become effective January 1, 2024, this means that the assessment of the gateways may already be relevant as of January 1, and in fact what is happening right now. How the lookback principle should be applied, and when this should be registered or declared by the relevant entity, is unfortunately not clear. For example, if the entity outsources its administration and decision-making for the first six months of 2022, but not for the remainder of 2022 and 2023, it is unclear whether this means that the third gateway will be immediately satisfied. Further clarification would be helpful, and some leniency may be appropriate given the very short time frame between publishing the draft Unshell directive and the rules becoming relevant.

## B. Step 2: Carveouts and Exemption

The Unshell directive provides a carveout for some entities, even if they would pass the gateways. The carveout applies to:
- specific *regulated* (financial) entities (a list of qualifying regulated entities is included in the Unshell directive);
- alternative investment fund managers;
- listed entities;
- entities of which the shareholders and their operational businesses are in the same member state;
- holding companies whose shareholder(s) or ultimate parent entity is in the same member state; and
- entities with at least five full-time equivalent employees or staff members exclusively generating the income.[3]

These entities would have no reporting requirements under the Unshell directive. Tax-transparent partnerships (for example, funds) are in principle not in scope of the Unshell directive. However, it is unclear whether, for example, hybrid entities would be in scope. Depending on how the carveout will be interpreted by member states, this could mean that the same member state carveout may not apply in a situation of a hybrid fund structure in which, for example, a European fund (transparent for EU tax purposes) invests in European operational companies through a European holding company in the same country as the European fund and is considered a shell company under the Unshell directive. If the same member state carveout cannot be applied

[2] *See* article 6, para. 1 of the Unshell directive.

[3] *See* article 6, para. 2 of the Unshell directive.



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because of the fund being transparent for EU tax purposes, distributions by the operational companies may become subject to withholding taxes.

The Unshell directive also provides a temporary exemption for entities that have passed all gateways.[4] An exemption from all obligations under the Unshell directive will be granted for one year (possibly extended to five years) if the existence of the entity does not reduce the tax liability of its beneficial owner or of the group as a whole — and this needs to be supported by sufficient and objective evidence. In this respect, a comparison of the overall taxes due with interposition of the EU entity and the taxes due without interposition would be made. However, it is not clear when such evidence would be considered "objective." If this would mean that such evidence cannot be provided by the group, but needs to be supported by a third party, this would lead to yet another administrative (and costly) burden. On top of that, it may be very difficult — for example, for fund structures — to come to a comparability assessment if this means that tax profiles from separate investors are required. The assessment of whether the exemption can be met is in and of itself subjective in nature, and tax authorities may hold different interpretations.

### C. Step 3: Minimum Substance Indicators

Meeting the above gateways and not being eligible for a carveout or temporary exemption leaves the entity to be considered "at risk." As a result, some reporting obligations to determine whether the entity has minimal or no substance would be applicable, and the information would be automatically exchanged with the other member states. The entity would need to declare in its annual tax return whether it meets the following three cumulative "minimum substance indicators":

- the entity has its own premises or exclusive use thereof in its member state;
- the entity owns at least one active bank account within the EU; and
- the entity has either (a) at least one adequately qualified and authorized (and actively and independently using such authorization) director that is a resident of the member state of the entity or within a reasonable distance to perform its duties, who is not an employee or director of another non-associated entity; or (b) the majority of its full-time equivalent employees tax resident in the entity's member state.[5]

In addition to declaring whether the above minimum substance indicators are met, the entity needs to include documentary evidence with its tax return, including information on:

- the type of business activities performed to generate the relevant income;
- outsourced business activities;
- resident directors or employees;
- the bank account number;
- any mandates granted to access the bank account; and
- evidence of the bank account's activity.[6]

The obligation to provide documentary evidence imposes an administrative burden on taxpayers.

As with the gateways, the Unshell directive does not provide much guidance on how to interpret the substance indicators. It is, for example, not clear what is exactly meant by "having its own premises or premises for its exclusive use" and whether it would be allowed to share the same premises within a group in case of multiple entities located in the same member state. Neither is it clear, regarding the resident director, if and when a director would be considered qualified or on what criteria this would be assessed.

Another important aspect to keep in mind is that the interpretation of the requirements should ideally be coordinated between member states to guarantee a level playing field. Therefore, it would be good if the Unshell directive contained more guidance on the gateways and substance indicators, ideally some examples and cases.

[4] *See* article 10 of the Unshell directive.

[5] *See* article 7, para. 1 of the Unshell directive.

[6] *See* article 7, para. 2 of the Unshell directive.



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Entities meeting the above minimum substance indicators and providing satisfactory documentary evidence will be presumed to have minimum substance. For these entities, there will be no tax consequences, but the declared information will be automatically exchanged with other member states through the EU's common communication network (CCN) within 30 days after filing their tax returns. This imposes an administrative burden on the tax authorities, as noted by the Dutch government.

Entities that do not meet the minimum substance indicators will be presumed to be shell companies. The information declared will be automatically exchanged with other member states through the EU's CCN. The tax consequences of being considered a shell company will be described in Section II.

### D. Step 4: Rebuttal

The presumption of being a deemed shell entity can be rebutted by providing additional supporting evidence of:

- the commercial rationale behind using the entity;
- information about employees, including their experience and position within the group; and
- concrete evidence that decision-making is taking place in the member state of the entity.[7]

The rebuttal will be accepted if evidence proves that the entity has performed, and continuously has control over and borne the risks of, the business activities that generated the relevant income (or assets). If the rebuttal is accepted, it may be valid for a period of five years if circumstances remain unchanged. This information will also be automatically exchanged with other member states through the EU's CCN.

The presumption of being a deemed shell entity can only be rebutted after filing a tax return, which is generally at least several months after closing of an entity's tax year. Assuming that it may take some more months before the authorities have assessed the rebuttal, there could be a long period of uncertainty on the entity's tax-filing position. Because of the presumption of guilt, the entity would face the tax consequences as discussed in Section II, pending the outcome of the rebuttal procedure. This would mean, for example, withholding taxes unnecessarily withheld.

## II. Shell Company Tax Consequences

Entities that satisfy the three gateways and are deemed not to meet the minimum substance indicators (and are not able to rebut the presumption of being a shell company) face the following tax consequences:

- the member state in which the shell entity is resident will deny a request for a certificate of tax residence or will issue a certificate with a warning that the entity is not entitled to double tax relief, leaving the entity no longer able to benefit from EU and non-EU tax treaties;[8]
- other member states will deny tax benefits under tax treaties and EU tax directives, notably the EU parent-subsidiary directive (2011/96/EU) and the EU interest and royalties directive (2003/49/EC);[9]
- the member state(s) in which the shell entity's shareholders are located will treat the shell entity as a disregarded entity (a sort of super controlled foreign corporation) and tax the relevant income as if it directly accrued to the shareholders (a tax credit will be given for any taxes already levied in the entity's member state);[10] and
- the member states in which underlying assets of the shell entity are located can impose withholding taxes on payments to the shell entity (as if paid directly to its shareholders).

Member states will have automatic access to information on shell entities from the automatic exchange of information under the Unshell directive. In addition to the automatic exchange of information on (deemed) shell entities, member states may request the performance of tax audits

[7] *See* article 9 of the Unshell directive.

[8] *See* article 12 of the Unshell directive.

[9] *See* article 11, para. 1 of the Unshell directive.

[10] *See* article 11, para. 2 of the Unshell directive.



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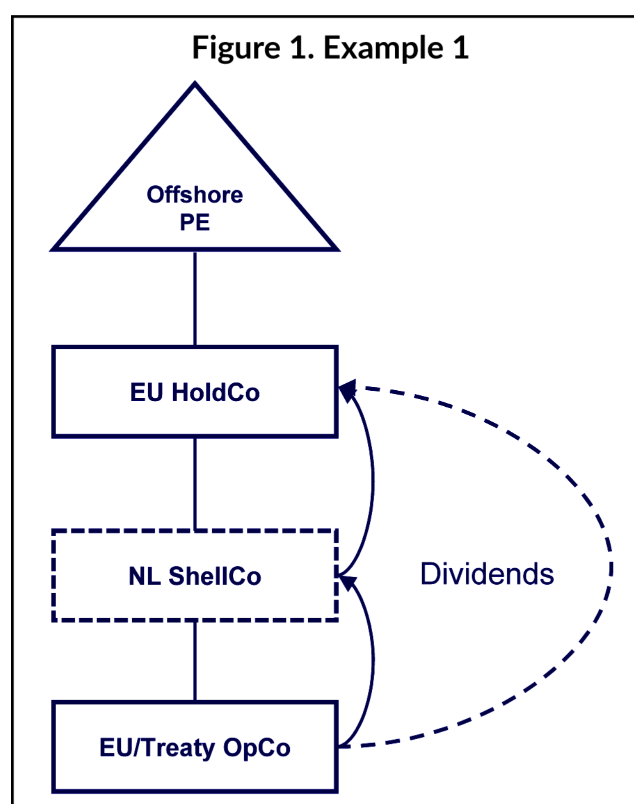
from other member states when it is suspected that an entity does not meet its obligations under the Unshell directive.[11] The member states would need to comply with the request within one month, which may impose another heavy administrative burden on taxpayers and tax authorities. The Unshell directive further provides noncompliance penalties, to be determined and laid down by the member states themselves. The European Commission proposes an administrative pecuniary sanction of at least 5 percent of the entity's turnover in the relevant tax year, which could result in significant penalties.[12]

## III. Impact on Dutch (Holding) Structures

On February 21 the Dutch Ministry of Foreign Affairs submitted its assessment of new commission proposals, including the draft Unshell directive, to the Dutch House of Representatives.[13] The Dutch government supports the policy goals as laid down in the Unshell directive and agrees on the need for an EU approach to effectively prevent the abusive use of shell companies. The government noted, however, that the Unshell directive is broad and contains many steps, which makes it challenging and complex to implement. For example, the 30-day deadline for exchanging information and responding to further information requests from other member states seems impracticable. Further, the Dutch government doubts that the plan for the directive to take effect January 1, 2024, is realistic.

For a long time, the Netherlands has been a popular jurisdiction for holding companies because of, *inter alia*, its broad tax treaty network, participation exemption, and absence of a withholding tax on interest and royalties. However, over the last couple of years the tax landscape within the EU has changed significantly, resulting in the introduction of (inter)national antiabuse rules (for example, the multilateral instrument, the first and second anti-tax-avoidance directives (ATAD 1, 2016/1164/EU; and ATAD 2, 2017/952/EU), and the general antivoidance or abuse rule) and a domestic conditional withholding tax on interest and royalty payments. The Unshell directive proposal is another EU initiative to discourage the use of holding companies, and it is expected that the proposal will affect private equity or debt fund structures with Dutch or European intermediary or subsidiary companies. The illustrative examples in figures 1 and 2 show the effects of the Unshell directive in a scenario in which a Dutch intermediary company is used that is considered a shell entity under the Unshell directive.

**Figure 1. Example 1**




In the first example (in Figure 1), the Dutch intermediary company (NL ShellCo) holds all shares in an EU/tax treaty jurisdiction operational company (EU/Treaty OpCo). NL ShellCo is considered a shell company under the Unshell directive: All its income consists of dividends from EU/Treaty OpCo, and it has outsourced its day-to-day management to a Dutch trust office (the gateways are met). NL ShellCo has one Dutch resident director, who also acts as director for other nonaffiliated companies, and no employees. The minimum substance indicators are therefore

[11] *See* article 15 of the Unshell directive.

[12] *See* article 14 of the Unshell directive.

[13] Dutch Ministry of Foreign Affairs, "Fiche 1 — richtlijn doorstroomvennootschappen" (Feb. 21, 2022) (in Dutch).



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not met. NL ShellCo is in principle considered a shell company under the Unshell directive, and we assume that the carveouts, exemption, and rebuttal option are not applicable in this case.

### A. At the Level of NL ShellCo

As a result of being a shell company, NL ShellCo would no longer be entitled to obtain a residency certificate in the Netherlands. Based on the draft preamble to the Unshell directive, shell entities will no longer benefit from the parent-subsidiary directive. It is noted in Dutch literature that this could even mean that the shell entity may no longer apply the domestic participation exemption, a regime that follows from the parent-subsidiary directive. NL ShellCo may therefore need to include dividends in its corporate income tax base. It is uncertain whether this is envisaged by the Unshell directive.

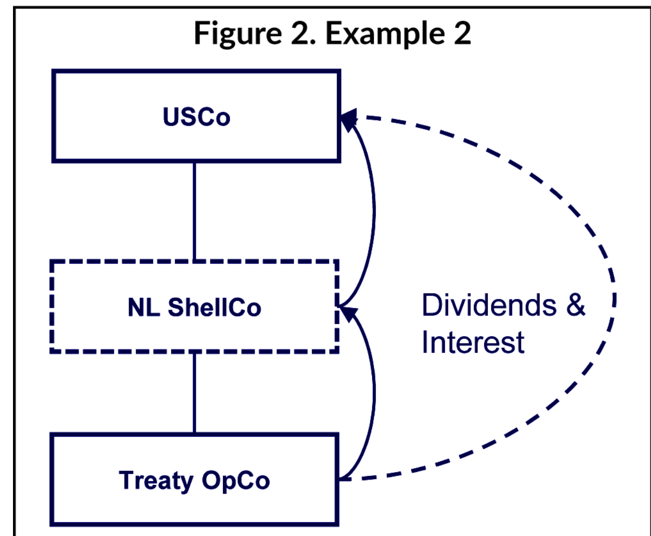
### B. At the Level of EU/Treaty OpCo

Dividends paid by EU/Treaty OpCo to NL ShellCo have been exempt from dividend withholding tax under the parent-subsidiary directive or an applicable tax treaty. Under the Unshell directive, however, the parent-subsidiary directive would no longer be applicable, so the dividends will be considered distributed to the EU HoldCo directly and possibly be subject to dividend withholding tax. In the case at hand, the parent-subsidiary directive may be applicable between EU OpCo and EU HoldCo so that the dividend could be exempt from dividend withholding tax. However, EU OpCo's jurisdiction may consider EU HoldCo to be a shell entity and deny the application of the parent-subsidiary directive, resulting in dividends being subject to dividend withholding tax (assuming no application of a tax treaty between EU/Treaty OpCo and the offshore jurisdiction of the private equity fund). Also, even if EU OpCo doesn't consider EU HoldCo to be a shell entity under the Unshell directive, whether the dividend distribution is exempt also depends on application of the domestic dividend withholding tax exemption in OpCo's jurisdiction (that is, implementation/interpretation of the parent-subsidiary directive and the GAAR). For Treaty OpCo, the result of not being entitled to a residency certificate may also have an impact. Without a residency certificate, NL ShellCo may, in the worst case, no longer be entitled to treaty benefits. The question can be raised whether it is lawful to deny benefits under a bilateral convention because of an EU directive.

### C. At the Level of the EU HoldCo

At the level of EU Holdco, assuming this is not a shell company under the Unshell directive, dividends would be considered to have been received directly from the EU/Treaty OpCo. Assuming the parent-subsidiary directive would be applicable, the dividends may, depending on the participation exemption regime in the EU HoldCo country, still be exempt. The exemption of the Unshell directive may have been applicable in this case, because using the shell company may not result in a tax benefit for the group.

**Figure 2. Example 2**




In the second example (in Figure 2), the Dutch intermediary company (NL ShellCo) that holds all shares in an operational company in a tax treaty jurisdiction (Treaty OpCo) is considered a shell company under the Unshell directive, and we assume that the carveouts, exemption, and rebuttal option are not applicable.

Because it's considered a shell company under the Unshell directive, NL ShellCo would no longer be entitled to obtain a residency certificate in the Netherlands and would no longer benefit from the parent-subsidiary directive. NL ShellCo may need to include the dividends in its corporate income tax base if the domestic participation exemption would be denied.



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Dividend/interest payments by Treaty OpCo to NL ShellCo may have been exempt from withholding tax under the applicable tax treaty. For Treaty OpCo, the result of NL ShellCo not being entitled to a residency certificate may have an impact on the applicability of the withholding tax provisions of the tax treaty. Without a residency certificate, NL ShellCo may no longer be entitled to treaty benefits. However, the question can be raised whether it is lawful to deny benefits under a bilateral convention only because of an EU directive and the fact that no residency certificate can be obtained.

## IV. Takeaways

Although there are still a lot of open questions, and it is unclear how some situations should be interpreted under it, the Unshell directive will probably affect a lot of European and Dutch holding structures.

It is important for structures that include Dutch or European entities to review their structures right now and assess whether the Unshell directive may be applicable, because the assessment of the gateways looks at the preceding two tax years. What is happening right now, as of January 1, may already be relevant (depending on what form of the proposed Unshell directive is adopted). As a next step, if it is likely that an entity satisfies the gateways, the minimum substance indicators should be reviewed, and if needed the substance can be bolstered or alternative structuring options could be carefully reviewed and considered before the Unshell directive comes into effect. ■

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