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EU Finance Ministers Discuss Pillar 2 Directive, Estonia Maintains Reservations

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On 18 January 2022 EU Finance Ministers held their first discussions concerning the European Commission proposal for an EU directive on global minimum level of taxation for multinational groups, proposed just prior to Christmas. The French Presidency of the Council of the EU has set out as its priority adoption of this directive in first half of 2022. The Directive intends to implement the OECD Pillar 2 agreement into the EU legal order, and will only become EU law with unanimous vote of all Member states.

The majority of the EU finance ministers highlighted the need to transpose the agreed rules of international corporate taxation, and thanked the Commission

services and France for prioritising the file. Dissenting, Estonia's Minister of Finance Keit Pentus-Rosimannus maintained certain reservations, contending the EU proposal goes beyond the OECD agreed rules, to the extent it extends to domestic companies. She also urged caution about the speedy adoption of Pillar 2 without concurrent adoption of Pillar 1. Estonia's finance minister has previously expressed certain reservations:

„The Estonian corporate income tax system is simple and efficient. It encourages innovation, growth, and job creation. It is in Estonia’s interest to keep it as such. Any new tax rules would have to be carefully targeted to avoid undue burden on business. The OECD minimum tax agreement has taken the Estonian tax system into consideration. Nevertheless, it is important to ensure that the EU proposal will not extend the tax beyond what’s already agreed.", Ms Pentus-Rosimannus said in December 2021.

According to the tentative agenda of the European Commission - College of Commissioners, the Pillar 1 directive is scheduled for College adoption on 27 July 2022 (proposal on the implementation of the OECD global agreement on re-allocation of taxing rights (Pillar One); whilst the Debt-Equity Bias Reduction initiative (DEBRA) is scheduled for adoption on 11 May 2022.

Presenting the priorities of the French presidency, Bruno Le Maire, Minister of Finance and Economic Affairs said:

"Europe has managed to bounce back from the worst economic crisis since 1929. We took the right action at the right time. However, the crisis showed us that it is necessary to build a new economic model, based on strategic autonomy. What kind of Europe do we want to build? We want an independent Europe that is capable of defending its values, promoting investment in innovation and key technologies, and protecting the environment. We want to build a new model based on sustainable growth."

EU Commission Seeks Feedback On Pillar 2 & Unshell Proposals

The European Commission is now formally seeking feedback on the two proposals adopted prior to Christmas, via the Have Your Say portal. The EU portal states that the feedback period is open until 22 March 2022.

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 Consultation 'VAT in The Digital Age'

The European Commission has published a call for evidence for an impact assessment, accompanied by a public consultation on the future of the VAT in the digital age. The Commission action plan for 2022 envisages ‘VAT in the digital age’ legislation, which will cover:

- VAT reporting obligations and e-invoicing
- VAT treatment of the platform economy
- Single EU VAT registration.

According to the Commission, for digital reporting requirements, costs linked to the introduction of new reporting obligations are expected, but the reduction of ‘fragmentation costs’ related to differences in jurisdictions’ data reporting requirements would benefit all businesses. This will require the highest level of new IT investments and may require a longer implementation period. Depending on the level of centralisation of the IT infrastructure to be built, implementation may run until 2030. However, Member States investing in their IT would benefit from a more efficient tool to fight against fraud and make good use of the data to provide better services to taxpayers. This would be a game changer in the fight against fraud, the Commission contends.

OECD Publishes 2022 Transfer-Pricing Guidelines

The OECD has published the latest iteration of the Transfer-Pricing Guidelines, containing detailed guidance on the application of the international tax rules in a cross-border context, in particular the Arm's Length Principle and the related transfer-pricing methods. The OECD Transfer Pricing Guidelines are an essential tool for both Multinational Enterprises and Tax Administrations. The document is available in English and French.

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.

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