EFAMA

European Fund and Asset Management Association

FIGHTING THE USE OF SHELL ENTITIES AND ARRANGEMENTS FOR TAX PURPOSES

EFAMA COMMENTS ON THE EUROPEAN COMMISSION'S PUBLIC CONSULTATION

27 August 2021

Rue Marie-Thérèse 11 | B-1000 Bruxelles
T +32 2 513 39 69 | info@efama.org | www.efama.org
EU transparency register: 3373670692-24

EFAMA's COMMENTS ON THE EUROPEAN COMMISSION's PUBLIC CONSULTATION ON FIGHTING THE USE OF SHELL ENTITIES AND ARRANGEMENTS FOR TAX PURPOSES

The Commission received several complaints and requests for action and is trying to understand how the EU legal framework could be improved to tackle the use of legal entities with no or minimum substance and no real economic activities, by taxpayers operating cross-border to reduce their tax liability (with focus on situations where the ultimate objective is to minimise the overall taxation of a group or of a given structure). While EFAMA fully supports the Commission's initiatives to fight tax avoidance and aggressive tax planning, **we understand that the Consultation on "shell entities" is not aimed at investment funds.**

As such, rather than respond to your questionnaire directly, EFAMA understands it would be more helpful to share with you the views of our industry and influence the upcoming initiatives by explaining: a) the commercial rationale behind many holding companies / SPVs (Special Purpose Vehicles); b) why, for our industry, tax planning is focused on reducing or eliminating double economic taxation rather than on no taxation.

In this vein, below you will find EFAMA's comments where we **explain the valid economic reasons to use certain entities/arrangements without the need to have them unintentionally deemed as abusive or aggressive tax structures.**

EFAMA would kindly ask the Commission to keep our industry's special requirements in mind, especially if intending to draft new tax rules to ensure investment structures and end-investors will not unintentionally be covered by them.

OVERVIEW

EFAMA's central point is straightforward. **Investment funds are established as an economically useful method of channelling the savings of smaller investors to the real economy and are also widely used by even the largest investors in situations where they are more cost-effective than direct investment**. Such vehicles **are typically required to be regulated but do not usually have business operating substance of their own that attaches instead to the manager of that vehicle.**

EFAMA urges that any legislation on shell entities along the lines proposed should be crafted carefully to effectively exclude from scope investment management firms, investment funds and investment structures that include SPV's set up for a legitimate and non-abusive purpose.

DISCUSSION

- **Definition of investment funds for this purpose:** **Investment funds shall not be deemed as shell entities.** EFAMA is commenting on this initiative on behalf of regulated investment funds, investors into those funds and the investment management firms (Management Companies or ManCo's) who manage them.

  The Commission must be aware of the challenges that stakeholders willing to engage in this public consultation are facing to understand which entities would be deemed as "shell entities". Without entering into this debate, after reviewing the several elements that are being raised by the Commission in the questionnaire, EFAMA would like to point out that **not all entities that present**

specific hallmarks (e.g. passive income, lack of employees, lack of substantial presence in its state of establishment or elsewhere) should be qualified as "shell entities".
We refer to investment funds operating throughout the EU (AIFs and UCITs), whose activities do not require significant physical presence and employees because the operating functions are carried out by the ManCo's. Since such **investments funds are regulated or managed by entities that are subject to supervision, they do not pose a risk of tax abuse.** It is therefore important that any measures introduced to tackle abusive tax practices will preserve existing structures and the EU capital markets union policy.

- **Increasingly European regulators set significant minimum regulatory standards anyway:** Our industry is highly regulated and operates under significant and specific legal, regulatory, transfer pricing and tax frameworks. **The role that investment funds have to play in providing investors with a diversified portfolio and global market access is crucial** and not to be underestimated. **European investment funds are subject to stringent EU and local regulations covering governance, organisational and operational arrangements, investment guidelines, transparency and investor protection.**

- **Funds are exempt:** Considering the structure of **investment funds** as **tax-neutral investment vehicles** [1] [2] – as a matter of public policy and the fact that individual investors are subject to tax with respect to the distributions from funds in line with the tax rules in their local jurisdiction – they **are generally highly regulated and do not pose the risks identified by the Public Consultation documents and they should not be the intended target of the Commission's planned actions**.

- **Funds include holding entities as subsidiaries:** In investment funds, particularly those investing in illiquid asset classes such as commercial property, housing, infrastructure assets, or unlisted debt and equity, **asset holding companies and other entities are used for a variety of reasons**. These include:

  (a) ensuring limitation of liability, to **protect investors** and maintain the value of the portfolio;

  (b) Meeting the requirements of third party lenders to **ring-fence assets and liabilities**;

  (c) **Managing the repatriation of profits to investors** and avoiding dividend traps;

  (d) **Facilitating joint ventures** between funds and other investors;

  (e) **Streamlining decision making** by giving authority to the directors of holding entities;

  (f) **Providing a convenient vehicle for sale or partial sale**.

  In this context, **it is imperative that tax neutrality is maintained for investors** such that the asset holding companies in the structure do not add significantly to the tax burden, compared with direct investment in the underlying asset by the same investors. Such additional tax burdens would significantly deter investment.

[1] This principle has been recognised by the OECD (please refer to the 2010 Report, to paragraph 22 of the Commentary to Article 1 of the OECD Model Tax Convention of November 2017) and to Recommendation 1.5 in the BEPS Action 2 - 2015 Final Report).

[2] This tax neutrality also has been recognised by the European Commission: *"… Member States generally seek to reduce adverse taxation effects on investments through investment funds or companies compared to direct investments by individual investors and, as far as possible, to* ***ensure that the overall final tax burden on the basket of various types of investments is about the same, irrespective of the vehicle used for the investment.***" - Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union - 19 July 2016 - Para. 161.

- **There are significant tax administrative advantages for funds to use holding entities to claim treaty reliefs:** The typical institutional investors in a fund (such as local authorities, pension schemes, or life insurers), and individual investors, are eligible for treaty benefits due to their own status.

  However, in the context of a fund, it would create a major administrative burden for both taxpayers and tax authorities if a widely held fund, investing in multiple territories, required every investor to make an individual claim for treaty relief in each country in which the fund operates. Indeed, the administrative complexity involved would be likely to act as a significant deterrent to investment on a collective basis.

  By use of a holding entity, such claims can be made at the fund level which significantly reduces the administrative burden on taxpayers and tax authorities. Treaty abuses of 'treaty platforms' by those not eligible for treaties should be and already are dealt with by targeted measures included in tax treaties. [3]

- **The existing tools are proving to be effective:** In recent years, EU Member States agreed to a series of legislative instruments to tackle tax avoidance and aggressive tax planning. These include the tax transparency packages, the existing administrative cooperation (e.g. the several DAC's) tools that allow the relevant stakeholders and national tax authorities that are more and more exchanging information between themselves, the list of non-cooperative tax jurisdictions, as well as other anti-tax avoidance measures (e.g. ATAD).

  In the roadmap released ahead of this public consultation, it is stated: *"… the new criteria and processes developed in the context of the EU list of non-cooperative tax jurisdictions to measure the substantial presence and the performance of real economic activity in jurisdictions with no or very low corporate taxes could serve as a useful point of reference as they have proven to be effective in stepping up the fight against the use of shell entities and arrangements in third countries."*

  We have recently seen increasing **pressure from the EU on certain jurisdictions** (e.g. Caymans, Jersey, Guernsey, etc.) **that have been called to adopt minimum substance requirements** i.e. under threat of being blacklisted if they didn't comply. [4]

  There is evidence the existing tools are being effective and domestic legal frameworks are being amended to meet all aspects of the EU/OECD minimum standards. EFAMA has been monitoring the implementation of these instruments across Europe and, rather than exploring new legislative measures, **the Commission's focus should be on making more effective use of the existing EU legal framework to tackle tax avoidance and aggressive tax planning.**

FINAL REMARKS

EFAMA stands ready to protect our industry from any adverse effects of this initiative on investment activity within the EU and to assist the Commission in the design of the necessary rules to exclude/carve-out our industry from any definition of "shell entities".

[3] We refer to the measures that have been implemented against tax treaty abuse, such as the Limitation of Benefits (LoB) and Principal Purpose Test (PPT) provisions included in Double Tax Treaties (DTT).

[4] In February 2020, Cayman Islands were added to the aforementioned list for not having *"appropriate measures in place relating to economic substance in the area of collective investment vehicles"*. After the adoption of new reforms to its framework on Collective Investment Funds in September 2020, the EU list of non-cooperative jurisdictions was updated and Cayman Islands were removed. In this process it was explicitly stated that **funds (as distinct from ManCo's) did not need to comply with those minimum requirements, being enough the existence of substance in the ManCo's**. This suggests an alignment between EU/OECD positions in this respect and should not be underestimated.

About EFAMA:

EFAMA is the voice of the European investment management industry, which manages over EUR 27 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities.

27 August 2021

EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

More information is available at www.efama.org.

or follow us on Twitter @EFAMANews or LinkedIn @EFAMA.

Contacts:

António Frade Correia
Senior Tax Advisor
antonio.fradecorreia@efama.org | +32 2 513 39 69