# CMS Funds Group Expert Guide

Substance issues across Europe

September 2023

# Introduction

The focus on entity substance in the context of investment structures has sharpened significantly in recent years. Holding companies involved in cross-border transactions must have sufficient economic and physical substance to fend off possible challenges from tax authorities and to protect the entitlement to tax benefits granted either by the domestic tax laws of the investment jurisdiction, or an applicable double tax treaty.

The degree of substance required for an entity may differ from one jurisdiction to another. The appropriate level of substance must therefore be assessed on a case-by-case basis according to the facts and local requirements.

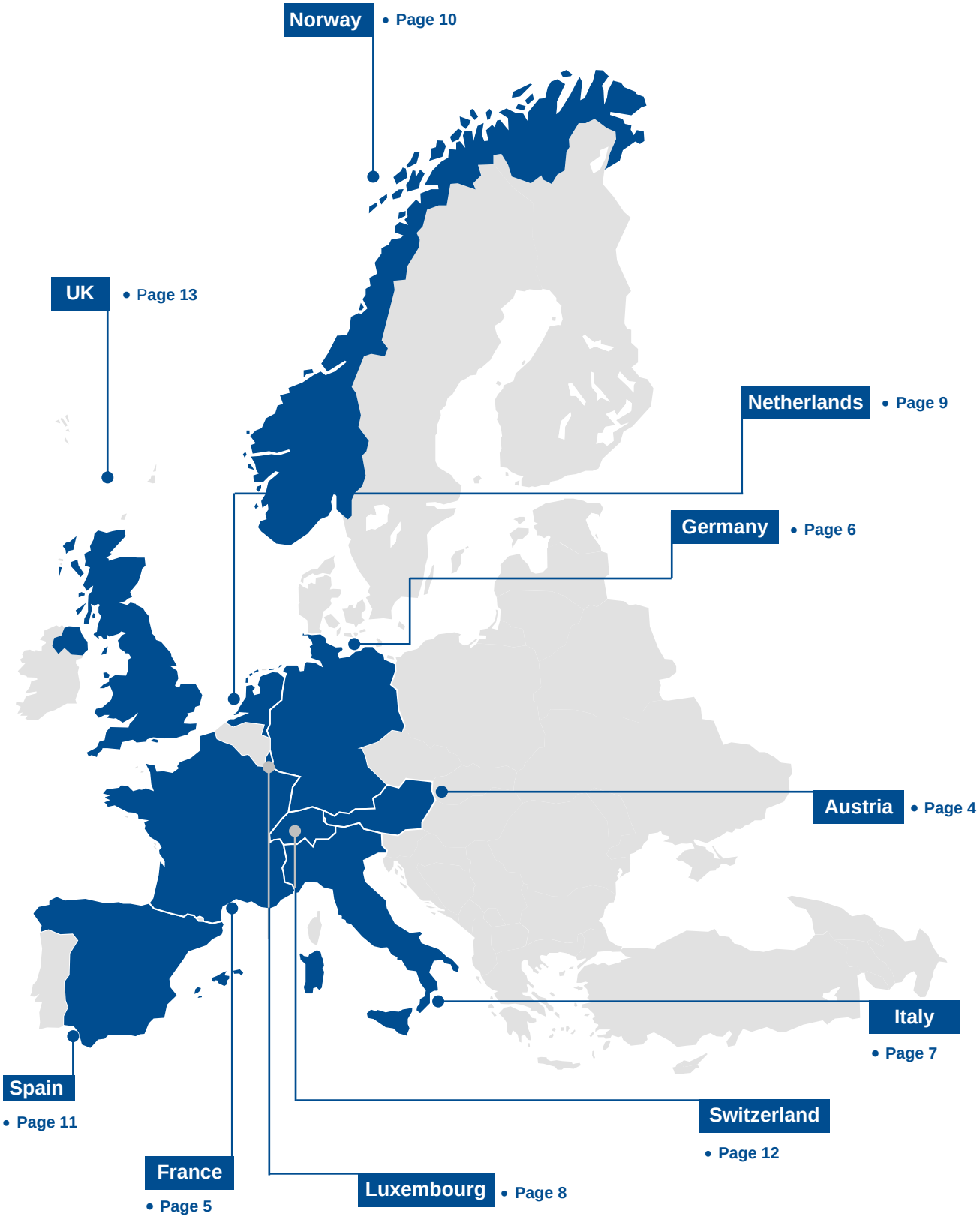
The third anti-tax avoidance directive (known as “ATAD 3”) will add a new layer of substance rules and should provide a more precise framework from an EU perspective. The directive aims to prevent the misuse of shell entities located in the EU for tax evasion and avoidance purposes, in part by imposing minimum standards for substance within the EU – without necessarily replacing local (more stringent) rules.

CMS Funds Group tax experts have designed this expert guide to provide an overview of the substance requirements currently applicable in selected jurisdictions. We are grateful to the numerous contributors to this guide. If you would like more information about a particular jurisdiction, please do get in touch with the authors.


**Frédéric Feyten**
**Managing Partner | Avocat**
**T** +35 22 627 5324
**E** frederic.feyten@cms-dblux.com

**Delphine Danhoui**
**Knowledge Lawyer | Counsel**
**T** +35 22 627 5324
**E** delphine.danhoui@cms-dblux.com

# Guide Overview



# AUSTRIA

The substance of foreign companies is more and more questioned and/or audited by Austrian tax authorities. This is especially true following the development of anti-abuse rules, measures against aggressive tax planning and a desire to move towards greater transparency. Formal rules governing substance are currently, prior to the enactment and incorporation of ATAD 3, very limited. Case law is developing.

**Tax residence criteria**

A company will be considered as tax resident in Austria if it has its registered office or place of management in Austria.

- Registered office: This is the place determined by law, contract, articles of incorporation, foundation deed and similar.
- Place of management: This is the place where the centre of business management is located. This is where the "decisive will" for the management is formed, i.e., where the measures necessary and important for the management of the company are ordered and company-directing dispositions are made.

**Direct relief at source**

Austria provides direct relief at source for distributions, which is an efficient and liquidity-saving procedure, especially in comparison to a refund method.

Distributions to an EU sub-holding company with an EU parent company can also be made without withholding tax in the case of a pure holding company, provided that the grandparent company meets the substance requirements.

**General requirements for direct relief at source**

Whether a company has sufficient economic substance is determined in Austria based on an overall consideration of three criteria (each decision will be on a case-by-case basis):

- Business activity
- Employees
- Business premises

If the entire operation activity is carried out by another group company, which also has the employees and business premises at its disposal, the substance requirements are not met.

**Activity**

The business activity criterion plays a major role in case-by-case decisions. The specific assessment will depend on the type of activity specifically performed. The activity needs to go beyond mere asset management.

At the level of a parent company, business and group management functions are sufficient – such as hiring a managing director, accountant, or office manager in the premises of the parent company. Stock market listing alone is not sufficient for an operating activity.

**Employees**

Both employees and posted workers (also from a third country) are part of the "employees" criterion, provided that they are (i) integrated into the business structure of the company in the same way as its own employees, and (ii) the company can instruct them.

The advisory influence of a shareholder (resident of a third country) on the management of the company is considered harmless.

**Premises**

Business premises may be rented (from a group company) and do not have to be owned by the company.

**Bank account**

Not required at present.

**Substance reporting obligations?**

At present, none.

**Substance criteria applied to a foreign entity?**

Same as those applied to an Austrian company.

**ATAD 3**

The implementation of ATAD 3 into Austrian domestic tax law will establish a more formal substance framework.

# FRANCE

Pending the implementation of ATAD 3, French domestic law does not currently contain formal rules governing substance. In practice, however, concept of substance is considered indirectly for the assessment of the tax residence of a company or the qualification of a permanent establishment ("PE"). Additionally, it is relevant for the framework of general anti-avoidance rules ("GAAR"), to assess the economic reality of controlled foreign companies and the validity of certain withholding tax exemptions or treaty benefits.

**Tax residence criteria**

French domestic law does not use the concept of 'residence' for corporate income tax purposes (the scope of which is defined with sole reference to the 'place of business' of a company).

However, the 'place of (effective) management' is generally used as criterion to determine the tax residence of a company and/or the existence of a PE under tax treaty law, and for the application of withholding tax exemption regimes. In practice, the 'place of effective management' means the place where the management, administrative and executive functions are primarily located. It can be different from the registered seat of the company.

**'Substance' criteria**

The term 'substance' is not defined by French law or administrative guidelines. It is a concept specified by French case law and used in practice within the context of GAAR to combat artificial arrangements. Such arrangements might consist, for example, of setting up a company without 'economic substance' in a country with the principal or sole purpose of benefiting from the advantageous provisions of a tax treaty (i.e., "treaty shopping"), from withholding tax exemptions or to exit the scope of French tax. Minimum substance is assessed on a case-by-case basis, depending on the factual situation.

**General requirements**

In the light of French case law in the context of GAAR, minimum 'substance' of a company requires essentially:

— Material and human resources (in accordance with the nature of the activity) and a certain level of autonomy in the decision-making process

— Justification of the economic rationale and the business purpose of the company and

— Demonstration of the effective and real involvement of the company in economic operations

**Activities**

It is not necessary for a company to have an operating activity (e.g., mere asset management activities do not necessarily imply the existence of an artificial arrangement devoid of economic reality).

**Employees**

The requirement to have employees depends on the activity of the company. In the case of holding companies, the lack of human resources is not decisive.

**Premises**

In principle, a company is not required to have its own premises.

**Bank accounts**

Having its own bank account is an indicator for the company's autonomy and should be a minimum requirement.

**Substance reporting obligations?**

At present, none.

**Substance criteria applied to a foreign entity?**

Please see above under '**General requirements**'.

**ATAD 3**

The transposition of ATAD 3 will establish a formal substance framework in French domestic law, which is larger than the existing GAAR framework. This will make it necessary to audit and monitor existing cross-border structures which include EU entities with essentially passive income, and which outsource their day-to-day management, to ensure that these entities could rebut a possible presumption of lack of minimal substance resulting from a strict application of the legal substance indicators.

# GERMANY

While German tax law does not impose substance requirements on a company resident in Germany, specific rules exist for foreign companies. In recent years these rules have been revised to comply with EU law, implement ATAD and reflect BEPS Action 6 (prevention of tax treaty abuse). The upcoming implementation of ATAD 3 is expected to lead to a more formal approach and increased reporting obligations.

**Tax residence criteria**

A company will be considered as tax resident in Germany if it has its registered office (as designated in the company's articles of incorporation), or 'place of central administration' in Germany.

Registered office / seat means the statutory seat as determined in the statutes of the entity or by law. The place of central administration is the place where the company is managed and controlled. A fixed place of business is not necessarily required. The place of central administration is determined based on an overall assessment taking into account the structure and characteristics of the company.

**'Substance' criteria**

German tax law provides for substance requirements in several provisions. The substance requirements are not aligned and there is no universal set of substance criteria under German tax law.

General substance criteria apply in outbound situations. More specific rules exist in relation to inbound structures (please see under '**General requirements**').

**General requirements**

In relation to inbound structures German tax law provides for a domestic anti-treaty shopping rule under which Germany denies treaty benefits to companies without sufficient substance solely established for the purpose of obtaining such treaty benefits.

Sufficient substance is deemed to exist if the company is listed on a recognised stock exchange (i.e., a regulated market under MiFID) and its main type of shares are significantly and regularly traded.

The substance of non-listed companies is determined on a case-by-case basis based on the following criteria:

- The company conducts an own economic activity to which the relevant source of income is linked
- It has appropriately organised business operations
- It does not merely pass-through income to its shareholders or beneficiaries

**Activities**

As a rule, a holding company needs to perform active management functions in order to comply with the requirements under the anti-treaty shopping rule.

A mere pass-through entity does not meet the substance test.

**Employees**

Human resources are considered as part of the overall substance assessment. No clear guidance exists, but sufficient personnel can be considered the strongest indicator of substance.

**Premises**

Like human resources, premises and equipment are considered as part of the overall substance assessment.

**Bank accounts**

Bank accounts are of lesser importance in the German substance analysis.

**Substance reporting obligations?**

There are no specific substance reporting obligations under German tax law.

**Substance criteria applied to a foreign entity?**

Please see above under '**General requirements**'.

**ATAD 3**

ATAD 3 contains more specific substance criteria and hopefully its implementation will make substance requirements more manageable in Germany. On the other hand, it has to be expected that documentation and reporting obligations will increase as well.

# ITALY

The substance criteria of entities established in Italy does not tend to be a troublesome area, given that the establishment of foreign entities in Italy is generally based on commercial and productive reasons. Instead, the Italian tax authority often challenges the delocalisation of profits / activities toward *foreign* entities, and the application of the more favourable regime provided by the EU Directive in the lack of a beneficial owner requirement for the recipient. To prevent these behaviours, Italy has strictly implemented controlled foreign company ("CFC") rules, and there have also been several cases derived from tax challenges related to the beneficial owner issue.

ATAD 3 is introducing more detailed criteria to identify substance rules, useful both for domestic and cross border cases.

**Tax residence criteria**

According to corporate income tax rule, an entity is deemed tax resident in Italy if, for more than half of the fiscal period, it has in Italy ether i) a registered office; or ii) the headquarters of administration; or iii) the entity's main business.

**'Substance' criteria**

None at present.

**General requirements**

None at present.

**Activities**

At present, no specific requirements.

**Employees**

No specific requirements

**Premises**

No specific requirements.

**Bank accounts**

No specific requirements.

**Substance reporting obligations?**

At present, no specific requirements.

**Substance criteria applied to a foreign entity?**

Substance criteria applicable to foreign entities are provided by the CFC rule implemented in Italy. As a general rule, foreign entities fall within the CFC provision if they have low level of taxation and their proceeds are mainly based on passive income, unless they are able to prove they carry out an effective economic activity, through the use of personnel, equipment, assets and premises.

In this respect the tax authority has provided a list of some indicators of 'substance', such as bills, organisation charts, employee's insurances, rent agreements for business premises and bank accounts with local banks. In addition, specific indicators are also provided for holding companies, such as actual decision-making powers for directors, a description of the intercompany economic-financial relations specifying the consistency and the type of transactions, and also assets and liabilities involved.

**ATAD 3**

The adoption of ATAD and the equalisation of criteria for 'substance' will be useful for the interpretation of all relevant EU provisions to prevent misleading approaches and behaviour.

# LUXEMBOURG

The substance of Luxembourg companies is often questioned and/or audited by foreign tax authorities. This is especially true following the development of anti-abuse rules, measures against aggressive tax planning and a desire to move towards greater transparency. From a pure Luxembourg standpoint, formal rules governing substance are, prior to the enactment and incorporation of ATAD 3, very limited, except for those applicable to Luxembourg companies involved in intra-group financing activities.

**Tax residence criteria**

A company will be considered as tax resident in Luxembourg if it has its registered office (as designated in the company's articles of incorporation), or 'place of central administration' in Luxembourg. This is the place where the company is managed and controlled. In practice, this is determined by a variety of factors, for example the place where strategic decisions are taken or the location of meetings of board of directors/managers and shareholders.

**'Substance' criteria**

Companies involved in intragroup financing are subject to specific 'substance' criteria. These are set out in a transfer pricing circular published in 2016. While this circular targets only companies involved in intragroup financing, it can help serve as a guide to how the Luxembourg tax authorities might deal with substance more generally. These factors are considered here.

**General requirements**

Under the circular, a company has 'real presence' in Luxembourg if:

- The majority of board members with decision-making power and the ability to bind the company are either Luxembourg residents or non-residents with a professional activity subject to tax in Luxembourg
- The company has qualified employees
- Key management decisions are taken in Luxembourg
- When required under company law, at least one general meeting per year is held in Luxembourg
- The company is not tax resident elsewhere

**Activities**

At present, none.

**Employees**

A company must employ or have access to 'qualified personnel' to manage and control its risks and transactions. Functions that do not have an impact on the control of risks assumed by the company may be outsourced.

**Premises**

There are no specific provisions which require a company to have premises in Luxembourg. However, it is often advisable to have a dedicated office space with a minimum level of facilities.

**Bank accounts**

There are no specific provisions which require a company to have a local bank account. However, having a bank account with a Luxembourg financial institution, which is used for day-to-day management, is normally recommended.

**Substance reporting obligations**

At present, none.

**Substance criteria applied to a foreign entity**

Same as those applied to a Luxembourg company.

**ATAD 3**

The implementation of ATAD 3 into Luxembourg domestic tax law will establish a more formal and binding substance framework.

# THE NETHERLANDS

Both the tax residence and substance of Dutch companies are frequently scrutinised by foreign tax authorities. Prior to the transposition of ATAD 3 (once adopted), specific statutory substance rules need to be observed by resident financing and licensing conduits. These substance conditions also apply for Dutch dividend withholding tax purposes (and, in certain cases, Dutch corporate income tax purposes), which may require non-resident shareholders to observe the same rules in order to secure a reduction or exemption of such tax.

**Tax residence criteria**

Companies incorporated under Dutch law are deemed to be residents of the Netherlands for most Dutch corporate income tax purposes, and are treated as resident withholding agents for dividend withholding tax purposes ('incorporation fiction').

A company is also considered a Dutch tax resident if it is actually situated in the Netherlands based on the facts and circumstances (of which the place of effective management is the most important factor).

**'Substance' criteria**

Dutch entities qualifying as intra-group financing and licensing conduit companies must meet the Dutch substance criteria if they want to benefit from a double tax treaty, or EU Directives. If not, they are exposed to the risk of exchange of information by the Dutch tax authorities and may, under certain circumstances, not be eligible for a Dutch tax credit for foreign withholding taxes.

For non-resident corporate shareholders of Dutch companies, meeting the Dutch substance criteria causes the burden of proof concerning the existence of an abusive intent of avoiding a liability to Dutch dividend withholding tax (and sometimes, Dutch corporate income tax) to shift to the Dutch tax authorities.

**General requirements**

— At least 50% of the statutory board members with (equal) decision-making powers must reside in the Netherlands
— The resident board members must have the necessary professional knowledge and skills to perform their duties, including decisions regarding transactions and follow-up
— The company must have qualified human resources for adequate implementation and registration of its transactions
— Board meetings must take place in the Netherlands and the important board decisions need to be made in the Netherlands (no 'rubberstamping')
— The bookkeeping must take place in the Netherlands

**Activities**

Resident financing and licensing conduits must observe increased substance requirements, including having sufficient equity at risk for their financing or licensing activities.

**Employees**

Resident financing and licensing conduits must incur annual personnel costs of at least EUR 100,000 relating to the human resources used for their financing or licensing activities.

**Premises**

Resident financing and licensing conduits must dispose of their own sufficiently equipped and actually used office space. The term of the relevant lease or similar agreement must be at least 24 months.

**Bank accounts**

The principal bank account needs to be managed out of the Netherlands, which does not mean that the bank account is also kept with a Dutch bank.

**Substance reporting obligations?**

Currently, resident financing and licensing conduits benefitting, in any given year, from a tax reduction or exemption pursuant to a double tax treaty or EU Directive must confirm, in their Dutch corporate income tax return for that year, whether they did meet the substance requirements. If not, then the Dutch tax authorities may exchange information about this lack of substance with the tax authorities of the source states. This may cause such source states to deny the reduction of exemption.

**Substance criteria applied to a foreign entity?**

For certain dividend withholding tax and corporate income tax purposes: same as those applied to resident financing and licensing conduit, except that the 'EUR 100,000 personnel expenses' requirement may be lower due to the country of residence's COLA (Cost-of-Living Adjustments) index.

**ATAD 3**

The transposition of ATAD 3 into Dutch domestic tax law will likely result in the current substance framework being replaced.

# NORWAY

As Norway is part of the EEA and not a member of the EU, it will not be directly bound by ATAD 3. Norway will normally align with EU rules for anti-tax abuse measures but has not yet taken any steps to implement ATAD 3. From a Norwegian perspective, formal rules governing substance are quite limited, prior to any measures which may be implemented as a consequence of the EU's ATAD 3.

**Tax residence criteria**

A company will be considered as tax resident in Norway if it is either: (i) incorporated in Norway, or (ii) effectively managed from Norway, taking into account both board level management and day-to-day management. In practice, this is determined by a variety of factors, for example the place where strategic decisions are made, the location of board meetings / general meetings, and the habitual abode of managing personnel etc.

A company would not be considered tax resident in Norway if it is tax resident in another jurisdiction under a double tax treaty.

| Activities | Employees | Premises | Bank accounts |
|---|---|---|---|
| At present, no specific requirements. | No specific requirements. | No specific requirements. | No specific requirements. |

**Substance reporting obligations?**

At present, no specific requirements.

**Substance criteria applied to a foreign entity?**

The place of effective management rule (alternative (ii) above) applies to foreign entities, so that foreign entities may be considered tax resident in Norway, even if they are incorporated abroad.

Some Norwegian tax regulations, such as the application of the participation exemption method for dividends from or to foreign companies in "low tax countries" within the EU/EEA, require that the foreign entity is "genuinely established" and performs "a genuine business activity" in the other state. The precise content of this threshold will depend on the nature of the business performed by such company and whether or not the functions performed are similar to those one would expect to find in a Norwegian company performing the same or similar business activity.

**ATAD 3**

Norway is not obligated to implement ATAD 3 but may take measures to align with EU countries.

# SPAIN

In Spain, the mechanism most commonly used by the tax authorities to consider the substance of companies is the "conflict in the application of the tax law". This mechanism is regulated in the Spanish general tax law and establishes that there will be a conflict when the taxable base is avoided through acts in which the following circumstances concur:

— that they are artificial or improper for the achievement of the result obtained.

— that their use does not result in relevant legal or economic effects, other than tax savings.

**Tax residence criteria**

Entities that meet any of the following requirements will be considered as tax resident in Spain: (i) incorporated under Spanish law, (ii) having their registered office in Spanish territory or (iii) having their effective place of management in Spanish territory.

In addition, the tax authorities may assume that an entity located in a non-taxable country is resident in Spanish territory when its main assets, directly or indirectly, consist of assets situated or rights that are exercised in Spanish territory, or when its main activity is carried out in Spanish territory.

**'Substance' criteria**

There are reports made by the tax authorities, which are a useful source of information on substance criteria.

These reports are called "*reports of the advisory committee on the conflict in the application of the tax law*". In them, we can see the factor considered by tax authorities in order to determine whether or not there is sufficient substance.

**General requirements**

The following are a selection of the requirements:

— Companies must have necessary employees and board members

— The company must carry out a real economic activity

— Existence of tangible or intangible assets, equipment or facilities

— The profit and loss account must be consistent with the company's activity

**Activities**

Companies must carry out a real economic activity. In the report, the tax authorities considered as an indication of lack of substance that the company had no customers, suppliers, or payments for supplies.

**Employees**

Companies must have the necessary employees and board members to carry out their corporate purpose. In the report, an indication of lack of substance is considered when there are no employees or when they do not carry out any activity.

**Premises**

The existence of equipment, facilities and premises is advisable. However, there are no specific provisions which require a company to have premises in Spain.

**Bank accounts**

There are no specific provisions which require a company to have a local bank account. However, in order to comply with Spanish tax obligations, it is strongly advisable to have one.

**Substance reporting obligations?**

At present, none.

**Substance criteria applied to a foreign entity?**

Same as those applied to a Spanish company.

**ATAD 3**

The implementation of ATAD 3 into Spanish domestic tax law will establish a more formal and binding substance framework.

# SWITZERLAND

Under domestic Swiss tax law, a legal entity becomes subject to unlimited Swiss tax liability if it has (i) its statutory place of incorporation and/or (ii) its place of factual management in Switzerland. Therefore, it is not necessary to establish any unilateral substance rules from a Swiss perspective. In contrast, the Swiss tax authorities apply very strict substance rules when reviewing the acceptance of foreign structures with a Swiss nexus and frequently deny the recognition of the shielding effect under the concepts of tax avoidance, piercing the corporate veil or beneficial ownership considerations. In particular, foreign multinational groups and family offices with a Swiss (intermediary) holding company should therefore review the local substance with a view to the enactment of ATAD 3.

**Tax residence criteria**

A company will be considered as tax resident in Switzerland if it has its registered office (as designated in the company's articles of incorporation), or 'place of effective administration' in Switzerland. This is the place where the company is managed and controlled. In practice, this is determined by the location where the daily business decisions take place, but may vary depending on the activity of the company..

**'Substance' criteria**

With a view to claiming title to double tax treaty benefits by a Swiss company, the so-called Anti-Abuse Decree 1962 (Ordinance on Measures against the unjustified use of Federal Double Taxation Agreements) enacted by the Swiss Federal Council stipulated certain substance criteria in order to prevent shell companies from abusing Swiss double tax treaties. The Anti-Abuse Decree 1962 has been abolished as per 1 January 2022 with a view to the newer BEPS regulations.

**General requirements**

With a view to indirect effects on Swiss companies and general sustainability of the structure, the following general substance recommendations should be followed:

- The majority of board members should be Swiss residents
- The board members should have independent decision-making power (no rubberstamping)
- The company should have qualified employees in Switzerland
- The daily management decisions should be taken in Switzerland
- The company should hold its board meetings and annual shareholder meetings in Switzerland
- The company should dispose of its own infrastructure adequate for its purposes
- The company should maintain its books and bank accounts in Switzerland
- The company should dispose of adequate equity (in line with the Swiss thin cap provisions)

**Activities**

At present, none. The issue of shell companies is dealt with at the level of criminal law and leads to regular verifications by the authorities in a wider context then tax law.

**Employees**

At least one Swiss resident director with sole signature power required for corporate law purposes.

**Premises**

There are no specific provisions which require a company to have premises in Switzerland. However, a registered address is required for purposes of the incorporation. If a company does not dispose of its own infrastructure at its registered address, it must designate it as a c/o address. See also reference to criminal law under '**Activities**'.

**Bank accounts**

There are no specific provisions which require a company to have a local bank account. However, having a bank account with a Swiss financial institution, which is used for day-to-day management, is normally recommended.

**Substance reporting obligations?**

At present, none.

**Substance criteria applied to a foreign entity?**

Depending on the issue in question (claiming treaty benefits, attributing income to a foreign affiliate, relying on unilateral exemptions etc.), the Swiss tax authorities apply very strict substance tests which considerably exceed the prospective ATAD 3 requirements under the concept of abusive structuring (tax avoidance).

**ATAD 3**

Switzerland is not part of the EU and there is no initiative currently to implement ATAD 3 or similar measures into Swiss law.

# UNITED KINGDOM

A company is tax resident in the UK by reason of either incorporation or central management and control. The question of 'substance' is therefore not relevant for UK incorporated companies. As the UK is no longer an EU member state, the implementation of ATAD 3 will not directly change this position. However, companies are advised to give greater attention to 'substance' where they are incorporated overseas but seeking UK tax residence status – or where they are not seeking UK tax residence but have a management presence in the UK.

**Tax residence criteria**

A company will be considered as tax resident in UK if it is incorporated in the UK. A non-UK incorporated company will be tax resident in the UK if it is *centrally managed and controlled* in the UK.

**'Substance' criteria**

There are no specific 'substance' criteria which apply to UK companies. If a company is incorporated in the UK, it will be automatically UK tax resident under UK law. To qualify for certain tax-advantaged regimes (such as the UK's Qualifying Asset Holding Company or the UK REIT regime), a company must be UK tax resident.

**General requirements**

As long as a company is incorporated in the UK, it will be considered UK tax resident. In this respect, the substance rules in the UK are very limited.

If a company is incorporated overseas, it will be considered UK resident if it is *centrally managed and controlled* in the UK. Whilst there is no defined set of criteria which will cause a company to be 'centrally managed and controlled' in the UK, set out in below are the important factors to consider.

HMRC takes the view that the correct starting point is to look to the location of the *highest level of control* of the business – which will normally mean the location of statutory board-level decisions.

In particular, a company should consider:

- To whom do the company's legal and constitutional documents (such as the Articles of Association) grant powers of central management and control?
- Do these people, in reality, exercise central management and control?
- In either case – where is the central management and control physically exercised?

Note that the UK's domestic test of 'central management and control' is different from the 'effective management and control' test found in the OECD model treaty – and which is commonly used by EU jurisdictions.

**Activities**

The highest level of control of the business should be undertaken in the UK. This means that physical board meetings should take place in the UK.

**Employees**

It is advisable to have a majority of board level directors tax resident in the UK.

**Premises**

It may be advisable to have a dedicated office space in the UK for physical board meetings.

**Bank accounts**

There is no requirement to have a local bank account.

**Substance reporting obligations?**

At present, none – given that the UK is no longer an EU member state, ATAD 3 will not directly apply to UK companies.

**Substance criteria applied to a foreign entity?**

An overseas incorporated company must have its centre of management and control in the UK in order to be UK tax resident. Separately, in order for the UK to provide certain tax treaty benefits (such as an exemption on the obligation to withhold tax on UK source interest payments), the UK requires that the overseas recipient is the 'beneficial owner' of the payment. Therefore, questions of substance often arise in this context, given that, for example, nominees or conduit companies cannot be 'beneficial owners'.

**ATAD 3**

While ATAD 3 will not apply directly to UK companies, UK companies which are part of a group including EU entities should be aware of the rules. Further, the European Commission has already announced that it intends to follow up with a similar initiative for non-EU entities – progress of this initiative will be closely monitored.

# ATAD 3 DIRECTIVE: AN OVERVIEW

In 2021, the European Commission issued the proposal of ATAD 3 directive which sets out indicators of minimum substance for undertakings in EU Member States and aims to increase scrutiny of "shell" companies within the European Union to prevent them from being used for tax evasion and avoidance. In 2022, the Committee on Economic and Monetary Affairs of the European Parliament proposed some amendments (to the initial draft directive) which were approved by the European Parliament on 17 January 2023.

**Entities in scope**

Any undertaking that is considered tax resident and is eligible to receive a tax residence certificate in an EU Member State, regardless of its legal form.

**Excluded entities**

- Listed entities
- Undertakings whose main activity is holding shares in operational businesses in the same Member State where their beneficial owners are also resident for tax purposes
- Undertakings with holding activities that are resident for tax purposes in the same Member State as their shareholder(s) or the ultimate parent entity (as defined in DAC)
- Certain regulated financial undertakings

**Determination if an undertaking is "at risk" – cumulative conditions to be assessed during the two preceding years (look-back period)**

- **Relevant income:** more than 65% of the revenues must be passive / mobile income such as interest, royalties or dividends
- **Activity:** either (i) more than 55% of the book value of the undertaking consists of qualifying assets located outside the Member State of the undertaking or (ii) more than 55% of the undertaking's relevant income is earned or paid out via cross-border transactions
- **Outsourcing of functions:** the day-to-day operations and the decision-making on significant functions is outsourced to a third party

**Reporting obligations when an entity is considered "at risk" – if one of the substance elements is not met it will be considered as a "shell".**

The undertaking must evidence:

- It has its own premises, premises for its exclusive use or premises shared with entities of the same group
- It has at least one own and active bank account or e-money account in the Union through which the relevant income is received
- Indicators related to the directors (residence and authority to take decision) or full-time equivalent employees (resident and qualification to carry out the activity

**Carve Outs**

**Rebuttal procedure:** rebut the presumption of being a shell company by (i) ascertaining the business rationale behind the establishment of the undertaking in the Member State where the activity is performed, (ii) providing information about the full-time, part-time, and freelance employee profiles and (iii) providing evidence that decision-making is taking place in the undertaking's Member State. The request shall be considered within 9 months.

**Exemption for absence of tax motives:** provide evidence that the interposition of the presumed shell company does not lead to a tax benefit for its beneficial owners or the group as a whole. That evidence shall include information about the structure of the group and its activities (including a list of its employees working on full-time equivalence).

**Tax Consequences for "shell" entities**

**Member State of the shell**

- Tax residence certificate denied **or**
- The Member State will have to issue an official statement duly justifying such decision and prescribing that the undertaking is not entitled to the benefits of the double tax treaties and EU tax directives (Parent-Subsidiaries Directive and Interest and Royalties Directive)

**Other Member States**

- Benefits under the double tax treaties and EU Directives (Parent-Subsidiaries Directive and Interest and Royalties Directive) denied
- Presumed "shell" entity treated as "flow-through" entity
- Allocation of taxing rights between the Member State of the source jurisdiction and of the undertaking's shareholder(s)

**Exchange of information and request for joint tax audit**

All Member States will have access, at any time, to information on EU shells, even for those which have rebutted the presumption or are exempt for lack of tax motives. The information will be exchanged automatically. Joint tax audit may be requested by the competent authority of a Member State when the latter has reason to believe that an undertaking tax resident in another Member State has not met its obligations under the Directive.

**Implementation**

Member States will be required to implement the Directive by 30 June 2023 for an application as from 1 January 2024 – This means that the "look back" period started on 1 January 2022.

# Contacts

**Austria**
CMS Reich-Rohrwig Hainz Rechtsanwälte GmbH
Gauermanngasse 2, 1010 Vienna, Austria
T +43 1 40443 0
F +43 1 40443 90000

**Sibylle Novak**
**Partner**
**M** +43 664 60443 3700
**E** sibylle.novak@cms-rrh.com

**France**
CMS Francis Lefebvre Avocats
2 rue Ancelle, 92522 Neuilly sur Seine Cedex, France
T +33 1 4738 5500

**Anne-Sophie Rostaing**
**Partner**
**T** +33 1 47 38 4002
**E** anne-sophie.rostaing@cms-fl.com

**Sebastian Boyxen**
**Counsel**
**T** +33 1 47 38 4002
**E** sebastian.boyxen@cms-fl.com

**Germany**
CMS Hasche Sigle
Neue Mainzer Straße 2 – 4, 60311 Frankfurt, Germany
T +49 69 71701 0
F +49 69 71701 40410

**Dr. Tillman Kempf**
**Partner**
**T** +49 69 71701 343
**E** tillman.kempf@cms-hs.com

**Italy**
CMS Adonnino Ascoli & Cavasola Scamoni
Via Agostino Depretis 86, 00184 Rome, Italy
T +39 06 4781 51
F +39 06 4837 55

**Stefano Chirichigno**
**Partner**
**T** +39 06 478151
**E** stefano.chirichigno@cms-aacs.com

**Berardo Lanci**
**Partner**
**T** + +39 06 478151
**E** berardo.lanci@cms-aacs.com

**Marta Puccini**
**Senior Associate**
**T** +39 06 478151
**E** marta.puccini@cms-aacs.com

**Luxembourg**
CMS DeBacker Luxembourg
5, rue Charles Darwin, 1433 Luxembourg, Luxembourg
T +352 26 2753 1
F +352 26 2753 53

**Frédéric Feyten**
**Managing Partner | Partner**
**T** +35 22 627 5324
**E** frederic.feyten@cms-dblux.com

**Delphine Danhoui**
**Knowledge Lawyer | Counsel**
**T** +35 22 627 5324
**E** delphine.danhoui@cms-dblux.com

**The Netherlands**
CMS The Netherlands
Atrium Parnassusweg 737, 1077 DG, Amsterdam, The Netherlands
T +31 20 3016 301
F +31 20 3016 333

**Anton Louwinger**
**Partner**
**T** +31 20 301 6448
**E** anton.louwinger@cms-dsb.com

**Norway**
CMS Kluge
Bryggegata 6 PO Box 1548 Vika 0117, Oslo, Norway
T +47 23 11 00 00
F +47 23 11 00 01

**Anders Heieren**
**Partner**
**T** +47 982 94 522
**E** anders.heieren@cms-kluge.com

**Anton Baumann**
**Associate**
**T** +47 906 49 464
**E** anton.baumann@cms-kluge.com

**Spain**
CMS Albiñana & Suárez de Lezo
Paseo de Recoletos 7 – 9, 28004 Madrid, Spain
T +34 91 4519 300
F +34 91 4426 045

**Diego de Miguel**
**Partner**
**T** +34 91 451 9281
**E** diego.demiguel@cms-asl.com

**Ricardo Héctor**
**Counsel**
**T** +34 91 451 9301
**E** ricardo.hector@cms-asl.com

**Switzerland**
CMS von Erlach Partners Ltd.
Dreikönigstrasse 7 P.O. Box, 8022 Zurich, Switzerland
T +41 44 285 11 11
F +41 44 285 11 22

**Mark Cagienard, LL.M.**
**Partner**
**T** +41 44 285 11 11
**E** mark.cagienard@cms-vep.com

**United Kingdom**
CMS Cameron McKenna Nabarro Olswang LLP
Cannon Place 78 Cannon Street, London EC4N 6AF
United Kingdom
T +44 20 7367 3000
F +44 20 7367 2000

**Lauren Alder**
**Partner**
**T** +44 20 7524 6119
**E** lauren.alder@cms-cmno.com

**Nick Burt**
**Partner**
**T** +44 20 7524 6338
**E** nick.burt@cms-cmno.com