PROPOSAL FOR A COUNCIL DIRECTIVE LAYING DOWN RULES TO PREVENT THE MISUSE OF SHELL ENTITIES FOR TAX PURPOSES

BPF RESPONSE

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Introduction

The British Property Federation (BPF) represents the real estate sector – an industry which contributed more than £116bn to the economy in 2020 and supported more than 2.4 million jobs. We promote the interests of those with a stake primarily in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments provide essential infrastructure and create great places where people can live, work and relax

We support the European Commission's efforts to tackle avoidance. However, in relation to the Commission's proposals on "shell entities", last autumn we were a signatory to a joint industry paper from stakeholders in the real estate investment, built environment and infrastructure sectors which asked the Commission to rethink its approach. That paper highlighted that the use of different types of intermediate entities in real estate investment structures (including asset holding companies) is driven by entirely legitimate commercial considerations (including legal, regulatory or accounting reasons). The paper asked for the commercial rationale for an entity to be taken into account when determining if it was within scope of the proposed measures. The paper therefore asked the Commission to avoid a "one size fits all" approach to determining substance.

On 22 December 2021, the Commission published its "Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU" (the "Proposal"). We set out below our comments on the Proposal. In preparing this response, we have had the benefit of seeing the responses prepared by both the European Association for Investors in Non-Listed Real Estate Vehicles (INREV) and the Association of Real Estate Funds (AREF) on the Proposal with which we agree. Where relevant, we refer to the INREV and AREF Responses in our comments below.

Consultation

The need to target the Proposal appropriately

First, we welcome the acknowledgement by the Commission in the Proposal that not all "shell companies" present tax avoidance risk and the inclusion of mechanisms that (a) allow a taxpayer to challenge the determination by a tax authority that a company is a "shell entity" within scope of the Proposal and (b) seek an exemption from the Proposal. These are helpful, but as the commentary in the Proposal acknowledges, are potentially burdensome - and, pending resolution of such a challenge/application, will result in economic costs for the entity concerned.

Further, although the Proposal includes an exclusion for specific types of entity (listed in Art 2), we remain concerned that the Proposal is too broad and so fails to have due regard to the commercial use of entities which, although they may cross the "gateway" set out in the Proposal, have a commercial purpose and, in particular, are not used for a tax avoidance purpose.

The gateway conditions

The exclusions in Art 6(2) include at (i) an alternative investment fund (AIF) managed by an AIFM and at (j) a UCITs. These exclusions would not appear to be apt to cover a (wholly owned) asset holding company set up by such a collective investment vehicle to hold particular assets. Within the real estate investment sector, it is common for the fund vehicle to set up specific "single purpose" vehicles to hold particular assets - and, in this context, refer to the explanation as to the rationale for such single purpose entities set out in each of the INREV Response (at "Statement of Principles") and the AREF Responses (at "Real Estate Fund Structures").) We agree with AREF that there appears to be a high likelihood of such asset holding companies crossing the gateway given the limited operational resources that may be required to carry out their activities. We therefore agree with the comments made in both the INREV and AREF Responses in relation to the gateway conditions concerning resources, staff and premises - in particular, that the condition be amended to reflect investment management norms involving the out-sourcing of certain functions to the fund manager and the sharing of premises by entities within the same fund investment platform to more accurately reflect the realities of how the investment management business generally seeks to organise itself.

Exclusion for companies wholly owned by excluded entities

If such an asset holding company were to cross the gateway, then we would expect that it would seek to rebut the presumption created under the Proposal and so challenge its presumed "shell" status. We note here the comments made in the AREF Response on the issues for companies within fund structures of this process and agree with AREF that instead the Proposal should include a gateway exclusion for asset holding companies wholly or almost wholly owned by a regulated financial undertaking that is itself excluded.

We note here that the exclusion for pension institutions in Art 9(h) expressly includes "any legal entity set up for the purpose of investment of such schemes". We therefore consider that the exclusion of AIFs and UCITs should similarly extend to legal entities (i.e., asset holding companies) set up for investment by such funds. -In particular we agree with AREF and INREV that the exclusion should be expanded to apply to entities wholly, or almost wholly, owned by such a regulated financial undertaking (adopting the same approach as proposed for asset holding entities owned by Excluded Entities within the OECD Pillar 2 Model Rules to provide consistency and certainty).

Excluded entities to include real estate investment vehicles

Additionally, the OECD Pillar 2 Model Rules include as "Excluded Entities" both investment funds and "real estate investment vehicles". We consider that "real estate investment vehicles" and their asset holding subsidiaries (each as defined for Pillar 2 purposes) should similarly be excluded from the Proposal (noting here that a "real estate investment vehicle" as so defined may not necessarily be an AIF or a UCITs).

We also note that, within the real estate investment sector, it can be common for investors to enter into joint ventures which again would commonly involve setting up single purpose asset holding vehicles. We would therefore ask the Commission to consider excluding such entities from the requirements of Art 7 by providing for the exemption in Art 6(2)(b) to include subsidiaries wholly or almost wholly, directly or indirectly owned by one or more regulated financial undertakings.

Basis for applying for exemption from the Proposal

If the Proposal is unchanged, the uncertainty as to tax status (and eligibility for the relevant cross-border benefits) resulting from the presumption under the Directive will, we expect, lead to entities established in an EU member state for commercial reasons seeking exemption from the rules under Art 10. To obtain exemption, an entity must provide evidence that "its interposition does not lead to a tax benefit for its beneficial owner(s) or the group as a whole" and shall "compare the amount of overall tax due by the beneficial owner(s) or the group as a whole, as the case may be, having regard to the interposition of the undertaking, with the amount that would be due under the same circumstances in the absence of the undertaking".

We agree with AREF that this test may be challenging for funds with a wide investor base and therefore ask the Commission to reconsider this element of Art 10. In this context, we note that, the exclusion of treaty benefits within the OECD Model Treaty as provided for under the "principal purpose test" is a main purpose test. As set out in the joint industry paper, we consider that the Proposal should have regard to purpose. Here, although the commentary in the Proposal says its purpose is "to tackle cross-border tax avoidance and evasion practices", there is no consideration of "purpose" within Art 10. Having a tax benefit is not by itself evidence of tax avoidance or evasion - and so we recommend that the test for exemption in Art 10 should either be more closely aligned with Art 9 or be amended to reference rationale (and main purpose).