An overview of shell companies in the EU

Study at the request of the Special Committee on Financial Crimes, Tax Evasion and Tax Avoidance (TAX3)

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Executive summary

This paper aims to contribute to a better understanding of the phenomenon of shell companies in the European Union. It has been written in response to a request from the European Parliament's Special Committee on Financial Crimes, Tax Evasion and Tax Avoidance (TAX3) from April 2018.

The term 'shell company' has been used widely in recent years, often interchangeably with terms such as 'letterbox company', 'mailbox company', 'special purpose entity', 'special purpose vehicle' and similar. However, these terms do not necessarily always refer to the same thing. A literature review reveals that shell companies are defined differently in different contexts.

For the purpose of this paper, 'shell' companies fall broadly into one of the following three categories: 'anonymous shell companies', 'letterbox companies', and 'special purpose entities'.

Anonymous shell companies: this type of 'shell' company provides anonymity as a key element, while simultaneously guaranteeing control over the shell company and its resources. The ultimate beneficial owner (UBO) remains hidden behind this company, or behind a chain of interconnecting shell companies, often in several jurisdictions. This type of company has featured prominently in many International Consortium of Investigative Journalists (ICIJ) reports over the past years, not least those based on the Panama Papers leaks. Such companies are often mentioned in relation to tax evasion, corruption, money laundering and terrorist financing.

Letterbox companies: this second type of 'shell' company, also referred to as a 'mailbox' company, is generally a company registered in one Member State while its substantive economic activity takes place in another Member State. These companies are sometimes used to circumvent labour laws and social contributions in the Member State in which the substantive economic activity is taking place. These 'letterbox' or 'mailbox' companies are generally mentioned in the context of circumvention of the Posting of Workers Directive.

Special purpose entities (SPEs): this third type of 'shell' company refers to entities whose core business consists of group financing or holding activities. These are entities with no or few employees, little or no physical presence in the host economy, and whose assets and liabilities represent investments in or from other countries. In this context, SPEs are usually mentioned with regard to their possible use in aggressive tax planning.

The main common feature of the above three types of shell company is the absence of real economic activity in the Member State of registration. This generally means that such companies have no (or few) employees and/or no (or little) production and/or no (or little) physical presence in the Member State of registration.

Reliable data on shell companies is not however available, especially in the case of the first two categories. That is why this study approaches the problem by looking for proxies as possible indicators of the presence and magnitude of shell companies in the EU, on the basis mainly on macroeconomic indicators. These indicators are: the number of foreign-owned companies in a Member State; the ratio of foreign direct investment (FDI) to a Member State's gross domestic product (GDP); and the profitability gap between foreign and domestic companies in a Member State.

It is worth noting that the use of shell companies can be legal. Shell companies do not necessarily bear risks because of what they are. However, when associated with anonymity, circumvention of the Posting of Workers Directive or treaty abuse, they can be misused and thus entail serious risks of tax avoidance, tax evasion, money laundering and abuse of social rights. Such misuses of shell

companies impact on the economy and society as a whole, with economic, security and social consequences.

In the past few years, the European Union has adopted a whole series of policies and legislation with the aim of addressing the above problems of tax avoidance, tax evasion, money laundering and abuse of social rights. These are presented in Section 3 of this paper.

However, these are recent moves, and many of the regulatory provisions contained in EU legislation have yet to produce their full effects, or even to come into force. In addition, several relevant legislative proposals are being negotiated at the time of writing this paper (for instance on the common consolidated corporate tax base, and on public country-by-country reporting).

It is therefore too early to assess how these recent pieces of legislation will perform on their own, and in combination with other related pieces of legislation. In the light of the interlinkage between the relevant legislative acts, the European Parliament could consider requesting a fitness check after several years of implementation of these acts. A fitness check (i.e. an evaluation of a group of interventions that have some relationship with each other) could lead to a more comprehensive picture of whether these legislative and policy interventions have performed in comparison with expectations.