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An overview of shell companies in the European Union

TAX 3 Committee Public Hearing

18/10/2018

European Parliament

Presentation outline

- **Term** ‘shell’
- Lack of reliable **data**
- **Indicators** used and findings
- Identified **risks**
- **Impacts**
- Mitigating **policies**
- Conclusions

What is a shell company?

- Term 'shell' widely used
- However, defined differently in different contexts
- Our approach – three distinct types of shell companies

Anonymous shell companies	**Letterbox companies**	**Special Purpose Entities**

Anonymous shell companies

key element =
anonymity
UBO hidden

one or more shells

several jurisdictions

context: tax evasion, corruption, money laundering, terrorist financing

Letterbox companies

key element =
registered in one MS

but

substantive economic activity in another MS

context: circumvention of labour laws and social contributions (Posting of Workers Directive)

Special Purpose Entities (SPEs)

key element =
group financing or holding activities

FDI through SPEs
channelling of funds via a country

context: aggressive tax planning, tax avoidance

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Common feature

Absence of real economic activity in the member state of registration

- no (or few) employees
- no (or little) production
- no (or little) physical presence

Lack of reliable data > thus use of indicators

Data

- Lack of data, esp. in cases of anonymous shell companies and letterbox companies
- Data exists for Special Purpose Entities (FDI data and, as of recently, data on FDI through SPEs)

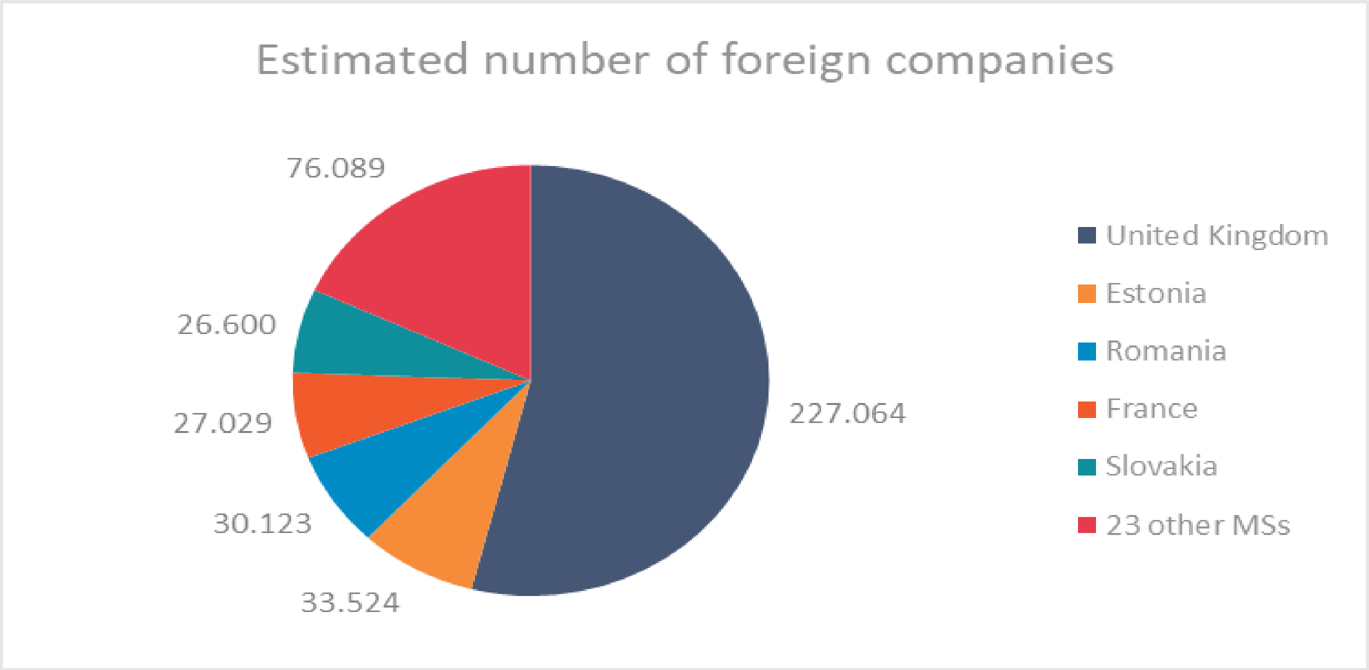
Indicators

- Foreign owned companies in a member state
- Ratio of FDI to a GDP of a member state, focus on FDI through SPEs
- Profitability gap between foreign and domestic companies in a member state

Indicator 1: Foreign owned companies in a member state

Source: 2016 Study on the Law Applicable to Companies (LSE for European Commission)

Big caveat!



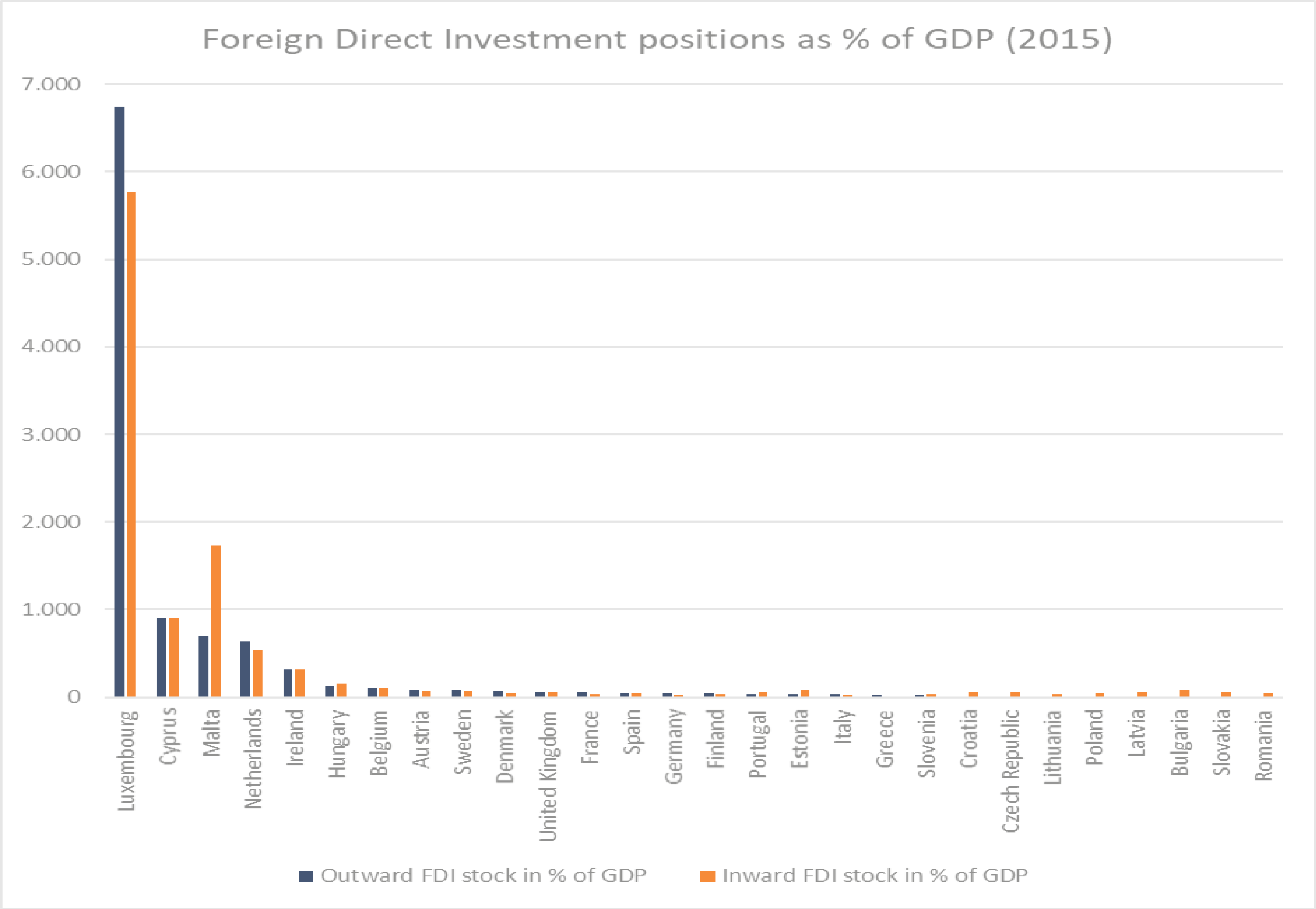
Indicator 2: Ratio of FDI to a GDP of a member state, focus on FDI through SPEs

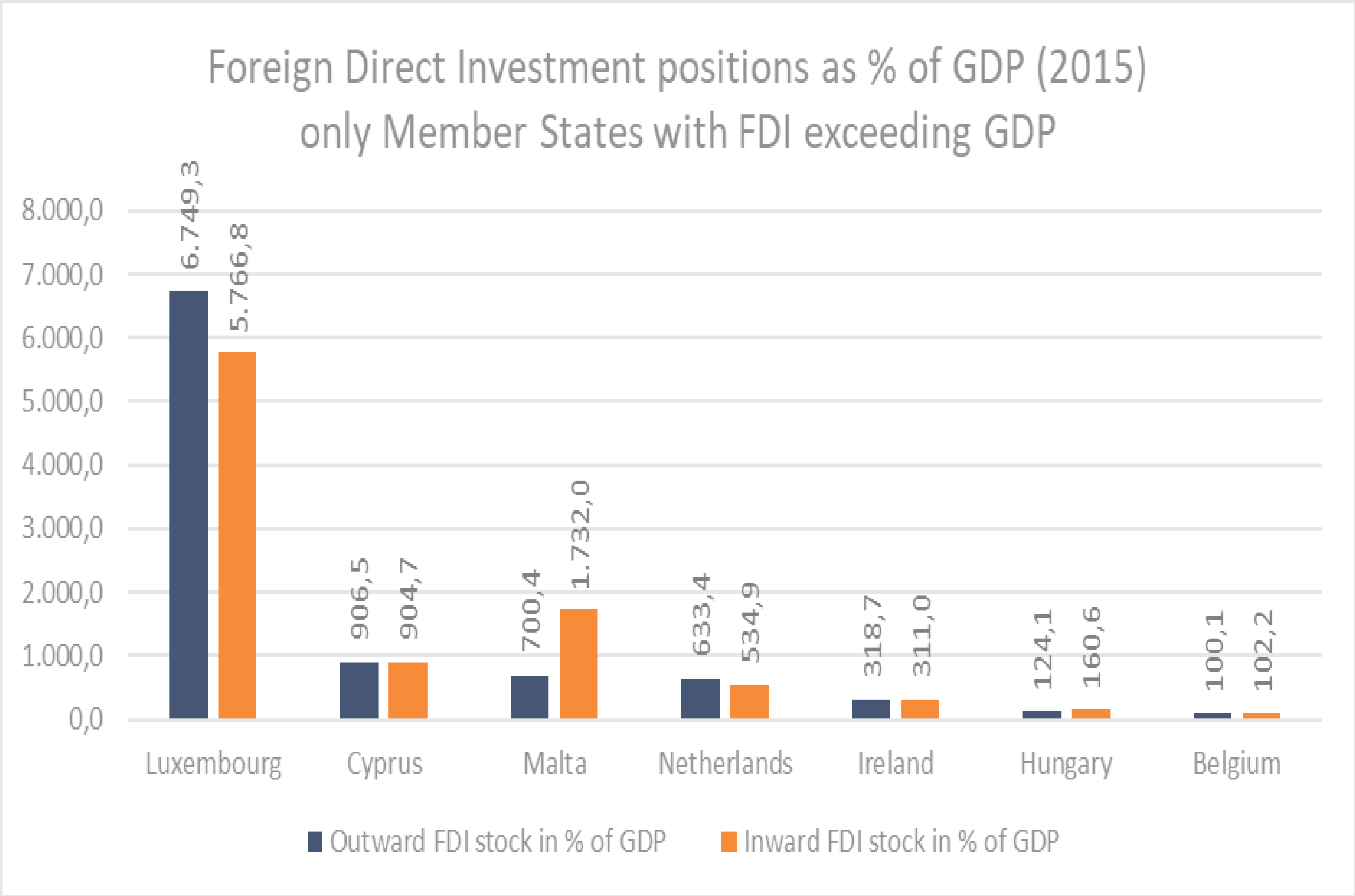
Foreign Direct Investment (FDI)

Source: 2017 Study on the Aggressive Tax Planning Indicators (IHS for European Commission)

We looked into:

- inward and outward FDI
  - in absolute values ($ Million) and as a % of member state's GDP (to account for country-size effects)
- FDI through SPEs


Foreign Direct Investment positions as % of GDP (2015)
7.000
6.000
5.000
4.000
3.000
2.000
1.000
0
Luxembourg
Cyprus
Malta
Netherlands
Ireland
Hungary
Belgium
Austria
Sweden
Denmark
United Kingdom
France
Spain
Germany
Finland
Portugal
Estonia
Italy
Greece
Slovenia
Croatia
Czech Republic
Lithuania
Poland
Latvia
Bulgaria
Slovakia
Romania
Outward FDI stock in % of GDP
Inward FDI stock in % of GDP


Foreign Direct Investment positions as % of GDP (2015)
only Member States with FDI exceeding GDP
8.000,0
7.000,0
6.000,0
5.000,0
4.000,0
3.000,0
2.000,0
1.000,0
0,0
6.749,3
5.766,8
906,5
904,7
700,4
1.732,0
633,4
534,9
318,7
311,0
124,1
160,6
100,1
102,2
Luxembourg
Cyprus
Malta
Netherlands
Ireland
Hungary
Belgium
Outward FDI stock in % of GDP
Inward FDI stock in % of GDP

... focus on FDI through Special Purpose Entities (SPEs)

An enterprise is usually considered as a SPE if it meets the following criteria:

- The enterprise is a **legal entity**, formally registered with a national authority, and subject to fiscal and other legal obligations of the economy in which it is resident.
- The enterprise is ultimately **controlled by a non-resident parent**, directly or indirectly.
- The enterprise has **no or few employees, little or no production in the host economy and little or no physical presence**.
- Almost all the **assets and liabilities** of the enterprise represent **investments in or from other countries**.
- The core business of the enterprise consist of **group financing or holding activities**, that is […] the **channelling of funds from non-residents to other non-residents**. However, in its daily activities, managing and directing plays only a minor role.

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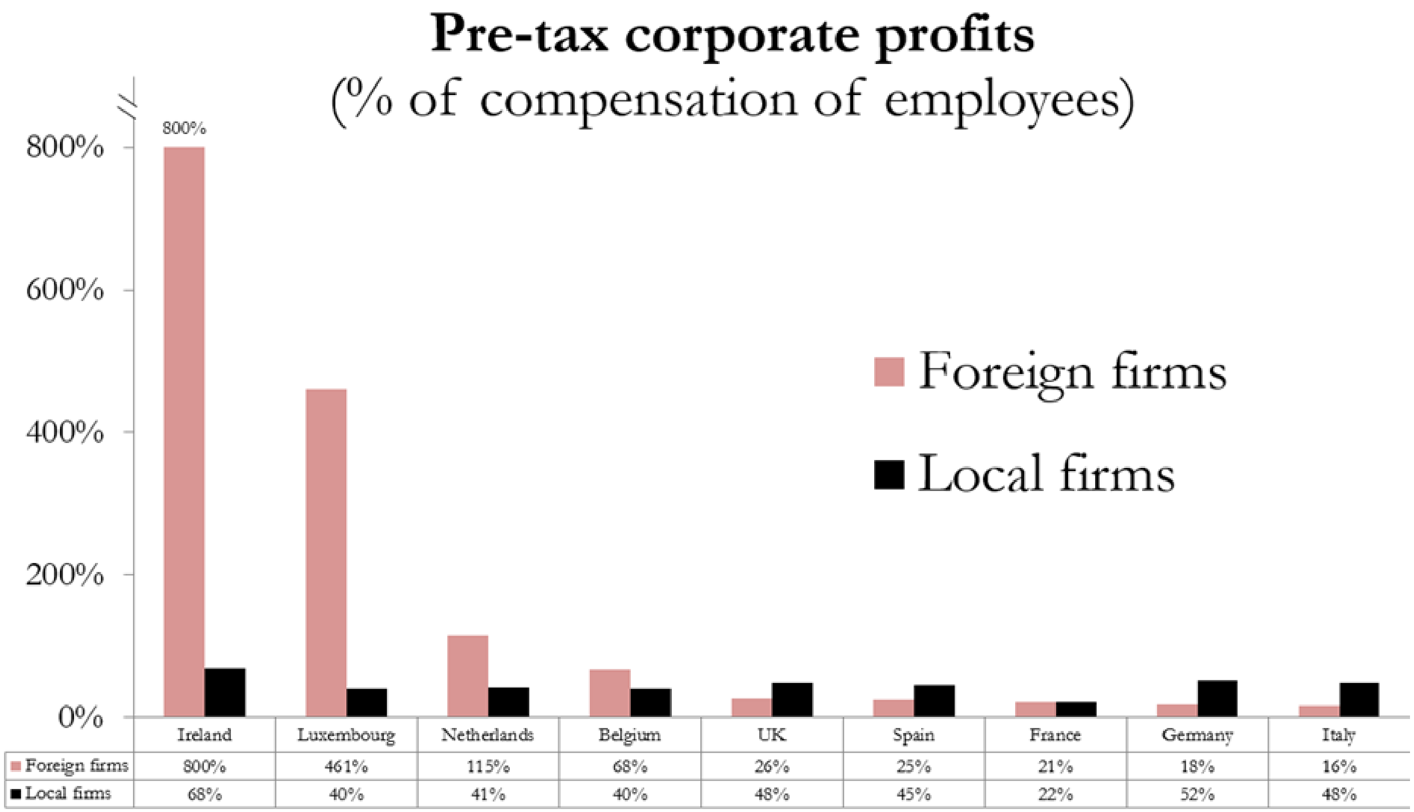
...focus on FDI through SPEs in member states

European Semester 2018 findings:

- **High inward and outward FDI stocks** is noted in seven member states which 'can only be partially explained by real economic activities taking place', and

- **high share of FDI stock held by SPEs** in several member states: Malta (96% inward and 98% outward FDI in SPEs), Luxembourg (around 95% of FDI in SPEs) and the Netherlands (80% inward and 73% outward of FDI in SPEs).

Indicator 3: Profitability gap between foreign and domestic companies in member states



	Ireland	Luxembourg	Netherlands	Belgium	UK	Spain	France	Germany	Italy
Foreign firms	800%	461%	115%	68%	26%	25%	21%	18%	16%
Local firms	68%	40%	41%	40%	48%	45%	22%	52%	48%

Identified risks

Shell companies do not necessarily bear risks because of what they are. However, they can be misused when associated with:

- Anonymity;
- Treaty abuse;
- Circumvention of the posting of workers directive.

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Impacts

- Such misuses of shell companies entail serious risks of:
  - Money laundering, tax avoidance and tax evasion,
  - Corruption,
  - Abuse of social rights.

- That has serious impact on the economy and the society as a whole, including:
  - Negative impact on GDP
  - Development of criminal activities
  - Decrease trust in institutions
  - Raise of inequalities
  - Diminish workers' protection

Mitigating policies

- Different approaches have been taken by Member States, including a ban of shell companies in Latvia.

- In the EU, mitigating measures include:
  - Lift on the anonymity: 4th and 5th AML
  - Anti treaty abuse measures, including:
    - Parent-subsidiary directive
    - Anti-Tax avoidance directive (ATAD)
    - Hybrid mismatches directive
    - Public country-by-country reporting (CBCR)
    - Common corporate tax base (CCTB) and Common consolidated corporate tax base (CCCTB)
  - Circumvention of PWD: Enforcement directive.

Conclusion

- Many of the regulatory EU are to produce their full effects.

- Fitness check needed?

Thank you for your attention

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