ATAD 3 & Substance

from a Tax Treaty Perspective

Prof. Dr. Kasper Dziurdź

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Maastricht University Faculty of Law – Department of Tax Law

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Minimum Substance Requirements

- ATAD 3 introduces minimum substance requirements for claiming (amongst others) tax treaty benefits
  - Entity fulfills conditions under a tax treaty
  - Entity is considered a "shell entity"
  - → Tax treaty benefits are denied
- Are the minimum substance requirements under ATAD 3 substantially different from those under tax treaties?
  - ATAD 3 uses some similar terms (e.g. control over risks)
  - ATAD 3 introduces new concepts alien to tax treaties
  - Every tax treaty is to some extent different (pre/post BEPS)
  - What are the substance requirements under a tax treaty?

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Gateways under Art. 6 ATAD 3

- Substantial amount of relevant income
- Substantial amount of cross-border activity
- Outsourcing (to a third party)
  - Entity outsourced the administration of day-to-day operations
  - Entity outsourced the decision-making on significant functions
- Outsourcing indicates new significant (control) functions, which may be relevant for treaty residence and profit allocation
  - Who has taken the decision to outsource the relevant activities?
  - Who is monitoring or controlling the activities of the third party?
  - Who instructs the third party how to perform the activities?

Indicators under Art. 7 ATAD 3

- Qualified premises in the Member State (even if no activities?)
- Own and active bank account in the European Union
- At least one relevant director or the majority of relevant employees with a sufficient nexus to the Member State
- No direct relationship to tax treaty criteria for residence:
  - Outside the Member State but at no greater distance than compatible with the proper performance of the duties ***vs.*** jurisdiction matters
  - One (even pro-forma?) director may ensure substance ***vs.*** the place of (effective) management may still be outside the Member State
  - Majority of relevant employees may ensure substance ***vs.*** there may still be only a PE and no tax treaty residence in the Member State

Rebuttal under Art. 9 ATAD 3

- Key definition of "insufficient substance" in Art. 9(3) ATAD 3
  - Entity has not performed the business activities
  - Entity had no continuous control over the business activates
  - Entity has not borne the risks of the business activities
- Is there any relevant profit left after a proper TP analysis?
- Who has performed, controlled and borne the risks?
  - Implications under domestic tax law?
  - Implications under tax treaty law?

ATAD 3 – Yes or No?

- Arguments for ATAD 3 from a tax treaty perspective
  - Unlimited tax liability not sufficient for a certificate of residence
  - Improvement compared to limited BO, vague PPT and complex LOB
  - Self-assessment by taxpayers (instead of ex post by tax authorities)
  - More than just a denial → "CFC-like" taxation of shareholders
- Arguments against ATAD 3 from a tax treaty perspective
  - Sufficient tools already exist to address shell entities: BO, PPT, LOB, TP, …
  - Better to use or improve existing tools (e.g. MLI, revision of tax treaties)
  - Minimum substance under ATAD 3 does not guarantee tax treaty benefits
  - Additional burden for taxpayers to assess and report ATAD 3 criteria

Conclusions

- Limit ATAD 3 to reporting obligations (DAC 9)?!
  - No changes to the relevant criteria under tax treaty law
  - Better assessment of tax treaty residence (e.g. dual residence)
  - Clearer indications of where relevant functions are performed
  - More information about potential “tax treaty abuse” (e.g. PPT)
  - Better knowledge about existing loopholes in tax treaties
- However, more and more reporting obligations require a careful balance between the benefits and the compliance burdens
  - Which information is really necessary (and will it be used)?
  - Can existing information be re-used?
  - Can existing concepts be re-used?