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Legislative proposal on rules to prevent the misuse of shell entities for tax purposes

The European Public Real Estate Association (EPRA) is the voice of Europe's listed real estate companies that derive income from the ownership, trading and development of income producing real estate assets. Listed real estate allows anyone, from retail investors to large institutional investors, to invest in the underlying assets of publicly quoted companies, the same way as investing in other industries through purchasing shares. With more than 280 members (companies, investors and their suppliers), EPRA represents over 680 billion EUR of real estate assets (European companies only) and 94% of the market capitalisation of the FTSE EPRA Nareit Europe Index.

EPRA plays a leading role in increasing the transparency of the listed real estate environment by improving the quality and consistency of the financial reporting, performance reporting and corporate governance framework within Europe. EPRA produces its Best Practice Recommendations (BPR) which are a recognised benchmark for reporting listed real estate under international accounting standards.

General position

EPRA welcomes the opportunity to provide feedback to the European Commission proposal laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (the “Directive” or “proposal”).

Whilst we fully support the Commission’s fight against tax avoidance, it is EPRA’s view that the proposal will risk resulting in incoherent legislation, as a number of significant measures in this domain have only recently been implemented and their impact has not yet been evaluated. The proposal is based on assumptions that predate and ignore several initiatives to counter base erosion and profit shifting. In the context of the EU, the shell entities initiative does not take into account in particular:

- the Anti-Tax Avoidance Directives (I&II)
- the Directive on Administrative Cooperation (DAC)
- the fourth Anti-Money Laundering Directive
- EU-list of non-cooperative jurisdictions for tax purposes
- the end of several national tax practices and the introduction of safeguards as a result of the OECD BEPS action plans, in particular the introduction of minimum standards (e.g. the principal purpose test of BEPS Action 6).

While the main goal of the Directive is to tackle tax avoidance and evasion via shell entities, which we share, the proposal integrates disproportionate elements also targeting entirely legitimate business structures. The current proposal triggers several concerns that will be addressed in more detail below.

Detailed explanation of position

In the Whereas 5, as first condition it is mentioned that it would be about geographically mobile economic activities. That being so, the inclusion of "income from immovable property" as relevant income in Article 4,e seems quite contradictory, hence income from immovable property should be excluded from Article 4.

- Article 6,1,c includes the test of outsourcing the administration of day-to-day operations and the decision-making on significant functions. It should be clarified what is meant with "outsourcing the administration". Generally, within large multinational groups, it's common to have local management entities per country (or region) performing the day-to-day operations of the local (holding) entities. For large multinational real estate investors, it's uncommon and impractical to have in-house management for each and every separate entity. Therefore, the management entity per country (or region) fulfills that role, based on transfer pricing documentation as explained in the respective Master File and Local File. Against this background, it should be considered to exclude undertakings that have in-house management functions, and make clear that this only applies (if at all) to undertakings that do not have own resources and engage third-party service providers, as is also indicated under the Whereas under (5).

- Article 6,2,a carves out listed entities from the scope of the Directive. Based on the Whereas (6) it is explained that it is fair to exclude such entities as they are already subject to an adequate level of transparency and do not present a risk of lacking substance for tax purposes. The proposal refers to the beneficial ownership definition of article 3 (6) of Directive EU 2015/849, whereby listed entities are excluded in this definition. Given this increased level of transparency and control that is already present at the level of the listed entity, it should be considered to also exclude subsidiary undertakings of this listed parent entity.

- Article 6,2,c refers to "undertakings that have the main activity of holding shares in operational business in the same Member State while their beneficial owners are also resident for tax purposes in the same Member State". It should be considered to include a reference to listed entities that have an operational business in the same Member State, as technically speaking this listed entity has no beneficial owners according to its definition in the proposal.

- Article 7,1,a should also be deemed to be fulfilled if the undertaking can share premises with associated enterprises, hence the wording then would be "the undertaking or an associated enterprise has own premises in the Member State, or premises that can exclusively be used by the undertaking and associated enterprises."

- Article 7,1,c,4 creates issues in case of JV-situations, as in some cases fully qualified directors are employed by the JV-partner and/or perform the function of director or equivalent of other enterprises that are not associated enterprises. Therefore, it should be considered to exclude such joint venture structures from the scope of this article.

- Overall, the Directive seems to be based on the assumption of entities all filing their own tax returns and notifications. In most EU countries we know the concept of a tax group. It should be clarified how the rules work in case of the existence of a tax group.

- When it comes to domestic investments, national regimes for Real Estate Investment Trusts (REITs) are characterised by (i) a taxation upon entry into the regime (exit tax), (ii) an absence of income taxation at the level of the REIT and (iii) a compulsory annual dividend distribution that leads to taxation (as the case via a withholding tax) in the hands of the shareholders. This tax regime combined with a shift of taxation to the shareholders has been confirmed as not constituting a state aid scheme (see decision EC C(2010) 2974 state aid nr. N131/2009 (Finland)).

- In absence of a mutual recognition of the 13 REIT regimes in Europe, the situation of REITs making cross-border investments might lead to additional tax burden which in turn jeopardise European cross-border investments (in contradiction with the goals of the EU):
  - a REIT might be prevented to benefit from a similar tax regime when investing in another Member State. As a result, the local real estate income is subject to local income taxation and any profit repatriation to the REIT might be subject to withholding tax (as the REIT shall often be prevented to access the European Directives). This foreign withholding tax is often not creditable at REIT level. In certain REIT regimes, the foreign-source income might also be subject to taxation in the hands of the shareholders, via a withholding tax, upon redistribution while this income has already been subject to local income taxation.
  - a REIT might be allowed to benefit from a similar regime when investing in another Member State, the local real estate income being exempt from income taxation and the taxation being shifted to the REIT via a compulsory dividend distribution subject to withholding tax. However, depending on its regime, the REIT (i) will be obliged to redistribute to its shareholders (significant part of) the dividend received, (ii) might subject this dividend to withholding tax and (iii) might not be able to credit the withholding tax of the source state.
  - The above demonstrates that, in absence of a mutual recognition of REIT regimes in the EU, significant cross-border investments by REITs might be jeopardised because of a higher tax burden compared to domestic investments.
  - In our view, cross-border investments within Europe by REITs should be encouraged and the recourse to so-called "shell entities" should not be sanctioned to the extent these entities allow the REIT to benefit from a similar tax regime in a domestic situation and in a cross-border situation.
  - We therefore plead for a modification of the proposed Article 10 (Exemption) in order for REITs' subsidiaries to have the possibility to request for an exemption in case it can be demonstrated that the overall taxation level in a cross-border scenario is similar to the taxation level in a domestic scenario. Such demonstration should in our view be evidenced by (i) delivering proof that the real estate income is subject to local income taxation (without benefitting from a REIT-like regime) and that this income is then repatriated without tax leakage (or at minimum) tax leakage to the REIT or (ii) delivering proof that the real estate income is subject to a local (REIT-like) exemption regime and is then either (a) repatriated to the REIT without tax leakage (or at minimum tax leakage) to the REIT but subject to withholding tax when distributed to its shareholders or (b) repatriated to the REIT subject to a non-creditable withholding tax and then distributed to its shareholders in exemption of withholding tax.

- Overall, we reiterate our demand for a harmonised mutual recognition of REIT regimes in the EU.
- We stand ready and welcome the opportunity to discuss and explain our views in more detail.