EUROPEAN COMMISSION "UNSHELL" PROPOSAL:

A BOOST TO UNIT-LINKED LIFE INSURANCE POLICIES (ULLIP)?

In this article, Mafalda Cesário, Head of Tax & Legal for Portugal at Utmost International, interviews Ricardo da Palma Borges, Managing Partner at Ricardo da Palma Borges & Associados and asks him some key questions about the European Commission's "Unshell" draft Directive proposal.

This interview provides some guidance to intermediaries and their clients on the draft proposal, its tax consequences and how unit-linked life insurance policies can be the solution.

MAFALDA CESÁRIO
UTMOST INTERNATIONAL

Mafalda Cesário is the Head of Tax & Legal for Portugal and Brazil in Utmost International, providing specialist tax and legal advice for sales cases related to Portuguese and Brazilian individuals. Mafalda draws upon her 15+ years of technical knowledge of multi-jurisdictional uses of life assurance policies to provide insights and solutions to partners in Private Banks, Family Offices, Asset Managers, legal and accountancy firms and their HNW and UHNW clients. Mafalda is also a fully qualified Portuguese lawyer.

RICARDO DA PALMA BORGES
RICARDO DA PALMA BORGES & ASSOCIADOS

Ricardo da Palma Borges is recognised as a Specialist Lawyer in Tax Law by the Portuguese Bar Association since 2004 and is one of the industry experts on the Non-Habitual Tax Resident regime.

E ricardo@rpba.pt
W www.rpba.pt

WHAT IS THE PURPOSE OF THE "UNSHELL" DIRECTIVE?

The "Unshell" draft Directive proposal issued on 22 December 2021 is designed to prevent the misuse of corporate entities for tax abuse purposes. Assuming consensus is reached between the Member States of the European Union (EU), the new rules will come into effect on 1 January 2024. The status of the entities is determined by analysing the two preceding years and as a result, 2022 is already a relevant period.

WHAT IS THE TYPICAL STRUCTURE THAT WILL BE AFFECTED BY THIS DIRECTIVE? WOULD A PRIVATE LUXEMBOURG HOLDING COMPANY WHOSE SHAREHOLDER DOES NOT HAVE A CONNECTION WITH LUXEMBOURG BE AFFECTED?

The proposal sets out a list of criteria to identify "reporting entities" with a potential lack of substance that will have to declare themselves as reporting entities in their annual returns. Reporting entities are EU resident entities that earn predominantly passive income (or mainly hold certain types of assets), in a cross-border context, and outsource daily management and decision-making for significant functions.

Accordingly, a Luxembourg private holding or wealth management company, whose shareholder does not have its tax residence in Luxembourg, is potentially at risk of being a reporting entity and ultimately qualified as a shell.

All reporting entities must demonstrate that they meet certain minimum substance requirements (own premises, exclusive local director or sufficient full-time resident employees and bank account in the EU). If the minimum substance requirements are not met, then the proposed Directive will consider the entity a "shell". This will result in the loss of benefits (based on double tax treaties and EU directives) and the shell being treated as a look-through for tax purposes. For example, source / payer States may apply domestic taxes on the outbound payment (without consideration for the double tax treaty entered into with the shell residence State). The data reported by entities in scope will be covered by automatic exchange of information and may generate requests for tax audits.

AS YOU KNOW, NON-EU STATES WILL NOT BE BOUND BY THIS DIRECTIVE. AS SUCH, WHAT IS YOUR VIEW ABOUT A PORTUGUESE TAX RESIDENT INDIVIDUAL KEEPING A SHELL COMPANY OUTSIDE OF THE EU? WHAT WOULD BE THE TAX CONSEQUENCES IN PORTUGAL FOR THIS INDIVIDUAL?

Shareholders of at-risk entities need to swiftly review current structures to prevent harsh consequences. It is possible that some individuals may redomicile their existing EU shell companies to non-EU jurisdictions, like the United Kingdom or Singapore, keep existing shell companies in such jurisdictions or even set up new ones there. However, such tax motivated behaviour might be subject to mandatory disclosure rules to the Tax Administration and to other anti-abuse rules, like Controlled Foreign Company rules, whereby the income of low-taxed entities is imputed to their Portuguese tax resident beneficiaries and taxed accordingly. Common Reporting Standard ("CRS") automatic exchange of financial account information and the increasingly widespread public registers of beneficial owners also provide means of scrutiny, at least vis-à-vis shells in some non-EU States. It is yet unclear if other non-EU States will follow the path of the EU and introduce their own anti-shell legislation.

This "Unshell" Directive will add to other tools that tackle aggressive tax planning, namely the recent mandatory disclosure rules for intermediaries and taxpayers, the future framework for business taxation in the EU (BEFIT), or the 8th Directive on administrative cooperation covering crypto assets. With requirements for corporate entities to be tax-compliant becoming increasingly complex, investors must reconsider wealth management structures. They may endeavour to conform with the multiple demands and disclosures and fight the assumptions of abuse or avail of a different route: dissolving corporate vehicles, namely those lacking enough substance. After Suisse Secrets 2022, Pandora Papers 2021, FinCEN Files 2020, Paradise Papers 2017, Malta Files 2017, Panama Papers 2016, Bahamas Leaks 2016, Swiss Leaks 2015, Lux Leaks 2014 and Offshore Leaks 2013-2012, there is a growing reputational fear as well as an increasingly reduced Tax Authority tolerance on tax driven shell companies, and a fatigue by their shareholders due to restructuring costs, substance demands, burdensome management needs and constant legal, tax and regulatory changes.

THE MAJORITY OF TAX EXPERTS BELIEVE THIS PROPOSAL WILL BE APPROVED AS THERE IS A BIG PRESSURE FROM THE EUROPEAN COMMISSION. IF THAT IS THE CASE, THE NEW RULES WILL COME INTO EFFECT ON 1 JANUARY 2024, WHICH PROVIDES TAX LAWYERS WITH LESS THAN TWO YEARS TO START ADVISING THEIR CLIENTS ON THIS MATTER. DO YOU CONSIDER A UNIT-LINKED LIFE INSURANCE POLICY (ULLIP) A GOOD SOLUTION FOR YOUR CLIENTS? WHAT ARE THE MAIN ADVANTAGES OF A ULLIP?

Indeed, a growing number of investors, as an alternative to the never-ending headaches stemming from these developments on entity management and compliance, will enter long-term saving products, such as the well-regulated investment or capital redemption bonds or ULLIP. These are widely accepted and efficient mechanisms to protect, manage and pass on wealth. Apart from flexibility in terms of investment selection, asset protection, privacy towards parties other than public authorities and probate avoidance, they typically allow advantages in line with the intent of the legislator, namely tax-deferred growth, exempt death benefits, and reduced tax rates for surrenders based on the length of the policy. So yes, ULLIP is a good solution in many instances.

TO LEARN MORE ABOUT UTMOST WEALTH SOLUTIONS, PLEASE VISIT

WWW.UTMOSTINTERNATIONAL.COM