



Letterbox companies: overview of the phenomenon and existing measures

Final Report

Written by ICF Consulting Services Ltd
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and Consumers*



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ABSTRACT

This study for the European Commission was carried out by the ICF Consulting Services Ltd. It aims to provide a factual overview about letterbox companies in the EU. Through a combination of desk research, inputs from EU and national experts, interviews and an online survey, it aims to assess the phenomenon of letterbox companies, including:

- Describing the phenomenon and its characteristics across countries (section 2);
- Providing an estimated quantification of such companies, based on data and indicators collected through literature review and the analysis of the Orbis database (section 3);
- Analysing the different types and uses made of letterbox companies (section 4);
- Examining the role played by company law requirements at Member State level (section 5);
- Mapping existing measures that have an impact on letterbox companies (section 6).

Glossary of Terms

Aggressive tax planning (ATP) – the use by multinational enterprises of the opportunities to reduce the tax burden that exist in an international context and due to the interaction of the tax rules of different jurisdictions¹.

Beneficial owner – the natural person or persons who ultimately own or control the corporate entity².

Business registers – central database where commercial and companies' data is recorded. Such registers have been established in all EU Member States in accordance with Directive 2009/101/EC.

Company law – legislation that regulates the creation, registration, incorporation, operation, governance and dissolution of companies.

Conduit company – a company which makes real or fictitious intra-EU supplies to missing or defaulting traders. It voluntarily takes part in a fraudulent scheme.

Connecting factor – the relevant link between a subject (in this context a company) and a legal order that determines the applicable law in a conflict of law situation.

Controlled foreign company – a Member State shall treat an entity, or a permanent establishment of which the profits are not subject to tax or are exempt from tax in that Member State, as a controlled foreign company where: (a) an entity, the taxpayer by itself or together with its associated enterprises, holds a direct or indirect participation of more than 50% of the voting rights, or owns directly or indirectly more than 50% of capital or is entitled to receive more than 50% of the profits of that entity; and (b) the actual corporate tax paid on its profits by the entity or permanent establishment is lower than the difference between the corporate tax that would have been charged on the entity or permanent establishment under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity or permanent establishment³.

Dormant companies – registered companies that have no significant activity (and no significant transactions within an accounting period).

Double taxation – tax principle referring to income taxes being paid twice on the same source of income.

Flag of convenience – a business practice whereby ship's owners register a vessel on the register of a country other than that of the ship's owners and the ship flies the civil ensign of that country, called the 'flag state'. The registration of vessels in foreign nations usually serves to take advantage of favourable tax structures and regulations.

Freedom of establishment of companies – the freedom of establishment applicable to legal entities pursuant to Articles 49 and 54 of the Treaty on the Functioning of the European Union.

¹ Dourado, A. P., 'Tax avoidance revisited in the EU BEPS context' in *International Tax Law: New Challenges to and from Constitutional and Legal Pluralism*, IBFD: Amsterdam, 2017, 9.3.

² Directive (EU) 2015/849 on preventing abuse of the financial system for the purposes of money laundering or terrorist financing, available at: <https://eur-lex.europa.eu/legal-content/en/LSU/?uri=CELEX%3A32015L0849#:~:text=Beneficial%20owner%3A%20the%20person%20who%20ultimately%20owns%20or%20controls%20a%20company> (last accessed February 2020).

³ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

Holding company – a parent corporation, limited liability company or limited partnership that owns enough voting stock in another company to control that company's policies and oversee its management decisions.

Incorporation requirements – legal (national) requirements that must be met to validly incorporate a company.

Incorporation theory – the legal regime applicable to a company is determined by the place where the company has been incorporated, and not by the place where its activity is undertaken⁴.

Letterbox companies – in the absence of an official definition, this study understands the term to refer to limited liability companies that are established in one Member State but do not perform any economic activity (i) in that Member State but in another country, or (ii) anywhere at all.

Limited liability company – a company with share capital and legal personality, possessing separate assets that alone serve to cover its debts.

Money laundering – the process by which criminal proceeds are cleaned so that their illegal origins are hidden. According to Directive 2015/849, conduct, when committed intentionally, shall be regarded as money laundering: (a) the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an activity to evade the legal consequences of that person's action; (b) the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property, knowing that such property is derived from criminal activity or from an act of participation in such an activity; (c) the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such an activity; (d) participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions referred to in points (a), (b) and (c)⁵.

Panama Papers – revelations of the International Consortium of Investigative Journalists (ICIJ) on the use of offshore companies. The Panama Papers comprise 2.6 terabytes of confidential information leaked from the law firm and licensed trust company Mossack Fonseca, which contained 11.5 million documents. The documents were released in April 2016.

Posting of workers – the process in which a posted worker, for a limited period of time, carries out their work in the territory of an EU Member State other than the state in which they normally work (Council and European Parliament Directive 96/71/EC as amended by Directive 2018/957).

Profit shifting – practice that involves making payments to other group companies to move profits from a high-tax jurisdiction to low-tax regimes.

Real seat – in the absence of a single accepted definition, the real seat is typically understood as the head office, headquarters, central administration, or place of business/effective management, usually referring to the place which has the closest connection to a company's management and operations.

Registered office or statutory seat – street address of a firm's registered office (as indicated in the business register and/or in the company's statute). The terms 'registered

⁴ Financial Law Institute, Working Papers Series, 2017.

⁵ Directive (EU) 2015/849 on preventing the use of the financial system for money laundering or terrorist financing (4th Anti-Money Laundering Directive).

office' and 'statutory seat' are used interchangeably, depending on the source (national laws and international instruments).

Regulatory arbitrage – structuring activity to take advantage of gaps or differences in regulations or laws⁶.

Shareholder – natural or legal person recognised as a shareholder under the applicable law⁷.

Special Purpose Entity (SPE) – (a) a legal entity formally registered with a national authority and subject to the fiscal and other legal obligations of the economy in which it is resident, (b) established to perform specific functions limited in scope or time, with one or a few primary creditors, (c) having little or no non-financial assets and employees, little or no production or operations and sometimes no physical presence beyond a 'brass plate' confirming its place of registration, (d) related to another corporation, often as a subsidiary and often resident in a territory other than the territory of residence of the related corporation (lacking any physical dimension, the residence of an SPE is determined by the economic territory under whose laws it is incorporated or registered), (e) its core business function consists of financing its group activities or holding assets and liabilities of its group, that is the channelling of funds from non-residents to other non-residents, and with only a minor role for managing and directing activities. SPEs are sometimes called **special-purpose vehicles (SPVs)** or **financial vehicle corporations (FVCs)**⁸.

Subcontracting chain – phenomenon that emerges if a principal contractor contracted by an investor, or the investor themselves, hires one or more subcontractors, who either contribute by bringing their own employees or by subcontracting another legal entity, such as a temporary work agency. This chain resembles a logistical chain, as well as a value chain of an economic nature - every link has its own contract commitment to one of the other links⁹.

Tax avoidance – practices intended to modify a taxpayer's tax liability to lower the amount of income tax owed. The notion of tax avoidance is not legally defined but emanates from a legal principle of abuse or general or specific anti-avoidance rules¹⁰.

Tax evasion (or tax fraud) – deliberate illegal evasion of taxes, generally punishable under criminal law or a punishable offence. This includes evasion of taxes by hiding income or information from the tax authorities or by falsifying information¹¹.

Tax planning – legal practice applied to reduce tax liability through planning the use of allowances, deductions or exemptions, for example.

Transfer pricing – refers to terms and conditions surrounding transactions within a multinational company. It concerns the prices charged between associated enterprises established in different countries for their inter-company transactions.

⁶ University of Oxford, Faculty of Law, Blog, June 2019, available at: <https://www.law.ox.ac.uk/business-law-blog/blog/2019/06/centros20-series-tech-regulatory-arbitrage-and-limits>

⁷ Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies.

⁸ [https://ec.europa.eu/eurostat/statistics-explained/index.php/Glossary:Special-purpose_entity_\(SPE\)](https://ec.europa.eu/eurostat/statistics-explained/index.php/Glossary:Special-purpose_entity_(SPE))

⁹ European Commission, Study on liability in subcontracting chains: national rules and the need for a European framework, 2017.

¹⁰ Dourado, A. P., 'Tax avoidance revisited in the EU BEPS context' in *International Tax Law: New Challenges to and from Constitutional and Legal Pluralism*, IBFD: Amsterdam, 2017, 1.1.1.1.

¹¹ European Commission, Communication of 27 June 2012 on concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries, COM(2012) 351 final, 2012, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0351&from=EN>; Organisation for Economic Co-operation and Development (OECD), Glossary of tax terms, available at: <http://www.oecd.org/ctp/glossaryoftaxterms.htm>

List of abbreviations

AML Directive	Anti-Money Laundering Directive
ATAD	Anti-Tax Avoidance Directive
ATP	Aggressive tax planning
BEPS	Base erosion and profit shifting
BRIS	Business Registers Interconnection System
CCBE	Council of Bars and Law Societies of Europe
CCTB	Common Corporate Tax Base
CCCTB	Common Consolidated Corporate Tax Base
CFC	Controlled foreign company
CJEU	Court of Justice of the European Union
EFBWW	European Federation of Building and Woodworkers
ETUC	European Trade Union Confederation
EU	European Union
FATF	Financial Action Task Force
FDI	Foreign direct investment
GAAR	General Anti-Abuse Rules
IBFD	International Bureau of Fiscal Documentation
LBCs	Letterbox companies
MNEs	Multinational enterprises
NGOs	Non-governmental organisations
OECD	Organisation for Economic Co-operation and Development
OFCs	Offshore financial centres
OPC	Open public consultation
PIL	Private international law
PWD	Posted Workers Directive
SMEs	Small and medium-sized enterprises
SPEs	Special purpose entities
SPVs	Special purpose vehicles
TNA	Transaction Network Analysis
TFEU	Treaty on the Functioning of the European Union
TSCPs	Trust and Company Service Providers
UNCTAD	United Nations Conference on Trade and Development
VAT	Value-Added Tax

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1 Introduction to the study

1.1 The phenomenon of letterbox companies

'In our thriving EU Single Market, companies have the freedom to move and grow. But this needs to happen in a fair way'¹². This statement rightly reflects both the need and the willingness of the European Union (EU) to tackle possible abuses in the functioning of the Single Market.

The diversity of legal frameworks at international, EU, national and local level, as well as historical, political, economic and custom-related factors means that the **phenomenon of letterbox companies (LBCs)** is complex and difficult to apprehend. With a broad geographical spread and occurring in various economic sectors, it impacts different policy areas, from company law to employment, social security, taxation and criminal justice. In addition, the ways in which these companies operate in practice is often unknown, and not all stakeholders are willing to disclose the structures and activities that characterise letterbox companies.

Paradoxically, despite growing awareness of its negative impacts, the phenomenon of LBCs has expanded as a result of both the development of the internal market and globalisation in general. The research conducted as part of this study shows that the phenomenon of LBCs is linked - albeit unintentionally - to EU efforts to develop the Single European Market, in particular through one of its cornerstones, the freedom of establishment. Since 1993, the EU has focused on promoting economic integration across the Union and removing cross-border barriers. The EU *acquis* has placed constant focus on improving the functioning of the internal market by simplifying and harmonising access, thus increasing the mobility of companies. In addition, cross-border activity is strongly encouraged by the freedom of establishment enshrined in and guaranteed by Articles 49 and 54 of the Treaty on the Functioning of the European Union (TFEU), the importance of which has been repeatedly confirmed in the case-law of the Court of Justice of the European Union (CJEU). This core freedom means that all companies validly incorporated in one Member State can exercise their right to free movement and do business in other Member States.

A natural consequence of this freedom is that, in their search and need for competitiveness at global level, companies actively and continuously search for more favourable jurisdictions, where costs are lowest in terms of wages, taxes, etc., contributing *in fine* to the further development of the phenomenon.

The fact that the LBC phenomenon is highly debated and sometimes controversial only adds to its complexity. Views differ substantially: on the one hand, LBCs can be set up in all legality by multinationals, small and medium-sized enterprises (SMEs) and individuals alike, for a wide variety of purposes, underlining the importance of being able to use letterbox companies as a means to achieve and maintain a competitive position in the global economy. On the other hand, LBCs can be also associated with abusive, illegal or even criminal behaviour, e.g., in the context of tax evasion, social dumping or even money laundering. In the social sector, for example, some stakeholders highlight the abusive use of LBCs to avoid or significantly reduce the social security benefits due, or to pay lower wages, etc. In addition to possible negative social impacts, such abusive uses of letterbox companies also bear risks for the economy and for society as a whole¹³.

¹² Statement from European Commission Vice- President Frans Timmermans on the occasion of the Commission proposed reform of company law, April 2018, available at:

https://ec.europa.eu/commission/presscorner/detail/en/IP_18_3508

¹³ European Parliamentary Research Service (EPRS), An overview of shell companies in the European Union, 2018, available at:

http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf

In recent years, public and political debates on LBCs have gained more attention. This is mainly due to a series of media revelations on their use, sometimes including well-known companies and prominent figures.

To date, existing research has primarily addressed the phenomenon in specific situations or individual sectors in which it has appeared. However, no comprehensive overview exists, in spite of its spread over different geographical levels (international, European, national and regional) and various economic sectors (see Section 4).

1.2 Context and objectives of the study

The Directorate-General for Justice and Consumers of the European Commission (DG JUST) commissioned this study in December 2018, as a European Parliament pilot project. The research work for this study was carried out by ICF during 2019 and the report was finalised in the end of 2020.

Debates on the need to pay greater attention to the social dimension of the Union and to tackle tax evasion and tax fraud within the internal market while ensuring fair competition, have shed light on the phenomenon, particularly the role played by abusive letterbox companies.

On that basis, the main objective of this research was to collect, analyse and triangulate as much robust and balanced information as possible in order to provide a factual overview of the phenomenon.

In the light of the multidisciplinary nature of the phenomenon, this study aimed to examine letterbox companies, their characteristics and impacts through the prism of all relevant disciplines (company law, taxation law, labour and social security law, criminal law). To date, most published studies have analysed the phenomenon from one specific angle and this study sought to take all these aspects into account and provide a comprehensive, albeit non-exhaustive, interdisciplinary review of the letterbox phenomenon.

Research for this study at EU level examined all Member States through a literature review and dissemination of an online survey to various national stakeholders¹⁴. In a second step, 15 Member States (Austria, Belgium, Bulgaria, Cyprus, Germany, Denmark, Estonia, Spain, Finland, France, Ireland, Luxembourg, the Netherlands, Poland and Romania) and the UK (an EU Member State at the time) were selected for further analysis, on the basis of a combined set of justifications, including i) the need for geographical balance, ii) a mix of company law regimes (real seat v. incorporation theory), iii) countries involved in known high-profile cases of company transfer and iv) countries known to have developed collaborations for tackling issues related to worker mobility. These 15 Member States, the UK and the other three third countries (Switzerland, the United States of America (US) and Panama) are referred to as '**countries for in-depth research**' in the remainder of this report.

Concerning the references to the United Kingdom in this study, as the research for this assignment was conducted between February and December 2019, when the UK was still a Member State of the EU, the UK was analysed as such at the time. As the last editorial changes to this report took place after the UK withdrew from the EU, the UK is referred to as a third country in the study, except in Section 3 on quantification, in which the majority of estimations are based on EU-28 (including the UK).

This study intended to assess the phenomenon of letterbox companies and its interrelated roots and impacts, including:

- Describing the phenomenon and its characteristics across countries;
- Providing an estimated quantification of such companies;

¹⁴ See Annex 2 for a complete list of stakeholders consulted at national level.

- Analysing whether the use of such entities constitutes an abuse and, if so, whether the latter is inherent to letterbox companies;
- Mapping existing measures taken at international, EU and national level, with a view to tackling this phenomenon;
- Assessing, to the extent possible, the effectiveness of these measures.

To this end, a tailored methodology was developed, which aimed to gather reliable qualitative input and quantitative data from Member States and countries covered by this study, through a combination of extensive desk research, inputs from EU and national experts, interviews and an online survey.

1.3 Structure of the report:

The remainder of this report is structured as follows:

Section 2 presents an overview of the different terms and understandings of the letterbox companies' phenomenon globally, at EU and national level.

Section 3 estimates the number of letterbox companies, based on data and indicators collected through literature review and the analysis of the Orbis database.

Section 4 summarises the key findings stemming from analysis of the different types and uses made of letterbox companies. This section also addresses the legitimacy of such uses, in particular in the context of the Single Market, and from different policy perspectives.

Section 5 examines the role played by company law requirements at Member State level and their potential impacts on the phenomenon.

Section 6 provides an overview of the existing measures at international, EU and national level that may – intentionally or otherwise - impact the abusive use of LBCs. To the extent possible and depending on the availability of indicators, this section also assesses the effectiveness of those measures.

2 Terminology, concepts and definitions of letterbox companies

When examining how letterbox companies are understood worldwide, a complex picture emerges, as **numerous other terms** are used alongside that of 'letterbox company' and there is a broad range of underlying concepts and understandings of the phenomenon, often heavily dependent on the context (e.g., company law, taxation, social affairs).

Although the term letterbox company appears regularly in the public discourse and in policy debates, it is usually used in a manner that best suits the proponent's particular argument, thus opening the door for misconceptions. Linked to this, existing terms are rarely enshrined in a single definition, and existing descriptions of letterbox companies often carry a (not always justifiable) negative connotation due to current public and political debates. Overall, the **lack of a definition**, combined with the fact that **characteristics of letterbox companies depend** on the type of regulation and/or legal obligation they seek to circumvent or benefit from, render the whole phenomenon challenging to apprehend.

2.1 Existing terminology and understandings of letterbox companies

Whilst the term 'letterbox company' is commonly used across the EU and worldwide, **there is no single common and agreed terminology** behind the concept, neither in layman's nor legal terms. Table 2.1 below further shows that a wide range of different terms is used in addition to the term letterbox companies and that their meaning is not always clear. In some cases, different terms describe the same or similar situations of a company's establishment and use¹⁵, while in others the same terms are used with different meanings¹⁶. This contributes to the difficulty of grasping the phenomenon.

Table 1. Overview of terms emerging from the research¹⁷

• Brass-plate companies • Base companies • Buffer companies • Conduit companies • Domicile companies • Dormant companies • Fictitious companies • Flow-through companies • Front companies • Ghost companies • Inactive companies • Intermediary companies • Letterbox companies • Mailbox companies	• Money box companies • Offshore companies • Paper companies • Pro forma companies • Pseudo-foreign companies • Seat companies • Shelf companies • (Anonymous) shell companies • Sham companies • Service body • Special purpose entities (SPEs) • Strawmen companies • Tax haven companies • Virtual companies

¹⁵ Examples for terms with the same underlying understanding are found in the OECD's Glossary of Tax terms entry, describing 'letterbox company', 'paper company', 'shell company' or 'money box company' as 'a company which has complied with only the bare essentials for organisation and registration in a particular country. The actual commercial activities are carried out in another country.'

¹⁶ For instance, the International Bank for Reconstruction and Development/ the World Bank described, for the purpose of a report, a 'shell company' 'as a non-operational company - that is, a legal entity that has no independent operations, significant assets, ongoing business activities, or employees.' This understanding focuses on the lack of economic activity, while the key element of the same term 'shell' company in an EPRS study is that it established anonymity for the actual owner while simultaneously guaranteeing control over the shell company and its resources.

¹⁷ Based on the findings from the research at national level, online survey and stakeholders' interviews at international and EU level.

This variety of terms used at EU, international and national level hinders the clear delineation of the letterbox company phenomenon. The term 'letterbox company' does not have a unique meaning, nor can it be easily distinguished from other types of concepts used to describe companies in similar or comparable situations. Some of the terms are linked to how such companies are designed and constructed, why they are established, or their specific uses. For example, those used for tax avoidance purposes are more likely to be referred to as *tax haven companies*, as opposed to those set up to circumvent labour standards, where *shell* or *intermediary companies* may be more frequently used. The existing disparities in stakeholders' perceptions of the phenomenon, as well as different terminology used across Member States and third countries, contribute to the panoply of terms. For instance, while used and understood in more or less the same way in most EU Member States, the term letterbox company is not employed as such in some countries. Estonia refers to *shell companies* exclusively, while Romania uses *ghost companies* and Poland *front companies*. *Brass-plate company* is the most frequently used term in Ireland, where shell companies and shelf companies are two different concepts. Denmark, however, refers to *letterbox companies* and *shelf companies* equally.

Alongside the multiple terms used to refer to letterbox companies a **wide range of underlying concepts and understandings** of the phenomenon exist (see Annex 2 for an overview).

While this demonstrates the lack of a common and unique understanding of the phenomenon, several **common key features** emerge when analysing the various existing concepts. However, given the possible overlaps, it was not possible to make a clear categorisation of each of the concepts, with some expressing the perception of a certain stakeholder group.

Firstly, the description of the phenomenon has evolved over time, particularly in the past decade, where attempts to define it have moved from general to sector-specific descriptions, especially at EU and international level.

In 2013, a Communication from the European Commission referred to letterbox companies as '*companies which have been set up with the purpose of benefitting from legislative loopholes while not themselves providing any service to clients, but rather provide a front for service provided by their owners. Such companies are normally very small and often only operate a letter box, hence the name*¹⁸. As part of a Communication on smart regulation in the context of SMEs, this description appears rather general and cross-cutting.

The OECD glossary of tax terms also includes a cross-cutting description, specific to the tax context though, describing letterbox company as '*a paper company, shell company or money box company, i.e., a company which has complied only with the bare essentials for organisation and registration in a particular country. The actual commercial activities are carried out in another country.*'

More recent descriptions tend to describe policy-specific situations (see Annex 2), with most referring to letterbox companies used in the context of taxation, financial services, anti-money laundering, and in the area of employment and social law. These concepts may be limited to specific sectors or policy fields and should be understood in this specific context rather than having a more general interpretation. The move towards a more sectoral approach to the phenomenon can be partly explained by a growing awareness of the phenomenon, as illustrated by the relevant sectoral studies in the last decade.

At national level, Latvia's Law on the prevention of money laundering and terrorism and proliferation financing explicitly forbids banks, intermediaries and investment management

¹⁸ Communication of the European Parliament, the Council, the European Economic and Social Committee and Committee of the Regions, Smart regulation – Responding to the needs of small and medium –sized enterprises, -COM (2013) 122 final, 2013.

companies from establishing and maintaining business relationships or executing transactions with shell companies¹⁹. This prohibition is followed by a delineation of 'shell arrangements' that consist of legal persons characterised by one or several indications set out in the legislation.

Excerpt from the Law on the prevention of money laundering and terrorism and proliferation financing (Latvia)

15) shell arrangement - a legal person characterised by one or several of the following indications:

a) has no affiliation of a legal person to an actual economic activity or the operation of a legal person forms a minor economic value or no economic value at all, and the subject of the Law has no documentary information at its disposal that would prove the contrary;

b) laws and regulations of the country where the legal person is registered do not provide for an obligation to prepare and submit financial statements for its activities to the supervisory institutions of the relevant state, including the annual financial statements;

c) the legal person has no place (premises) for the performance of economic activity in the country where the relevant legal person is registered;

This understanding of shell companies thus has a legal basis that sets clear limits on what falls within the scope, through a set of specific characteristics. As such it can be regarded as a definition, albeit one that applies only in one country.

Another specific description of letterbox companies can be found in the US. The Code of Federal Regulations of the United States Securities and Exchange Commission contains a clear delineation of the concept of shell companies for the purposes of regulating the issuance of securities, stating that '*a shell company is described as a corporation required to register with the Commission that has: (1) No or nominal operations; and (2) Either: (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets.*' Based on a legislative document, this description sets clear limits and attaches a precise meaning to shell companies. As such, it comes very close to a definition.

Secondly, irrespective of the sector, reference to one or all the following characteristics is often made when describing letterbox companies:

✓ **Lack of economic activity**

The **absence of substantial economic activity** appears as the **main feature** defining letterbox companies; often depicted as artificial arrangements, whereby the legal reality of the incorporated entity claiming to engage in a specific economic activity does not reflect the material reality²⁰. This element is recurring in all Member States' descriptions, often appearing as the main characteristic.

The International Bureau of Fiscal Documentation (IBFD) also refers to a letterbox company that 'lacks any further business substance'²¹, while the Guidance paper on transparency of beneficial ownership prepared by the Financial Action Task Force (FATF)

¹⁹ Latvia, Law on the prevention of money laundering and terrorism and proliferation financing, March 2019, available at: <https://likumi.lv/ta/en/en/id/178987-on-the-prevention-of-money-laundering-and-terrorism-financing>

²⁰ European Trade Union Institute (ETUI), Policy brief, Ending regulatory avoidance through the use of letterbox companies, Policy brief, March 2020, available at: <https://www.etui.org/Publications2/Policy-Briefs/European-Economic-Employment-and-Social-Policy/Ending-regulatory-avoidance-through-the-use-of-letterbox-companies>

²¹ IBFD, International Tax Glossary, available at: <https://www.ibfd.org/IBFD-Products/IBFD-International-Tax-Glossary-7th-Edition>

lists several definitions of letterbox companies (shell, front or shelf companies) and defines shell companies as those companies that have 'no independent operations, significant assets, ongoing business activities, or employees'²².

The OECD specifies that 'While there is no uniform international definition of SPEs, statistical manuals provide similar criteria for identifying an SPE. These include: formally registered legal entity that is subject to national law, ultimate owners are not residents of the territory of incorporation, few or no employees, little or no production in the host economy, little or no physical presence, most assets and liabilities are vis-à-vis non-residents, and the core business of the enterprise consists of group financing or holding activities'²³. The same description is provided by the International Monetary Fund (IMF)²⁴.

Irrespective of whether activities are carried out somewhere else or nowhere at all, this feature indicates that the absence of economic activity in the jurisdiction of registration is a commonly recognised characteristic of a letterbox company.

✓ **Existence of a cross-border/international element:**

If the lack of economic activity appears to be the main characteristic of letterbox companies, the existence of a **cross-border/ international element** is also recurrent and, in some cases, seen as directly linked to the absence of activity in the Member State of registration (the substantial activity - if any - may be conducted abroad and is therefore non-existent in the country of registration). The cross-border element is often also inherent in the use of the letterbox companies.

In its Glossary of Tax Terms, the OECD specifies that 'the actual commercial activities [of a letterbox company] are carried out in another country'. Similarly, the European Trade Union Confederation (ETUC) notes that a letterbox company is a 'business that establishes its domicile in one Member State merely with a mailing address, while conducting its activities in other Member States'²⁵. In its Eurofood ruling, the CJEU referred to letterbox companies as those that '[do] not [carry] out any business in the territory of the Member State in which its registered office is situated'²⁶.

In addition, use of letterbox companies is also considered in the context of groups.

For example, an amendment to the Parent-Subsidiary Directive²⁷ is aimed at denying a tax benefit under the Directive through the use of a group company which is a wholly artificial arrangement without substance. The general anti-abuse provision would deny a tax benefit derived from such a group company either at the level of the parent company or the subsidiary company resident in the EU depending on where the tax benefit is sought. The use of such conduit companies for tax avoidance purposes is examined in Section 4.2.3.2.

²² FATF, Concealment of beneficial ownership, 2018, available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/FATF-Egmont-Concealment-beneficial-ownership.pdf>

²³ OECD, Benchmark definition of foreign direct investment, 2008, Chapter 6.2, Box 6.2, p.102, available at: <https://www.oecd.org/daf/inv/investmentstatisticsandanalysis/40193734.pdf>

²⁴ The IMF defines those entities as follows: *legal registration subject to national law, ultimate ownership by foreigners, few or no employees, little or no production in the host economy, little or no physical presence, mostly foreign assets and liabilities, and group financing or holding activities as their core business* (IMF, 'Piercing the veil' Financial and Development, June 2018, available at: <https://www.imf.org/external/pubs/ft/fandd/2018/06/inside-the-world-of-global-tax-havens-and-offshore-banking/damgaard.htm>)

²⁵ <https://www.etuc.org/en/pressrelease/letterbox-type-practices-avoiding-taxes-and-exploiting-workers-across-eu#.V8alfEQbIX> (accessed 29 August 2018).

²⁶ Case 341/04, Eurofood IFSC Ltd, 2006 E.C.R. § 35.

²⁷ 2013 Proposal for a Council Directive amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different member States. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013PC0814&from=EN>

The cross-border element is often inherent in the use of the letterbox companies indeed. For example, there are cases where Western European transport companies set up Eastern European subsidiaries with no or small transport operations and these subsidiaries are used to sign contracts with workers. In some cases, it is found that these workers/drivers effectively work in the country of the transport company itself, which may amount to an artificial posting arrangement.

✓ **The intentional element**

Several descriptions of letterbox companies make references to the companies' behaviour and/or intention or purpose behind the use of a letterbox company. In this respect, they contain **subjective elements**, as opposed to a neutral description of their nature and use. Some of these understandings specifically refer to the intention to perform abusive or illegitimate activities. For example, a subjective element can be found in the description of letterbox companies in the European Commission's Communication on smart regulation, which describes letterbox companies as 'companies which have been set up with the purpose of benefitting from legislative loopholes [...]'²⁸. Similar understandings appear frequently in the area of labour law, labour mobility and posted workers.

There seems to be a shared assumption among trade unions that letterbox companies "are - and should always be considered - unlawful and/or abusive, since their aim is the circumvention of obligations"²⁹. The research and interviews conducted for this study demonstrate, however, that perceptions and understandings of the intention behind the use of letterbox companies vary from one sector to another and often reflect the subjective views of a stakeholder group, and that neutral approaches also exist.

2.2 Absence of a formal common definition of letterbox companies

As demonstrated above, there is neither a single and agreed definition of a letterbox company, nor a common understanding of the concepts behind it. Only very few similar descriptions seem to reappear in different publications, hence at least coming somewhat close to a definition.

The above-mentioned description provided by the OECD in its Glossary of Tax Terms - whereby a letterbox company is described as 'a paper company, shell company or money box company, i.e., a company which has complied only with the bare essentials for organisation and registration in a particular country [...and which] actual commercial activities are carried out in another country' - is used and cited in various publications³⁰. It thus appears to be commonly applied and agreed and could be considered to come close to a definition **at international level**.

With respect to definitions **at national level**, a recent pan-European overview of the national situation carried out in the context of research on undeclared work noted that most Member States had no legal or working definition of letterbox companies nor had

²⁸ European Commission, Smart regulations: responding to the needs of small and medium-sized enterprises, 2013, available at: <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0122:FIN:EN:PDF>

²⁹ Interview with the ETUC, June 2018

³⁰ For example, in Hastings, T. and Cremers, J., *Developing an approach for tackling letterbox companies*, 2017, available at: https://www.researchgate.net/publication/322855817_Developing_an_Approach_for_Tackling_Letterbox_Companies_-_a_learning_resource; Conley, H., Stefanov, R., Ruy, D. and Vladimirov, M., 'The Kremlin Playbook 2- The Enablers', CSIS Report, 2019, available at: http://csis-prod.s3.amazonaws.com/s3fs-public/publication/190326_KP2.pdf; Cremers, J., *Artificial legal corporate entities: The (ab)use of letterbox companies*. Tilburg: Tilburg Law School, 2017; ETUC, *A hunter's game: how policy can change to spot and sink letterbox-type practices*, 2016, available at: https://www.etuc.org/sites/default/files/publication/files/ces-brochure_compiled_thematic-uk-v2.pdf.

they a legal definition of what constituted a 'genuine' company³¹. This is confirmed by this study's in-depth research of 15 Member States and four third countries (including the UK), with very few countries having a description of the phenomenon of a letterbox company enshrined in official documents and only minimal descriptions appearing in non-official publications (see Annex 2).

According to the stakeholders consulted during this study, there may be several reasons for the lack of a formal definition. Firstly, the phenomenon is difficult to categorise, as there are different types of letterbox companies and they are used for different purposes, risking a definition that is either too broad or too narrow³². For instance, according to an interview with the European Confederation of Independent Trade Unions (CESI), there is no strict definition of letterbox companies, because of the very large playing field of uses and the broad spectrum of users³³. Secondly, some countries may consider that the legal frameworks of other countries hold sufficient provisions to address the issue of abusive or illegitimate letterbox companies without having to establish a specific national definition³⁴. Thirdly, in some countries, the letterbox company phenomenon is not perceived as problematic, and it does not feature prominently on the political agenda³⁵.

The absence of both a formal definition and a common understanding of what a letterbox company is, constitutes a finding in itself. To fully apprehend the phenomenon and effectively tackle the associated abuses, there is scope for EU policymakers to develop a common definition, including a set of criteria to determine whether a company could be considered as such.

Until that is achieved, research will likely struggle to address the phenomenon comprehensively, instead continuing to examine it from (policy-) specific angles.

2.3 Working definition for the purpose of this study

Notwithstanding the variety of existing terms and concepts, the above analysis identified several core common denominators across most understandings of letterbox companies, namely:

First, the **lack of economic activity** in the country of incorporation and/or anywhere in the world; and

Second, in cases where the economic activity is carried out in a country other than the country of incorporation, the existence of a **cross-border/foreign element**. The cross-border element is often also inherent in the use of the letterbox companies.

On that basis, and to delineate the analysis, letterbox companies are - for the purpose of this study only - understood as those **companies that are incorporated in one Member State but do not perform any activity in that Member State, or anywhere else**.

³¹ Hastings, T. and Cremers, J., 2017. *Developing an approach for tackling letterbox companies*, A learning resource from the Seminar of the European Platform Tackling Undeclared Work: How to identify and tackle fraudulent letterbox companies, Brussels, 30 November 2017.

³² Based on research carried out in Germany.

³³ Interview No. 3

³⁴ Reported by the national experts in Estonia, Finland, Switzerland.

³⁵ The Spanish country experts suggest that no definition exists in Spain, as the phenomenon might not be a significant public policy issue and not prominent in the public debates.

3 Quantification of letterbox companies

This section first summarises the main existing proxy approaches at national, EU and international level that appear relevant to quantify the phenomenon of letterbox companies. A quantification is then undertaken, based on the Orbis databases.

3.1 Quantification of letterbox companies at EU and international levels

EU and international literature show that **it is not possible to quantify the number of letterbox companies** based on a single indicator. Different (proxy) indicators are therefore used to potentially arrive at some estimation of the likelihood of the presence of letterbox companies. The key approaches identified make use of:

- Foreign direct investment (FDI) flows, the number of Special Purpose Entities/Vehicles (SPEs/Vs), the use of cross-border subcontracting processes, and the number of foreign-owned companies (the latter is integrated in section 3.2 on the Orbis quantification);
- Other indicators with a more indirect link to the existence of letterbox companies, include the dimension of undeclared work, the number of posted workers, specific sectoral estimates (see the case study in Annex 4, for indicators on transport), etc.

Sections 3.1.1 - 3.1.5 present the key results found in existing literature using these indicators to estimate the potential presence and scale of letterbox companies, while section 3.1.6 includes the main findings of this exercise.

3.1.1 Estimates of the presence of letterbox companies based on indicators on Foreign Direct Investment (FDI) flows and Special Purpose Entities (SPEs)

The phenomenon

Two main indicators employed in literature as possible proxies to identify the potential presence of letterbox companies are the quantification of **FDI³⁶ flows³⁷**, which show the scale of investment from abroad, and the proportion of these flows **channelled through SPEs**.

The fact that a proportion of FDI is channelled through SPEs is often indicative of using the latter to handle investment flows between subsidiaries. When combined with an absence of genuine activity, such practices could point to the existence of a potential artificial arrangement (see Section 2.1). They may also hint at certain behaviours in relation to taxation (aggressive tax planning (ATP) or even tax evasion).

Precise estimates of such scenarios are not available, however. It is important to bear in mind that FDI flows themselves do not constitute an illegal or abusive activity, and indeed are often a vehicle for economic growth. Similarly, SPEs per se are not economic entities intrinsically established and used for abusive purposes but they play an important role in the global economy with extensive cross-border activity³⁸.

³⁶ FDI is a cross-border investment made by an investor in one economy and intended to establish an interest in an enterprise located in a different economy. The objective of the investment is to directly influence the management of the investment enterprise. The investor may also want to gain access to the economy where the direct investment enterprise is located (EPRS, 2018).

³⁷ Inward FDI refers to investments by foreigners in businesses registered in a Member State, outward FDI refers to investment by residents in affiliated businesses abroad.

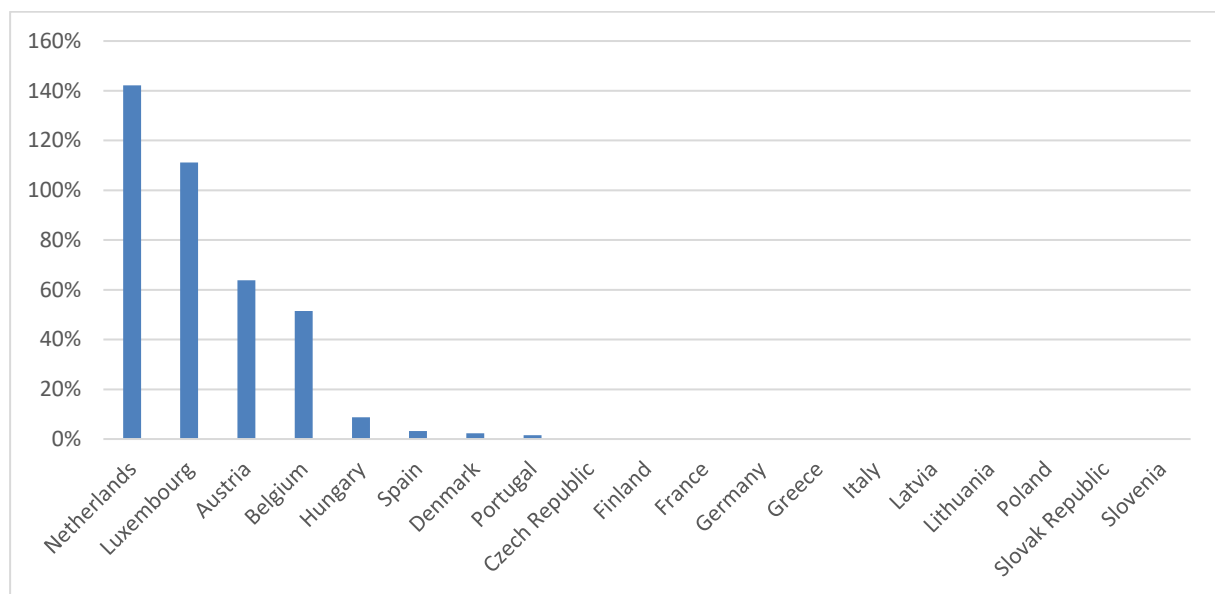
³⁸ IMF, Spillovers in international corporate taxation, IMF Policy Paper, 9 May 2014; IMF, Final report of the Task Force on Special Purpose Entities, 2018, available at: <https://www.imf.org/external/pubs/ft/bop/2018/pdf/18-03.pdf>

In its 2012 World Investment Report (WIR, the United Nations Conference on Trade and Development (UNCTAD) highlighted the increase of FDI flows through tax havens and the relative role of SPEs. In its paper on the impact of letterbox-type practices on labour rights and public revenue, ETUC states that SPEs act as a channel for over USD 600 billion of investment flows³⁹.

The findings from a 2018 European Parliament study point to the high share of FDI stock held by SPEs in some Member States, such as 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)⁴⁰.

Figure 1 shows the share of FDI paid into SPEs as a percentage of FDI paid into all entities, with the Netherlands and Luxembourg having the highest shares. As outlined earlier, this points to the potential presence of artificial undertakings.

Figure 1. Share of FDI paid into SPEs as % of FDI paid into all entities, 2019



Source: OECD, <https://stats.oecd.org/Index.aspx?QueryId=64225> own calculations. Estonia and Sweden do not report data on SPEs due to secondary confidentiality. Ireland and the UK do not report this data to the OECD. Resident SPEs are not present or not significant in the Czech Republic, Finland, France, Germany, Greece, Italy, the Slovak Republic, Slovenia.

Geographical patterns

Inward and outward FDI can provide useful information on the geographical spread of FDI and its potential connection to the presence of letterbox companies. The key argument made is that when compared to the size of national economy, a **disproportionate size of FDI** may not represent genuine long-term capital investment or actual economic activity (and therefore suggests the possible presence of letterbox companies).

This discrepancy between the size of FDI and the size of GDP is shown in the EPRS 2018 study, which identified that the high rate of inward and outward investments goes hand-in-hand with a high number of foreign-owned holding companies in countries like

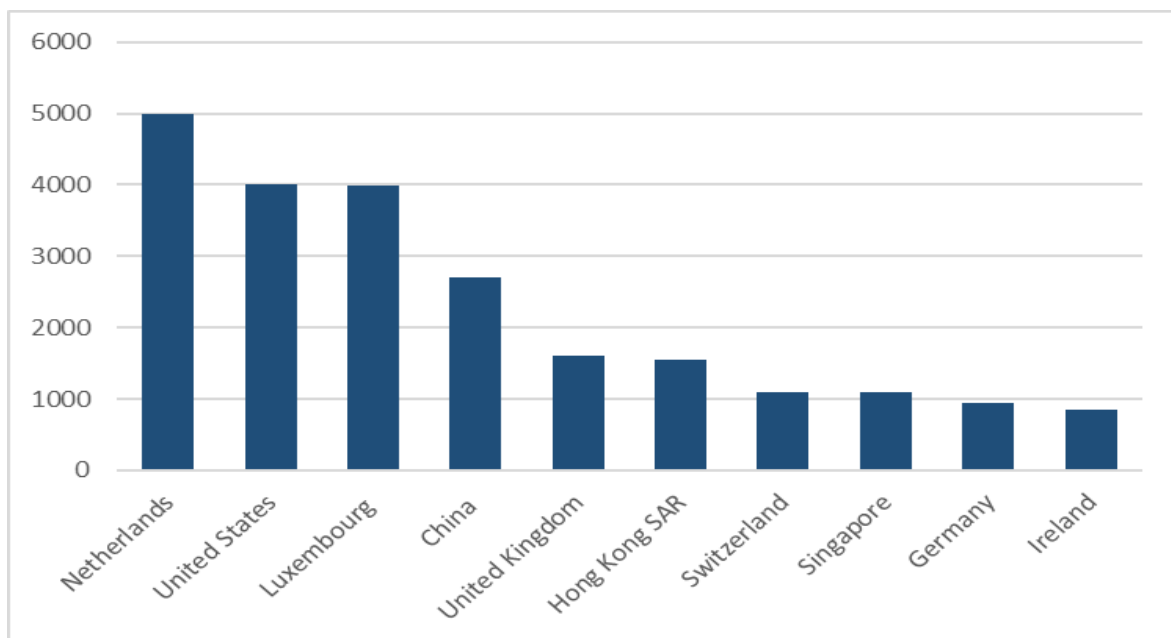
³⁹ McGauran, K., The impact of letterbox-type practices on labour rights and public revenue, 2016, p.55, available at: https://www.etuc.org/sites/default/files/press-release/files/ces_letterbox_compagnies_gb_juin_ok_0.pdf

⁴⁰ European Parliamentary Research Service (EPRS), An overview of shell companies in the European Union, 2018, available at: http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf

Luxembourg, Malta and the Netherlands⁴¹. The study pointed to a link between the high inward and outward FDI stocks versus the national economy size noted in several Member States and which can be only partially explained by real economic activity.

According to the same study, Luxemburg shows the highest figures of inward FDI flow, amounting to 57 times its GDP. Malta is next, with inward FDI more than 17 times its GDP, while this figure is nine times for Cyprus, five times for the Netherlands, and three times for Ireland. These countries also present relatively high levels of outward FDI stocks. This suggests the presence of companies without real economic activity through which the FDI flows are conducted. Similarly, a European Parliament study on 'Offshore Activities and Money Laundering'⁴² noted that the high level of inward and outward FDI as a percentage of GDP in seven Member States (Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta, and the Netherlands) could be explained to only a limited extent by real economic activities taking place in those Member States.

Figure 2. *Inward direct investment: top 10 reporting economies in the world (USD million, 2017)*



Source: IMF Data, 2017

The top three conduits of inward FDI in the EU are the Netherlands, Luxembourg and the UK⁴³. Significantly, each is specialised in a specific geographical area: the UK is used as a conduit between European countries and Luxembourg, Bermuda, Jersey, the British Virgin Islands and the Cayman Islands, while the Netherlands serves as a conduit between European companies and Luxembourg, Curaçao, Cyprus and Bermuda. While most investments from Luxembourg or Hong Kong do not involve a conduit (as Luxembourg

⁴¹ The findings contained in this study of the European Parliament may no longer apply in the case of Cyprus. In March 2019, the Central Bank of Cyprus passed a law imposing full prohibition on credit institutions' cooperation with organisations that meet the criteria of shell companies. Recent estimates of the number of LBCs present in Cyprus suggest that their presence has already decreased. More detail is available at: <https://www.uniwide.biz/latest-news/central-bank-of-cyprus-has-prohibited-service-of-shell-companies/>

⁴² Unger, B., Offshore activities and money laundering: recent findings and challenges, Study for the European Parliament, 2017, available at: [http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU\(2017\)595371](http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU(2017)595371)

⁴³ Garcia-Bernardo, J. et al., 'Uncovering offshore financial centres: conduits and sinks in the global corporate ownership network', *Scientific Reports*, Vol. 7, No. 1, 2017 July 2017, available at: <https://www.nature.com/articles/s41598-017-06322-9>

and Hong Kong companies invest directly in European countries), investments from countries usually identified as 'tax havens' require using a conduit and companies located in such jurisdictions invest in other offshore financial centres (OFCs⁴⁴). This indicates a large rerouting of international investment through these jurisdictions for tax optimisation or other investment benefits (such as those granted under bilateral investment treaties), and also through the use of SPEs⁴⁵.

In addition to FDI flows, **conduit OFCs** sometimes appear in the literature as connected to the LBC phenomenon⁴⁶. These are used to route funds to more traditional tax havens, the so-called sink OFCs⁴⁷, five of which were identified in the Netherlands, the UK, Switzerland, Singapore and Ireland⁴⁸. According to this study, these countries facilitate the transfer of value between sink OFCs and are often used as conduits to non-OFCs as well, showing that conduit OFCs are not solely used for the transfer of value to sink OFCs.

Some literature argues that the Netherlands is the world's top country in terms of investment flowing into the country, substantially ahead of larger economies, and that it might be home of a high share of letterbox companies used by **multinational enterprises** (MNEs), including for ATP. While available estimates point to 14 000 to 23 000 such letterbox companies present in the country, it is difficult to estimate the share that is used for abusive purposes (see Box 1).

Box 1. FDI flows and letterbox companies in the Netherlands

IMF estimations show that the Netherlands attracts the highest levels of foreign investment in the world, ahead of the far larger economy of the US, and closely followed by Luxembourg⁴⁹. Another study mentions that the annual FDI flowing through the country amounts to about EUR 11 trillion, *i.e.*, 20 times the Dutch GDP⁵⁰.

⁴⁴ Ibid.

⁴⁵ European Parliamentary Research Service (EPRS), An overview of shell companies in the European Union, 2018, available at:

http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf (accessed 6 May 2019).

⁴⁶ OFCs: a country or jurisdiction that provides financial services to non-residents on a scale not commensurate with the size and financing of its domestic economy (see Zoromé, A., 'Concept of offshore financial centres: in search of an operational definition', IMF Working Paper 07/87, 2007).

⁴⁷ Sink OFCs are usually considered jurisdictions in which a disproportional amount of value disappears from the economic system. Conduit OFCs are jurisdictions through which a disproportional amount of value moves toward sink OFCs (see Unger, B., Offshore activities and money laundering: recent findings and challenges, Study for the European Parliament, 2017, available at:

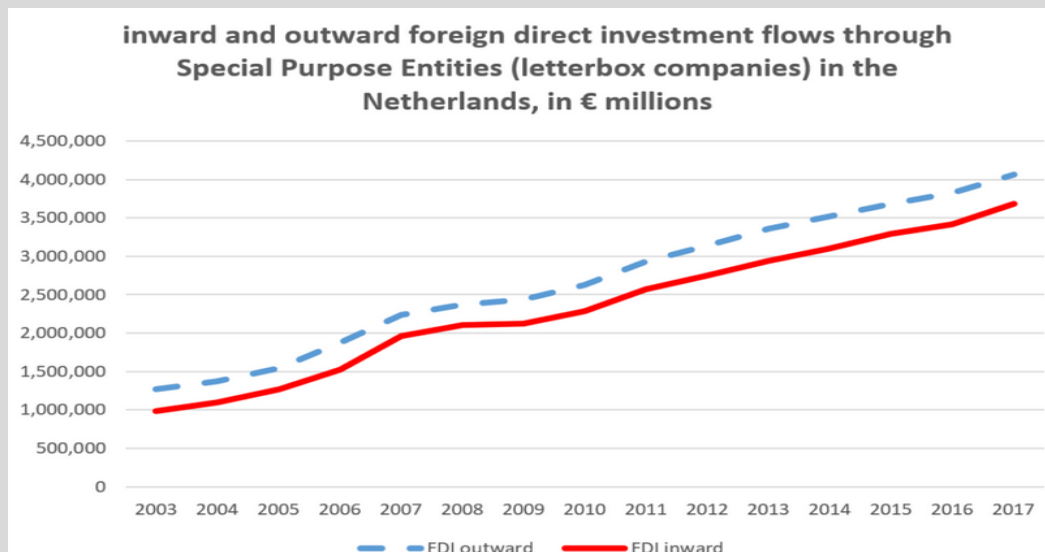
[http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU\(2017\)595371](http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU(2017)595371)

⁴⁸ J. Garcia-Bernardo, J., 'Uncovering offshore financial centres: conduits and sinks in the global corporate ownership network', *Scientific Reports*, Vol. 7, No. 1, 2017, p. 6246, available at: <https://doi.org/10.1038/s41598-017-06322-9>

⁴⁹ IMF Data, 2016, available at: <https://data.imf.org/?sk=388dfa60-1d26-4ade-b505-a05a558d9a42>

⁵⁰ Hendriksen, J., et al., *The role of offshore tax havens in the international tax system*, 2016, available at: http://www.apec-europeus.com/uploads/6/6/3/7/66379879/hendriksen_jules_2016.pdf

Figure 3. Trends of FDI through SPE in the Netherlands



Source: SOMO (2018).

Some research provided more specific information about links to tax purposes and/or numbers of SPEs or letterbox companies.

Research from the University of Amsterdam showed that, in 2017, the Netherlands was the world's biggest conduit country for channelling capital to offshore tax havens.

According to a study from the Centre for Research on Multinational Corporations (SOMO), Dutch tax policies - by enabling companies to reduce their tax base and allowing easy set-up of new companies - attract SPEs that may take advantage of the country's policies and establish artificial entities deprived of real economic activities⁵¹ (see Section 5 for more details on incorporations requirements in the Netherlands).

The same 2018 study estimated that there were over 14 000 letterbox companies in the Netherlands, used by multinational corporations for tax avoidance purposes⁵².

Similarly, the Q4 2018 edition of the Internationalisation Monitor, Statistics Netherlands (CBS) pointed to the existence of over 14 000 SPEs or SPVs. Approximately 80% of those entities have no real economic activity in the Netherlands and are considered to be used by multinationals for the mitigation of tax costs⁵³.

Multinational enterprises (MNEs) often use **complex networks of parents and subsidiaries**, including letterbox companies, to set their ownership structure and global operations.

MNEs and Offshore Financial Centres (OFCs), which may easily be used to facilitate the set-up of artificial structures such as letterbox companies through low taxation regulations, are increasingly under scrutiny as they might enable tax avoidance schemes. Typically, they would set-up (letterbox) companies in a country other than that of their headquarters.

⁵¹ SOMO, 'Dutch efforts to combat letterboxes have no effect', 2018, available at: <https://www.somo.nl/dutch-efforts-combat-letterbox-companies-no-effect/>.

⁵² SOMO, 'Dutch efforts to combat letterboxes have no effect', 2018, available at: <https://www.somo.nl/dutch-efforts-combat-letterbox-companies-no-effect/>.

⁵³ The Netherlands' national statistical office (CBS), '80 % percent of inward investments channelled out directly', December 2018, a. Available at: <https://www.cbs.nl/en-gb/news/2018/50/80-percent-of-inward-investments-channelled-out-directly>

In the Panama Papers case, for instance, the majority of the shell companies involved actually had their headquarters in the British Virgin Islands⁵⁴.

Box 2. The abusive behaviour of shell companies worldwide identified in the Panama Papers

The European Parliament has examined how the Panama Papers case revealed the role of shell companies in the transfer of funds between jurisdictions for legitimate and illegitimate purposes⁵⁵. The Panama Papers revealed the presence of offshore firms being set-up in OFCs, with shell companies being registered in small jurisdictions and not supporting the scale of financial services they offered. Although meaning of the term 'shell companies' remains unclear, the European Parliament paper details the numbers that might be defined as shell companies, as the term is understood in respect of the Panama Papers case⁵⁶, in various tax havens:

Table 2. Number of shell companies incorporated in top tax havens

Tax havens	Number of registered 'shell companies'
British Virgin Islands	113 648
Panama	48 360
Bahamas	15 915
Seychelles	15 182
Niue	9 611
Samoa	5 307
British Anguilla	3 253
Nevada	1 260
Hong Kong	452
UK	148

Source: European Parliament, 2017.

Similarly, recent banking leaks from the Isle of Man - which involved the Cayman National Bank – similarly illustrate the role played by shell companies in channelling funds (in that case, between the Isle of Man and Belgium). Indeed, payment orders processed as 'consultancy fees' and totalling EUR 0.5 million from an Isle of Man company to the Belgian bank account of a Dutch scientist were disclosed. As part of the same data hack, the account of a Belgian resident was identified as receiving payments of EUR 200 000 from another Isle of Man company, labelled 'payment as agreed'. From preliminary

⁵⁴ Garcia-Bernardo, J., 'Uncovering offshore financial centres: conduits and sinks in the global corporate ownership network', *Scientific Reports*, Vol. 7, No. 1, 2017, p. 6246, available at: <https://doi.org/10.1038/s41598-017-06322-9>

⁵⁵ European Parliament, *The impact of schemes revealed by the Panama Papers on the economy and finances of a sample of Member States*, 2017, available at:

http://www.europarl.europa.eu/RegData/etudes/STUD/2017/572717/IPOL_STU%282017%29572717_EN.pdf

⁵⁶ The paper describes shell companies as companies used to transfer funds between national jurisdictions for both legitimate and illegitimate reasons. They might be established by an intermediary, registered in small jurisdictions that would not normally support the scale of financial services being offered, and registering their operations at an empty and unused building (European Parliament, 2017).

investigations, concrete references were found to cases of apparent tax evasion linked to Belgian individuals⁵⁷.

In examining the reasons for setting up such complex cross-border schemes, the literature points to the profitability gap between domestic and foreign companies in Member States. Tørsløv et al., for example, revealed that some countries show systematically higher profitability in the foreign sector compared to domestic operations (in EPRS, 2018). They argue that the profitability gap can be explained through patents, logos, algorithms, etc. as combinations of multinationals booking intangible assets. The researchers revealed a pattern in global macro data of movement of profits within divisions of multinational groups from high-tax affiliates to low-tax affiliates (EPRS, 2018).

In conclusion, the indicators on FDI flows and SPEs show the extent of inflows of foreign capital in individual Member States. They thus help to identify the overall 'pool' of companies across the Member States that could contain letterbox companies as a subgroup. The advantage of these indicators is their public availability and regular updating of the underlying data, which in principle would allow for regular monitoring of the trends and time series. However, they do not provide precise enough indications to isolate the numbers or extent of letterbox companies in the different flows measured. Where these indicators are useful is in relation to identifying Member States with FDI disproportionate to the size of their economy, as this could indicate an increased likelihood of the presence of letterbox companies in these Member States, especially in smaller EU economies where it would point to some form of financial engineering.

3.1.3 Estimates of the presence of letterbox companies related to posting of workers or undeclared work

Abusive letterbox companies seek to avoid the rules on posting of workers, thus facilitating both undeclared and under-declared work arrangements, with a view to benefiting from cost savings (i.e., labour/tax regulations of the Member State where the subcontractor is established)⁵⁸.

Therefore, the extent of undeclared work⁵⁹ and the numbers of posted workers, which are sometimes linked to the letterbox company phenomenon, could provide geographical (and sectoral) insights into where their presence could be associated with the use of letterbox companies for abusive/illegitimate purposes. However, such data is estimated qualitatively (often with specific case studies in certain countries) rather than quantitatively in the literature.

Therefore, it is not possible to provide an accurate or even indicative quantification of the scale of use of letterbox companies in this context. This is confirmed specifically for undeclared work by the study cited above, which authors note that research on the link between undeclared work and letterbox companies has been inconclusive and remains unable to estimate the scale of the problem.

⁵⁷ Hope, A., 'Tax authorities investigate new leaks incriminating Belgians', *The Brussels Times*, 22 December 2019, available at: <https://www.brusselstimes.com/news-contents/economic/85298/tax-authorities-investigate-new-leaks-incriminating-belgians/>

⁵⁸ Hastings, T. and Cremers, J., *Developing an approach for tackling letterbox companies*, A learning resource from the Seminar of the European Platform Tackling Undeclared Work: How to identify and tackle fraudulent letterbox companies. Brussels, 30 November 2017.

⁵⁹ According to the European Commission Communication 98/219, undeclared work refers to 'paid activities that are lawful as regards their nature but not declared to the public authorities, bearing in mind that difference in the regulatory economy or voluntary work. Consequently, the 'only difference between undeclared and declared work is that undeclared work is not declared to the authorities for tax, social security or labour law purposes.'

3.1.4 Estimates of the presence of letterbox companies in fraudulent operations

One well-known way in which letterbox companies are used is in the so-called **Missing Trader Intra-community (MTIC) fraud** or **carousel fraud**⁶⁰. These schemes are used by criminal networks to illegally reclaim value-added tax (VAT) or to avoid paying VAT where it is due. They involve trade between mostly (but not solely) letterbox companies, where goods are transferred from one company to another (buffer companies) and eventually through a 'missing trader' company, which steals the VAT (see Section 4.2 for detail). One criminal scheme may involve dozens of letterboxes (and other types of) companies.

The value of MTIC fraud and the possible number of associated letterbox companies is difficult to estimate. While the EU publishes an annual report on the VAT gap, which most recently estimated an EU-wide VAT gap of EUR 146 billion⁶¹, **only part of this gap involves fraud schemes, and only part of the fraud schemes is MTIC fraud involving letterbox companies** (most other fraud schemes involve other types of companies).

A recent study on the methodology to assess MTIC fraud by the European Commission found that few Member States estimate the size of MTIC fraud and use quite different methodologies to do so⁶². Depending on the methodology applied, EU-wide estimates may range from EUR 20 billion to EUR 100 billion in MTIC fraud annually. Evidence from some of the Member States (see Bulgaria below, for example) suggests that potentially tens of thousands of companies may be involved in MTIC fraud across the EU.

3.1.5 Quantification of letterbox companies at national level

There are no official statistics compiled by the national authorities nor any data aimed at quantifying artificial arrangements across economic sectors. Very few countries have sought to estimate the phenomenon. Instead, national experts have indicated prevailing views/anecdotal evidence of the letterbox company phenomenon in their respective countries, based on stakeholder views, sectoral estimates, proxy indicators, available studies and/or other sources. The available estimates and the information provided by national experts are presented in Table 3 below.

The situation varies substantially between Member States. On one end of the spectrum is a group of countries where the letterbox company's phenomenon is considered a minor issue (Spain) or declining (Switzerland). In between, there are countries where letterbox companies are considered to be frequently set up in certain sectors, such as construction, transport, and the meat industry (Belgium, Bulgaria, Germany). Finally, there is a group of countries where interviewed stakeholders report the letterbox company's phenomenon to be widespread (Estonia, Finland, Luxembourg).

⁶⁰ Europol, MTIC Fraud, n.d., available at: <https://www.europol.europa.eu/crime-areas-and-trends/crime-areas/economic-crime/mtic-missing-trader-intra-community-fraud>

⁶¹ https://ec.europa.eu/taxation_customs/sites/taxation/files/2018_vat_gap_report_en.pdf

⁶² European Commission, 2018, available at:

https://ec.europa.eu/taxation_customs/sites/taxation/files/tax_gaps_report_mtic_fraud_gap_estimation_methodologies.pdf

Table 3. Estimates of letterbox companies in the countries for in-depth research

Country	Direct and quantification	specific Letterbox companies' terms used for quantification	Qualitative assessments/other relevant estimates
Austria	In relation to social security fraud	fictitious/sham undertakings	In relation to social security fraud: The Act on Fighting Benefit Fraud defines a process by which companies can be declared fictitious/sham undertakings. 164 companies have formally been declared fictitious/sham undertakings since 2016.
Belgium	No	No official term, different understandings	No official estimates exist. In the area of social security, sectors of construction and transport are considered to be affected by the increased presence of letterbox companies.
Bulgaria	Yes, in some sectors.	Letterbox companies used for VAT fraud and in the transport sector	There are estimates for two aspects: MTIC fraud (VAT) and the transport sector. MTIC fraud companies: National Revenue Agency identifies around 2 000 missing trader companies annually, as well as a higher number of buffer companies. Estimates are based on risk analysis. Transport sector: estimated that approximately 20% of all licensed road transport operators are letterbox companies. This estimate is based on two key criteria: 1) foreign ownership/ ultimate beneficiary and 2) having no real physical presence in Bulgaria (i.e., registered at an address with multiple other foreign-owned companies (usually an accounting, legal office, or socially disadvantaged person). See case study on transport (Annex 4)
Cyprus	No	-	No official statistics on the presence of LBCs
Denmark	No	Limited partnerships with foreign owners used for illegal tax evasion abroad through letterbox companies	No official statistics on the presence of LBCs. In 2016, the Danish Tax Authority issued a report on limited partnerships (<i>Kommanditselskaber</i>), which – while operating as legitimate companies with management and business located in Denmark – are flagged as potentially used for tax evasion. It is estimated that in the 2010-2014 period, out of around 5 500 limited partnerships, 384 (7%) had foreign owners, and that limited partnerships in this latter group could be used for illegal tax evasion abroad through LBCs.

Country	Direct and quantification	specific Letterbox companies' terms used for quantification	Qualitative assessments/other relevant estimates
Estonia	No	Companies that are registered at one address but have business operations elsewhere or do not have business operations at all	No official estimates exist. The country expert believes that the use of LBCs for both legitimate and illegitimate uses is widespread, although the views of national stakeholders differ in this respect.
Finland	No	No official term	No official estimates exist. Views from stakeholders are that the phenomenon is rather widespread, especially inbound LBCs.
France	No	Letterbox companies	No official estimates exist.
Germany	No	Outbound letterbox companies or inbound letterbox companies	No official estimates exist. Outbound LBCs (i.e. established in Germany) are not considered to be numerous. The use of inbound LBCs (i.e. established outside Germany but active in the country) seems to be more substantial, especially in sectors such as construction, transport/logistics, the meat industry (at least formerly), healthcare (elderly people), or (to evade workers' participation) clothing retail business. Companies uses vary, but no quantification for all forms is possible.
Ireland	No	Brass-plate company is more commonly used	No official estimates exist. One form of Irish investment company, known as the Section 110 SPV has attracted special comment because of the low reporting requirements and favourable tax regime. An official number of such companies is not available, but a 2017 study placed it at around 2 500. A number of these entities (up to 5%) are identified as problematic in another 2017 study, with alleged connections to shadow banking or individuals and entities suspected of crime ⁶³ .
Luxembourg	No	No official term	No official estimates exist. Studies point to a high prevalence of LBCs in Luxembourg. The Panama Papers revealed that more than 10 000 offshore companies created by

⁶³ TASC Seminar, 'Section 110' Companies: A Success story for Ireland?', School of Business, Trinity College, Dublin, January 2017, available at:

https://www.tasc.ie/assets/files/pdf/seminar_on_section_110_12th_jan_2017.pdf

and

https://www.tasc.ie/assets/files/pdf/ireland_global_finance_and_the_russian_connection.pdf

Country	Direct and quantification	specific Letterbox companies' terms used for quantification	Qualitative assessments/other relevant estimates
			Mossack Fonseca in Panama had a link with Luxembourg. The Belgian newspaper <i>Le Soir</i> wrote recently that more than 60 % of the 100 wealthiest Belgians have set up letterbox companies in Luxembourg.
The Netherlands	No		Several sources estimated the number of letterbox companies, ranging from 14 000 SPEs/SPVs (Statistics Netherlands, in the Q4 2018 edition of the Internationalisation Monitor) to 23 000 (Financial Times). Approximately 80% of those 14 000 entities had no real economic activity in the Netherlands and were considered to be used by multinationals for the mitigation of tax costs (CBS, 2018). The SEO used the data of the Dutch National Bank which is responsible for the collection of data of the Dutch balance of payments and the international investment position. Finally, around 23 000 letterbox companies were identified, managed by 176 licensed trust firms and making EUR 8 trillion worth of transactions in 2011.
Poland	No	No official term, different understandings	No official estimates exist.
Romania	No	Ghost companies (companies declared inactive because were not identified at their headquarters or their associates/administrators)	No official estimates exist. Officially registered companies are <200 per year (2016 and 2017 data from the National Agency of Fiscal Administration (ANAF)). A study estimated that so-called ghost/zombie companies (companies without any activity or with constant losses) represent up to 25% of the companies in Romania (93% of the 60 000 ghost/zombie companies are domestic capital companies).
Spain	No	No existing term	No official estimates exist. Not considered a major issue as there is no case-law or other political/public discussions of LBCs.
Switzerland	Yes	Domicile companies: companies that do not pursue any business activities.	The latest available estimate of domicile companies dates from 2011, when around 9 100 of a total of 357 000 legal entities were domiciled. This means that 2.5% of legal entities in Switzerland at that time were letter-box companies. Experts interviewed for the country report maintained that the legal

Country	Direct and quantification	specific Letterbox companies' terms used for quantification	Qualitative assessments/other relevant estimates
		Seat companies: companies in Switzerland that are only engaged in administrative activities and have no economic activity in the country. Domicile companies are a sub-group of seat companies but not every seat company is a domicile company.	and regulatory reforms in the recent years have likely to led to declining numbers of letterbox companies, but no hard data is available. Unofficial figures show the distribution of seat companies to be more widespread. The Panama Papers (2016) pointed to around 34 000 domicile companies in Switzerland. Compared with the total of 357 000 legal entities domiciled in Switzerland, this would be about 10% of Swiss companies. These figures are supported by another unofficial study from 2013, which identified around 13% of Swiss companies as domicile companies.
Panama	No		In 2017, Panama's public registry registered 15 413 new public limited companies (PLCs) (<i>Sociedades Anónimas</i>). In that same year, the country's system registered the dissolution of 12 044 PLCs. While it is not possible to draw any conclusion from the data, the latter sheds light on the facility for, and fast evolving pace in, establishing/shutting undertakings in the country.
US	Not available		No official estimates exist. Proxy data identified: Data collected by the New York Times showed that nearly half of residential purchases over USD 5 million were made by shell companies (Story and Saul, 2015).

The results of the online survey in the remaining countries show that most respondents are not aware of any available estimates of letterbox companies at national level.

3.1.6 Main findings

The existing indicators and research at EU/international and national level do not provide any direct and specific information on the number, geographical spread and core characteristics of letterbox companies. To date, no single specific estimate of letterbox companies exists for the EU, either across the full economy or in any specific economic sector. This is in part due to the different interpretations and terms used for of letterbox companies (see Section 2).

The proxy indicators used at EU/international level, such as FDI flows and the number of SPEs provide an indication of where letterbox companies may be more concentrated geographically but are ultimately only indicative. The same applies to the information related to posting of workers/undeclared work.

At national level, several countries have more precise measurements, for example through specific studies (the Netherlands) or because the country keeps track of actions against certain types of companies likely to be letterbox companies (Bulgaria, Austria, Romania). Other countries also use proxy indicators, such as Switzerland. As both the definitions used and the methods deployed vary greatly, it would be impossible to aggregate this data even if more countries had information available.

Without precise quantifications of LBCs, it is difficult to draw any hard evidence-based conclusions on their prevalence across the EU. However, considering the available indications, it can nevertheless be concluded that letterbox companies are present in the EU and are also used for abusive/illegitimate purposes (as well as legitimate purposes), but their prevalence differs between the Member States⁶⁴.

3.2 Quantification of letterbox companies using the Orbis database

Having analysed the existing literature and national findings on the quantification of letterbox companies, this section attempts to quantify the problem using the Orbis database. This is challenging for the reasons described earlier, some general in nature and others specific to the Orbis database. The phenomenon is very complex, as illustrated by the lack of a single definition, and providing a single figure for the number of letterbox companies risks simplifying its intricate nature. In addition, estimating the size of a phenomenon that often wants to remain hidden is a difficult task. The use of the Orbis database also comes with some specific data challenges, with data availability varying substantially between the Member States. This section presents the main findings of the quantification exercise, while a more extensive analysis and methodology can be found in Annex 3.

Problem statement and research questions

Grasping the phenomenon of letterbox companies requires a return to its definition. Although no single definition exists (see Section 2), certain elements recur in the definitions at European and national levels. The most important element is the **lack of economic activity**. For active companies, the **cross-border/foreign element** often appears when identifying letterbox companies. However, bearing in mind that artificial arrangements may also be set up and used solely at domestic level, these two elements become relevant and indicative when occurring concomitantly. The quantification presented here focuses on these elements in the analysis.

The central and sub-research questions that guided the quantification are listed below.

Central research question:

How is the letterbox company phenomenon characterised (size and profile of these artificial arrangements)?

Sub-research questions:

1a. How many companies have a majority shareholder from another EU Member State?

1b. What is the profile of companies with a majority shareholder from another EU Member State?

2a. How many companies have one or more subsidiaries in another EU Member State?

⁶⁴ A similar conclusion is reached in a European Parliament study: 'the three indicators do point to the existence of shell companies within the EU, on a magnitude that seems to differ in each EU Member State.' (EPRS, *An overview of shell companies in the European Union*, 2018, available at: http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf)

2b. What is the profile of companies with one or more subsidiaries in another EU Member State?

3. What 'red flags' can be defined that can indicate the existence of an LBC?

4. How many companies have a so-called 'red flag'?

Research method

These research questions were addressed by a defined research process (Figure 4). Firstly, the number and characteristics of companies in the EU/European Free Trade Association (EFTA) with a foreign majority shareholder (Section 3.2.1) and with a foreign subsidiary (Section 3.2.2) were analysed.

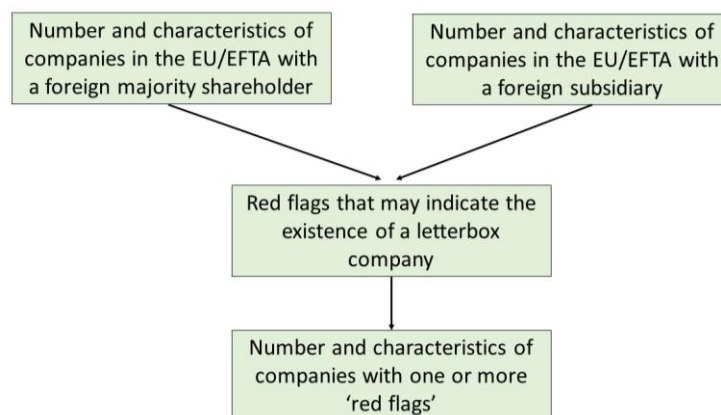
In this context, although the public and private limited liability companies are the most common legal forms for companies, this research also included other legal forms (see Tables 19 and 20 in Annex A3.1.2.) to have the broadest analysis possible, which should be borne in mind when comparing these results to other research. These included: partnerships, foreign companies, other legal forms, companies with unknown/unrecorded legal form, but also non-profit organisations. Forms that are excluded are sole traders/proprietorships, public authorities, and branches. As can be seen in Table 20 in Annex A3.1.2, 60% of all EU-28 companies covered in this research are public and private limited liability companies and the rest accounts for the other legal forms.

As regards the foreign majority shareholder and a foreign subsidiary, the Orbis database makes it possible to look at companies owned by a foreign shareholder and companies owning a foreign subsidiary.

The shareholder corresponds to the (global) 'Ultimate Owner'. Majority shareholder/ultimate owner means an owner who owns a minimum of 51% of the company. The term 'foreign' indicates that the shareholder/owner is located in a country other than the country of establishment of the company. For a foreign subsidiary to be selected, the company must be the global ultimate owner of the foreign subsidiary, owning at least 51% in its foreign subsidiary.

The next step was to estimate the number of letterbox companies based on several 'risk indicators' defined from the review in Section 3.2, that could help to identify the (lack of) economic activity of a company. For each indicator, a 'red flag' was developed, corresponding to a threshold value that could indicate the existence of letterbox companies. After defining the indicators and their 'red flags', the risk variables were selected in the Orbis database and a risk assessment was performed. This allowed for an overview of the number and profile of companies with 'red flags'.

Figure 4. Research process



It is important to note that none of the steps of the research process will provide the exact number of letterbox companies as the indicators used are proxies (see Annex A3.1.3 for

the limitations of this research process). For example, companies with a foreign majority shareholder or foreign subsidiary are not equivalent to letterbox companies and nor are companies with a 'red flag'. Only the competent authorities in each Member State, such as tax authorities or labour inspectorates, would be able to verify whether a company acts as a letterbox in practice.

The variables selected in the Orbis database to carry out the analysis are provided in Table 19 in Annex 3.1.1. A distinction was made between variables to filter the data in order to select the 'right' companies, and variables to describe the data in order to provide a profile of the selected companies and analyse their data.

This **research was carried out in 2019 and it was based on EU-28**, including the UK as a Member State.

Orbis database

The Orbis database from Bureau van Dijk contains (non-)financial information from private companies across the world⁶⁵. The data is collected from over 160 providers and own sources, which are then treated, appended and standardised to ensure comparability⁶⁶. The Orbis database is increasingly used by academics studying multinational enterprises and tax analyses, among others⁶⁷ as it is very extensive database, considered to be the 'most comprehensive commercially available company-level global database at present'⁶⁸.

Although the information provided is very broad and standardised between countries, some flaws should be kept in mind. The most important limitations in terms of the analysis carried out in this section are discussed below, with a complete overview of Orbis and its limitations provided in Annex A3.1.3.

The first and most important limitation of Orbis relates to incomplete data. This incomplete coverage is understandable, as Orbis is not an administrative dataset⁶⁹. Firms observed in Orbis typically represent only a small share of all firms⁷⁰. The principal reason for missing data seems to relate to the different obligations with regard to the provision of information in different countries. However, missing data could also signal a 'red flag' (see Section 3.2.3).

For this specific quantification exercise, the problem of incomplete data was acknowledged and corrected, to the extent possible. For instance, the location of the foreign shareholder/subsidiary was often not available, which is an important limitation. To counter this problem, an estimation was made (see Section 3.2.1 and Annex A3.2 for detail). The data availability for variables for companies with a foreign shareholder is also reported in Section 3.2.3, as certain gaps could in themselves be considered a possible 'red flag'.

⁶⁵ This database has been used in similar research on letterbox companies, including Gerner-Beuerele et al., 2016 and European Commission, 2017. The data used in this section was downloaded from Orbis between June 2019 and November 2019.

⁶⁶ Bureau van Dijk website, available at: <https://www.bvdinfo.com/en-gb/>

⁶⁷ Rungi, A., Morrison, G., and Pammolli, F. (2018). Global Ownership and Hierarchies of Firms. 'What is essential is invisible to the eye'. Available at: <https://www.aeaweb.org/conference/2019/preliminary/paper/rbKyH49Y>

⁶⁸ Nakamoto, T., Chakraborty, A. and Ikeda, Y. (2019:4). Identification of key companies for international profit shifting in the Global Ownership Network. *Applied Network Science* 4(58), pp. 1-26. <https://doi.org/10.1007/s41109-019-0158-8>

⁶⁹ European Commission (2017). Aggressive tax planning indicators. Final Report. Working paper N0 71 – 2017. Available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp_.pdf. Accessed on 23 May 2019.

Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

⁷⁰ Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C., & Timmis, J. (2020). Coverage and representativeness of Orbis data. OECD Science, Technology and Industry Working Papers 2020/06. <https://doi.org/10.1787/18151965>

In addition to missing values for companies in the Orbis database, the question arises as to whether the Orbis database includes all relevant companies. Although full coverage of all companies worldwide is unlikely, Orbis collects company data from companies in every country in the world and its data coverage is growing⁷¹. The data availability in Orbis has been compared to many other sources in research and is generally held to be a good approximation of reality. For instance, a study⁷² compared the production shares of multinational firms identified in Orbis to the shares identified by another study⁷³ using OECD and Eurostat data. They found that the shares were very similar, meaning that Orbis captures reality quite well. A similar exercise was performed⁷⁴ albeit on the Augmented Amadeus database (AUGAMA), another database of comparable financial information for public and private companies across Europe, provided by Bureau van Dijk. That research found that AUGAMA adequately approximates the structure of the European economy across countries, regions and industries, when comparing data to Eurostat data and Cambridge Econometrics.

A final important limitation of Orbis is the fact that it does not allow certain ownership data to be downloaded, although it is possible to consult this data in the database itself. This means that certain interesting information, for example concerning the exact location of a foreign majority shareholder or foreign subsidiary, could not be provided in the analysis⁷⁵.

3.2.1 Number and profile of companies with a foreign majority shareholder

This section looks in more detail at companies with a *foreign majority shareholder*, both by country of establishment and by sector of activity. As explained earlier, the concept of foreign majority shareholder refers to the ultimate owner who owns a minimum of 51% of the company.

The estimated number of companies located in the EU-28 in 2019 with a foreign majority shareholder amounted to 1.2 million, which equalled 4.2% of all companies in the EU-28. Of these 1.2 million companies, 706 764 had a foreign majority shareholder located in the EU-28, which equals 57%⁷⁶. Section 3.2.1.1 explains the methodology developed and used to estimate the number of companies with a foreign majority shareholder⁷⁷.

⁷¹ Bureau van Dijk (2019). Orbis. Available at: <https://www.bvdinfo.com/en-gb/our-products/data/international/orbis>. Accessed on 28 June 2019

⁷² Cravino., J. and Levchenko, A. (2014). Multinational Firms and International Business Cycle Transmission. Available at: https://economics.nd.edu/assets/147537/levchenko_paper.pdf

Cravino., J. and Levchenko, A. (2016). Multinational Firms and International Business Cycle Transmission. Working Paper 22498. Available at: <https://www.nber.org/papers/w22498.pdf>

⁷³ Alvarez, V. (2013). Multinational production and comparative advantage. Mimeo, University of Michigan.

⁷⁴ Merlevalde, B., De Zwaan, M., Lenaerts, K. and Purice, V. (2015). Multinational Networks, Domestic, and Foreign Firms in Europe. Working Paper: University of Ghent. Available at: http://wps-feb.ugent.be/Papers/wp_15_900.pdf

⁷⁵ A broad analysis of the location of the foreign majority shareholder/subsidiary is possible (EU-15/EU-13/non-EU), and for some Member States, a more detailed analysis is provided, but an extensive determination of the exact country of the foreign majority shareholder/subsidiary is not possible for all Member States and goes beyond the purpose of this study.

⁷⁶ When only taking in account public limited companies, we can see that 4.7% of EU-28 companies have a foreign majority shareholder located in the EU-28. Regarding private limited companies, 3.6% of companies located in the EU-28 have a foreign majority shareholder in the EU-28 (see Table 20 in Annex A3.1.2).

⁷⁷ The study by Gerner-Beuerle et al. (2018) looked at companies of which all managers are from a different Member State than the Member State in which the company is located, and the majority of these managers have to be shareholders. See Annex A3.2.1 for a more detailed analysis of their methodology. The study estimated the number of foreign-owned companies across the EU at between 0.2 and 0.5 million in 2017. High numbers of such companies were found especially in the UK, and to a lesser extent in Romania, Slovakia, Czechia, Estonia, France and Germany, which the study believed due to comparatively favourable tax and labour laws in the UK. Gerner-Beuerle, C., Mucciarelli, F., Schuster, E.P. & Siems, M. (2018). Why do businesses incorporate in other EU Member States? An empirical analysis of the role of conflict of laws rules, *International Review of Law and Economics*, 56, pp. 14-

3.2.1.1 By country of establishment

Although it is possible in Orbis to select companies with a foreign majority shareholder, the location is not available for some shareholders, which means that they could either be located abroad (foreign) or in the country of establishment (domestic). As a result, a lower limit (excluding all shareholders for which the location is unknown) and an upper limit (including all shareholder with an unknown location) of the number of 'foreign' shareholders can be extracted from the database. The 'real' number of companies with a foreign shareholder lies somewhere in between.

In order to estimate this 'real' number, a methodology was developed, using the lower and upper limit and the total number of companies (see Annex A3.2.1 for detail). The result of this estimation is shown in Table 4 below.

Table 4. Estimated number of companies with a foreign majority shareholder, corrected for the number of companies whose country of the shareholder was not available

	Number of companies with a foreign majority shareholder	Column percentage (share in the number of companies in the EU-28 with a foreign majority shareholder)
Belgium	20 800	1.7%
Bulgaria	18 932	1.5%
Czechia	50 070	4.0%
Denmark	17 180	1.4%
Germany	103 409	8.3%
Estonia	23 384	1.9%
Ireland	36 533	2.9%
Greece	5 125	0.4%
Spain	28 966	2.3%
France	35 393	2.9%
Croatia	14 425	1.2%
Italy	46 941	3.8%
Cyprus	18 152	1.5%
Latvia	19 292	1.6%
Lithuania	2 570	0.2%
Luxembourg	45 172	3.6%
Hungary	3 476	0.3%
Malta	13 335	1.1%

27. Available at: <https://www.kcl.ac.uk/law/newsevents/eventrecords/Siems-Why-Do-Businesses-Incorporate-in-other-EU-Member-States-002.pdf>. Accessed on 14 May 2019.

	Number of companies with a foreign majority shareholder	Column percentage (share in the number of companies in the EU-28 with a foreign majority shareholder)
Netherlands	41 248	3.3%
Austria	17 173	1.4%
Poland	23 484	1.9%
Portugal	26 155	2.1%
Romania	77 965	6.3%
Slovenia	4 213	0.3%
Slovakia	47 397	3.8%
Finland	9 626	0.8%
Sweden	14 271	1.2%
UK	503 394	40.6%
EU-28	1 239 612	100.0%
EU-27**	736 218	
Iceland	385	
Liechtenstein	291	
Norway	9 497	
Switzerland	16 969	

* Data extracted on 19 June 2019

** The EU-27 row presents updated data (as of 2020). It corresponds to the EU-28, minus the UK, taking its official exit from the EU into account.

Source: Own elaborations based on Orbis

Of the 1 239 612 companies in the EU-28 with a foreign majority shareholder, more than 40% were located in the UK. Germany and Romania also had a high share of companies with a foreign shareholder, albeit to a substantially lesser extent, with more than 5% each. Approximately 61% of the shareholders were located in the EU-28, and 39% outside the EU-28. The shareholders located outside the EU-28 were mainly concentrated in Far East and Central Asia (30%)⁷⁸ and North America (21%)⁷⁹.

From a money laundering perspective, it may be interesting to look at the companies located in the EU-28 with a foreign shareholder located in a tax haven or high-risk jurisdiction. For instance, some of these tax havens are identified⁸⁰. Four common ones are the British Virgin Islands (2.4% of companies in the EU-28 with a foreign shareholder

⁷⁸ The countries included in this group are AF, AM, AZ, BD, BT, BN, KH, CN, GE, HK, IN, ID, JP, KZ, KP, KR, KG, LA, MO, MY, MV, MN, MM, NP, PK, PH, SG, LK, TW, TJ, TH, TM, UZ and VN (Orbis data extracted on 25 November 2019).

⁷⁹ The countries included in this group are CA and US (Orbis data extracted on 25 November 2019).

⁸⁰ Garcia-Bernardo, J., Fichtner, J., Takes, F. W., & Heemskerk, E. M. (2017). Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network. *Scientific Reports*, 7(1), 6246. Available at: <https://doi.org/10.1038/s41598-017-06322-9>. Accessed on 15 May 2019.

outside the EU-28 were located here), Taiwan (0.4%), Bermuda (1.0%) and the Cayman Islands (2.5%). Although the share of companies with a foreign shareholder located in these four countries was rather low (6.3% of total companies in the EU-28 with a foreign shareholder located outside the EU-28), comparing turnover per number of employees is interesting. In 2017, the average turnover per employee for companies located in the EU-28 without a majority foreign shareholder was around EUR 202 000, those with a foreign shareholder located in the EU-28 had an average value of EUR 1 100 000, and those with a foreign shareholder located outside the EU-28 had an average turnover per employee of EUR 1 085 000. However, those companies located in the EU-28 with a foreign shareholder located in the British Virgin Islands, Taiwan, Bermuda, or the Cayman Islands had an average value of EUR 1 392 000. This indicates that EU-28 companies with foreign shareholders located in these countries had more turnover (or fewer employees) relative to other companies, which could signal that these countries were indeed used as tax havens⁸¹.

To put the above figures in perspective, Figure 5 shows the relative share of companies with a foreign majority shareholder of the total number of companies in each Member State. Luxembourg⁸² and Malta stand out, with more than 25% and 22%, respectively, of the companies located in these countries having a foreign majority shareholder. Slovakia and Ireland also had a high percentage of companies with a majority foreign shareholder. It is worth noting that the share in the Netherlands was rather small; approximately 2.4% of companies with a foreign majority shareholder. This unrealistically low share was noted in another study⁸³ that used Orbis, as well as in another one that relied on the AUGAMA database⁸⁴. Although the researchers are aware of this issue, no robust explanation could be found for this underrepresentation of foreign majority shareholders in the Netherlands⁸⁵.

⁸¹ Orbis data extracted on 25 November 2019.

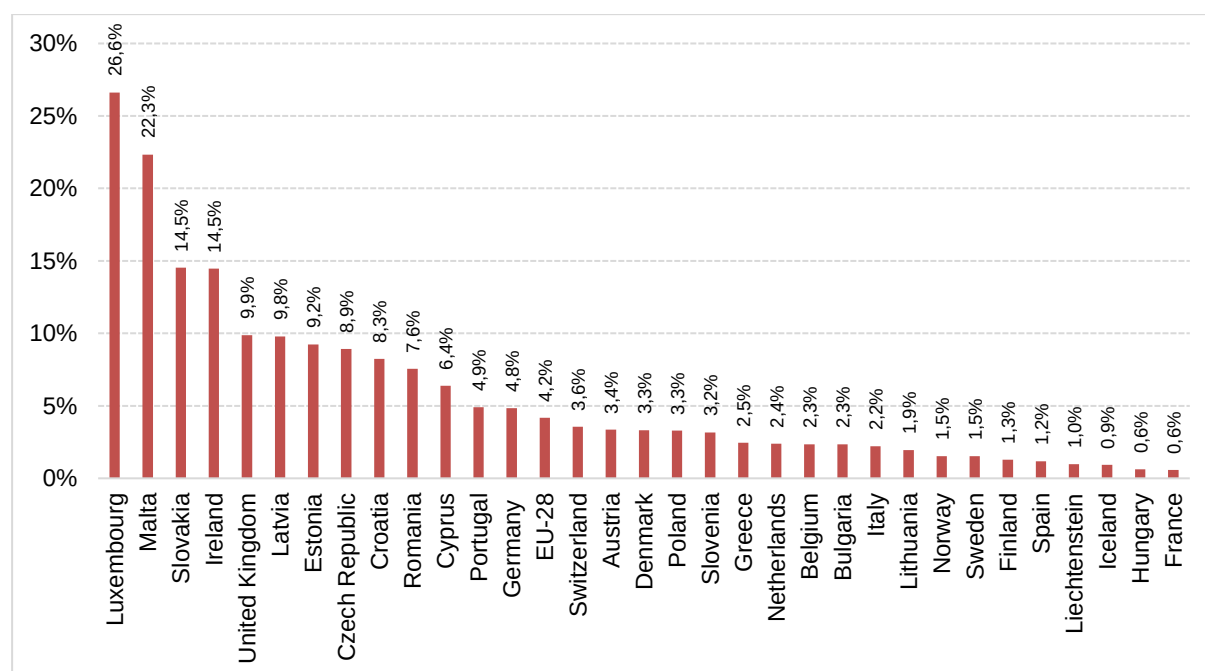
⁸² The same exercise on the location of the foreign shareholder can be repeated for companies located in Luxembourg. Around 38% of the companies located in Luxembourg with a foreign shareholder located outside of the EU-28 have a shareholder located in North America (CA and US) and 35% are located in South and Central America (AI, AG, AR, AW, BS, BB, BZ, BM, BO, BR, KY, CL, CO, CR, CU, CW, DM, DO, EC, SV, GD, GT, GY, HT, HN, JM, MX, NI, PA, PY, PE, KN, LC, VC, SX, SR, TT, UY, VE, VG). Regarding the tax havens described above, almost 30% of Luxembourg companies with a foreign shareholder outside of the EU-28 are located in one of the four mentioned countries (0.1% in Taiwan, 2.3% in Bermuda, 6.6% in the British Virgin Islands, and 19.3% in the Cayman Islands). Although these figures are very interesting, especially from a money laundering perspective, they will not be analysed in further detail here (Orbis data extracted on 25 November 2019).

⁸³ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

⁸⁴ Merlevelde, B., De Zwaan, M., Lenaerts, K. and Purice, V. (2015). Multinational Networks, Domestic, and Foreign Firms in Europe. Working Paper: University of Ghent. Available at: http://wps-feb.ugent.be/Papers/wp_15_900.pdf

⁸⁵ Johansson et al. (2017) attributed this difference to missing ownership links in the Orbis database, but other reasons are possible as well.

Figure 5. Estimated share of companies with a foreign majority shareholder of total number of companies



* Data extracted on 19 June 2019

Source: Own elaborations based on Orbis

Table 5 shows an overview of the shares of companies with a foreign majority shareholder located in EU-15, EU-13, EFTA or non-EU/EFTA. For instance, of the companies located in Belgium with a foreign majority shareholder, 62% had a shareholder located in the EU-15, 7% in EU-13, 4% in EFTA, and the remaining 28% outside of the EU-28/EFTA.

In the EU-28, of 62% of companies with a foreign majority shareholder, that shareholder was located in the EU-28 itself. A further 35% of these companies had a shareholder located outside the EU-28/EFTA. Excluding the UK, only 30% of EU-27 companies had a foreign majority shareholder located outside the EU-28/EFTA, indicating the large influence of the UK, whose share of companies with a foreign majority shareholder located outside the EU-28/EFTA was particularly high.

In Cyprus and Greece, the importance of companies with a foreign majority shareholder located outside the EU-28/EFTA was relatively high, at 54.1% and 51.9%, respectively. In Latvia and the UK, this share also exceeded 40% (see Figure 11 in Annex A3.2.1).

Table 5. Share of companies with a foreign majority shareholder located in EU-15, EU-13, EFTA or non-EU/EFTA of total number of companies with a foreign majority shareholder

	Share of companies with a foreign majority shareholder located in EU-15	Share of companies with a foreign majority shareholder located in EU-13	Share of companies with a foreign majority shareholder located in EFTA	Share of companies with a foreign majority shareholder located in non-EU/EFTA
Belgium	62.3%	6.5%	3.5%	27.8%
Bulgaria	51.7%	11.6%	4.5%	32.1%
Czechia	31.6%	27.6%	2.8%	38.0%

	Share of companies with a foreign majority shareholder located in EU-15	Share of companies with a foreign majority shareholder located in EU-13	Share of companies with a foreign majority shareholder located in EFTA	Share of companies with a foreign majority shareholder located in non-EU/EFTA
Denmark	64.8%	4.1%	14.0%	17.1%
Germany	52.4%	7.3%	13.1%	27.2%
Estonia	55.7%	14.1%	5.8%	24.4%
Ireland	59.2%	2.0%	3.0%	35.8%
Greece	36.1%	7.9%	4.1%	51.9%
Spain	74.5%	1.5%	6.0%	17.9%
France	72.0%	0.4%	7.2%	20.4%
Croatia	46.8%	24.5%	4.7%	24.0%
Italy	45.7%	11.1%	8.5%	34.8%
Cyprus	36.0%	6.8%	3.0%	54.1%
Latvia	27.8%	23.7%	3.0%	45.5%
Lithuania	57.1%	20.5%	9.1%	13.3%
Luxembourg	60.3%	2.4%	4.3%	33.0%
Hungary	76.5%	3.1%	8.0%	12.5%
Malta	55.2%	6.8%	4.8%	33.3%
Netherlands	53.9%	2.9%	4.5%	38.7%
Austria	65.4%	11.1%	13.2%	10.2%
Poland	73.2%	11.2%	5.0%	10.5%
Portugal	75.9%	4.0%	3.7%	16.4%
Romania	54.5%	14.5%	2.0%	29.0%
Slovenia	63.0%	14.0%	6.3%	16.6%
Slovakia	28.4%	56.9%	1.9%	12.8%
Finland	50.9%	17.8%	5.5%	25.7%
Sweden	61.7%	3.2%	21.1%	14.0%
UK	29.9%	25.0%	1.6%	43.4%
EU-28	34.2%	27.5%	3.1%	35.3%
EU-27**	36.9%	29.1%	4.0%	30.0%

	Share of companies with a foreign majority shareholder located in EU-15	Share of companies with a foreign majority shareholder located in EU-13	Share of companies with a foreign majority shareholder located in EFTA	Share of companies with a foreign majority shareholder located in non-EU/EFTA
Iceland	71.6%	0.8%	12.6%	15.0%
Liechtenstein	36.1%	2.1%	51.9%	10.0%
Norway	79.9%	3.4%	4.4%	12.3%
Switzerland	76.6%	1.6%	1.7%	20.1%

* Data extracted on 19 June 2019

** The EU-27 row presents updated data (as of 2020). It corresponds to the EU-28, minus the UK, taking its official exit from the EU into account.

Source: Own elaborations based on Orbis

The further analysis was largely undertaken on companies located in the EU-28 and with a foreign majority shareholder located in another country of the EU-28, unless otherwise specified. These were estimated to amount to 706 764⁸⁶ (see Table 21 in Annex A3.2.1 for detail). Table 21 also shows that for most Member States, the majority of companies with a foreign majority shareholder in the EU-28 had a shareholder located in the EU-15. The exception is Slovakia, where 67% of the companies with a foreign shareholder in the EU-28 had a shareholder located in the EU-13.

3.2.1.2 By sector of activity

In addition to examining the country of establishment, it is useful to investigate the sectors in which most companies with a foreign majority shareholder are active, which can be identified using the NACE-code, the statistical classification of economic activities in the EU. Such analysis is of interest, as certain studies assume that letterbox companies are especially prevalent in specific sectors of activity. For instance, a specific focus concerns the meat industry, the transport sector and the construction industry⁸⁷.

The analysis below reviewed the NACE-code of the 706 764 companies located in the EU-28 with a foreign majority shareholder inside the EU-28. The same analysis was also performed on companies located in the EU-28 with a foreign majority shareholder outside the EU-28 (see Annex A3.2.3 and Table 22). It found that similar NACE-codes came up in the two groups, with 15 of the top 20 NACE-codes the same. For both groups, NACE-code 8299 'Other business support service activities' was the most prevalent, meaning that this is a frequent field of activity for companies with a foreign majority shareholder. As both groups of companies with a foreign majority shareholder were quite comparable, the further analysis was only performed for companies located in the EU-28 with a foreign majority shareholder within the EU-28.

The top 20 NACE-codes for companies with a foreign majority shareholder in the EU-28 are shown in Table 6, which includes both the absolute number and the share of the total number of EU-28 companies with a foreign majority shareholder within the EU-28. It is interesting to compare the number of companies with a foreign shareholder in the EU-28 with the total number of companies with a certain NACE-code. Therefore, the fourth column

⁸⁶ This figure is underestimated as it does not take into account companies for which the location of the (foreign) shareholder is not available.

⁸⁷ McGauran, K. (2016). The impact of letterbox-type practices on labour rights and public revenue. Available at: https://www.etuc.org/sites/default/files/publication/files/ces_letterbox_compagnies_gb_juin_ok.pdf. Accessed on 06 May 2019.

shows the share of EU-28 companies with a foreign shareholder in the EU-28 from the total number of EU-28 companies with the same NACE-code.

A high share of companies with a foreign shareholder were active in the fields of 'Other business support service activities', 'Freight transport by road', 'Business and other management consultancy activities', and 'Activities of holding companies'. The kinds of activities these NACE-codes covered are not always clear, as they referred to, for instance, 'Other business support service activities' or 'Business and other management consultancy activities'. The explanatory notes for the NACE-classification specified that NACE-code 6420 'Activities of holding companies' goes beyond the traditional scope of NACE, which is economic productivity⁸⁸. Companies active under this NACE-code do not have any revenue from the sale of products and usually do not employ staff, which implies that they could be used as letterbox companies. Eurostat notes that some of these companies only have a name and an address and are used to gain tax advantages in certain countries⁸⁹. NACE-code 7010 'Activities of head offices' and NACE-code 7022 'Business and other management consultancy activities' showed similar peculiarities.

With the exception of the road transport sector (almost 9% of all EU-28 companies with the NACE-code 4941 'Freight transport by road' had a foreign majority shareholder in the EU-28), the sectors identified here were not those that usually come up in other literature on letterbox companies, which tends to focus on sectors such as construction, transport and meat production (see Section 3.1). The focus on those sectors was because the literature chiefly seeks to identify abusive and illegitimate uses of letterbox companies, rather than mapping the entire phenomenon.

Table 6. Top 20 NACE-codes of companies located in the EU-28 with a foreign majority shareholder located within the EU-28

NACE-code	Number of companies with a foreign majority shareholder	Column percentage (share of total number of companies with a majority foreign shareholder)	Share of total number of EU-28 companies by NACE	Description of NACE-code
8299	30 176	4.7%	5.9%	Other business support service activities n.e.c.
4941	29 754	4.7%	8.5%	Freight transport by road
7022	25 752	4.0%	3.3%	Business and other management consultancy activities
6420	22 493	3.5%	2.9%	Activities of holding companies
6820	21 639	3.4%	0.8%	Rental and operating of own or leased real estate
4120	18 550	2.9%	3.1%	Construction of residential and non-residential buildings
6810	15 693	2.5%	4.0%	Buying and selling of own real estate
9609	12 221	1.9%	5.0%	Other personal service activities n.e.c.

⁸⁸ Eurostat. (2008). NACE Rev. 2 Statistical classification of economic activities in the European Community. Available at <https://ec.europa.eu/eurostat/documents/3859598/5902521/KS-RA-07-015-EN.PDF>

⁸⁹ Ibid

NACE-code	Number of companies with a foreign majority shareholder	Column percentage (share of total number of companies with a majority foreign shareholder)	Share of total number of EU-28 companies by NACE	Description of NACE-code
6202	11 982	1.9%	4.4%	Computer consultancy activities
4690	10 526	1.7%	5.7%	Non-specialised wholesale trade
7010	10 382	1.6%	3.4%	Activities of head offices
4110	10 240	1.6%	2.7%	Development of building projects
6201	10 002	1.6%	4.1%	Computer programming activities
5610	8 804	1.4%	1.2%	Restaurants and mobile food service activities
7112	8 513	1.3%	2.7%	Engineering activities and related technical consultancy
7490	8 149	1.3%	3.4%	Other professional, scientific and technical activities n.e.c.
3511	7 830	1.2%	6.9%	Production of electricity
4399	7 237	1.1%	3.1%	Other specialised construction activities
4791	6 587	1.0%	3.9%	Retail sale via mail order houses or via Internet
4669	6 451	1.0%	7.3%	Wholesale of other machinery and equipment

* Data extracted on 14 October 2019

Source: Own elaborations based on Orbis

Certain NACE-codes identified as part of this analysis also emerged in a study on cross-border corporate mobility in the EU⁹⁰. More specifically, a high share of cross-border mergers and cross-border seat transfers were conducted by companies active in the fields of NACE-code 6420 'Activities of holding companies' and NACE-code 7010 'Activities of head offices'. This signalled that companies active in these fields are quite mobile, and it is unsurprising that the current research showed a high share of companies with a foreign majority shareholder and/or foreign subsidiary (see Section 3.2.2) operating under these NACE-codes.

Table 6 does not show whether the top 20 NACE-codes for foreign-owned companies are especially common for companies with a foreign shareholder in the EU-28 as compared to companies without foreign shareholders. Table 7 provides the shares of foreign-owned companies and domestic companies from the total number of foreign-owned companies and domestic companies, respectively, for the top 20 NACE-codes for companies with a foreign shareholder. The latter showed that for all but two NACE-codes (6820 'Rental and operating of own or leased real estate' and 5610 'Restaurants and mobile food service activities'), the share of foreign-owned companies was higher than the share of domestic

⁹⁰ Biermeyer, T., and Meyer, M. (2019). Cross-border Corporate Mobility in the EU: Empirical Findings 2019 (Vol. 1). Available at: <http://dx.doi.org/10.2139/ssrn.3403791>

companies. This suggests that the NACE-codes mentioned were proportionally more common for companies with a foreign EU-28 shareholder than for companies without a foreign shareholder.

For the first three NACE-codes in particular, the differences between the shares of foreign-owned and domestic companies are noteworthy. Whereas only 2% of domestic companies were active in the 'Other business support service activities', almost 5% of foreign-owned companies carried out these activities. This considerable difference can also be seen for companies with NACE-code 4941 'Freight transport by road' and NACE-code 7022 'Business and other management consultancy activities'. Almost 5% of foreign-owned companies were active in the transport industry, while only 1% of domestic companies operated under this NACE-code.

Table 7. Comparison of occurrence of top 20 NACE-codes of companies located in the EU-28 with a foreign majority shareholder within the EU-28 between foreign-owned companies and domestic companies

NACE-code	Share of foreign-owned companies*	Share of domestic companies**	Description of NACE-code
8299	4.7%	1.6%	Other business support service activities n.e.c.
4941	4.7%	1.1%	Freight transport by road
7022	4.0%	2.6%	Business and other management consultancy activities
6420	3.5%	2.7%	Activities of holding companies
6820	3.4%	10.6%	Rental and operating of own or leased real estate
4120	2.9%	2.0%	Construction of residential and non-residential buildings
6810	2.5%	1.2%	Buying and selling of own real estate
9609	1.9%	0.8%	Other personal service activities n.e.c.
6202	1.9%	0.9%	Computer consultancy activities
4690	1.7%	0.5%	Non-specialised wholesale trade
7010	1.6%	1.1%	Activities of head offices
4110	1.6%	1.3%	Development of building projects
6201	1.6%	0.8%	Computer programming activities
5610	1.4%	2.4%	Restaurants and mobile food service activities
7112	1.3%	1.1%	Engineering activities and related technical consultancy
7490	1.3%	0.8%	Other professional, scientific and technical activities n.e.c.
3511	1.2%	0.4%	Production of electricity
4399	1.1%	0.8%	Other specialised construction activities
4791	1.0%	0.5%	Retail sale via mail order houses or via Internet
4669	1.0%	0.3%	Wholesale of other machinery and equipment

* Foreign-owned companies are companies located in the EU-28 with a foreign shareholder located in the EU-28

** Domestic companies are companies located in the EU-28 without a foreign shareholder anywhere in the world

*** Data extracted on 17 October 2019

Source: Own elaborations based on Orbis

As a next step, the NACE-code was combined with the country of establishment in order to evaluate these indicators more closely. The four most common NACE-codes⁹¹ for EU-28 companies with a foreign majority shareholder in the EU-28 were looked at in more detail for each Member State. The most significant findings are discussed below (the complete analysis can be found in Table 23 in Annex A3.2.3).

For NACE-code 8299 'Other business support service activities n.e.c.', more than 60% of companies with a foreign shareholder located in the EU-28 were located in the UK. The second most popular location was Germany, where 12% of the companies with a foreign shareholder in the EU-28 were located. More than 20% of the companies with this NACE-code located in Luxembourg and Malta had a foreign shareholder in the EU-28.

When looking at NACE-code 4941 'Freight transport by road', both Luxembourg and the UK showed more than 35% of the companies with this NACE-code having a foreign shareholder in the EU-28. Of the companies with a foreign majority shareholder located in the EU-28 operating in this sector, more than 80% of these companies were located in the UK.

Companies with NACE-code 6420 'Activities of holding companies' appeared to be located predominantly in the Netherlands, which had more than 350 000 of the 750 000 companies with this NACE-code. The same applies to companies with a foreign majority shareholder [with this NACE-code] located in the EU-28, 33% of which were located in the Netherlands. In Romania, 34% of the companies with this NACE-code had a foreign shareholder in the EU-28.

Finally, for NACE-code 7022 'Business and other management consultancy activities', more than one-quarter of the companies based in Luxembourg had a foreign shareholder located in the EU-28. Again, when looking at the column percentages, both Romania and the UK stood out, with more than 10% and 43% of the companies with a foreign majority shareholder based in the EU-28 located in these two Member States, respectively.

3.2.2 Number and profile of companies with a foreign subsidiary

A similar analysis can be undertaken for companies with a foreign subsidiary, using the same steps outlined in Section 3.2.1 (i.e., first examining the country of establishment of companies with a foreign subsidiary, followed by an analysis of their NACE-codes). As explained earlier, for a foreign subsidiary to be selected, the company must be the global ultimate owner of the foreign subsidiary, owning at least 51% in its foreign subsidiary.

3.2.2.1 By country of establishment

Here, too, information about the exact location of the subsidiary is sometimes missing. To estimate the 'real' number of companies with a foreign subsidiary, a similar calculation was used, with the results presented in Table 8 below (see Annex A3.3.1 for full detail). It is estimated that a total of 200 530 companies in the EU-28 had a foreign subsidiary. This equalled only 0.7% of all companies located in the EU-28. The majority of these had a foreign subsidiary located in the EU-28 (128 229 companies). Most were located in Germany, the Netherlands and the UK, which each hold more than 10% of the total number of companies with a foreign subsidiary.

⁹¹ NACE-codes 8299 'Other business support service activities n.e.c', 4941 'Freight transport by road', 7022 'Business and other management consultancy activities' and 6420 'Activities of holding companies' (see Table 6).

Table 8. Estimated number of companies with a foreign subsidiary, corrected for the number of companies whose country of subsidiary was not available

	Number of companies with a foreign subsidiary	Column percentage (share of number of companies in the EU-28 with a foreign subsidiary)
Belgium	8 481	4.2%
Bulgaria	1 358	0.7%
Czechia	4 374	2.2%
Denmark	8 510	4.2%
Germany	21 239	10.6%
Estonia	1 602	0.8%
Ireland	3 609	1.8%
Greece	1 590	0.8%
Spain	10 772	5.4%
France	13 538	6.8%
Croatia	746	0.4%
Italy	15 159	7.6%
Cyprus	15 979	8.0%
Latvia	855	0.4%
Lithuania	1 159	0.6%
Luxembourg	12 547	6.3%
Hungary	1 931	1.0%
Malta	1 889	0.9%
Netherlands	21 359	10.7%
Austria	6 713	3.3%
Poland	2 963	1.5%
Portugal	2 545	1.3%
Romania	632	0.3%
Slovenia	1 205	0.6%
Slovakia	1 846	0.9%
Finland	2 791	1.4%
Sweden	8 605	4.3%

	Number of companies with a foreign subsidiary	Column percentage (share of number of companies in the EU-28 with a foreign subsidiary)
UK	25 996	13.0%
EU-28	200 530	100.0%
EU-27**	174 385	
Iceland	383	
Liechtenstein	1 449	
Norway	4 061	
Switzerland	13 267	

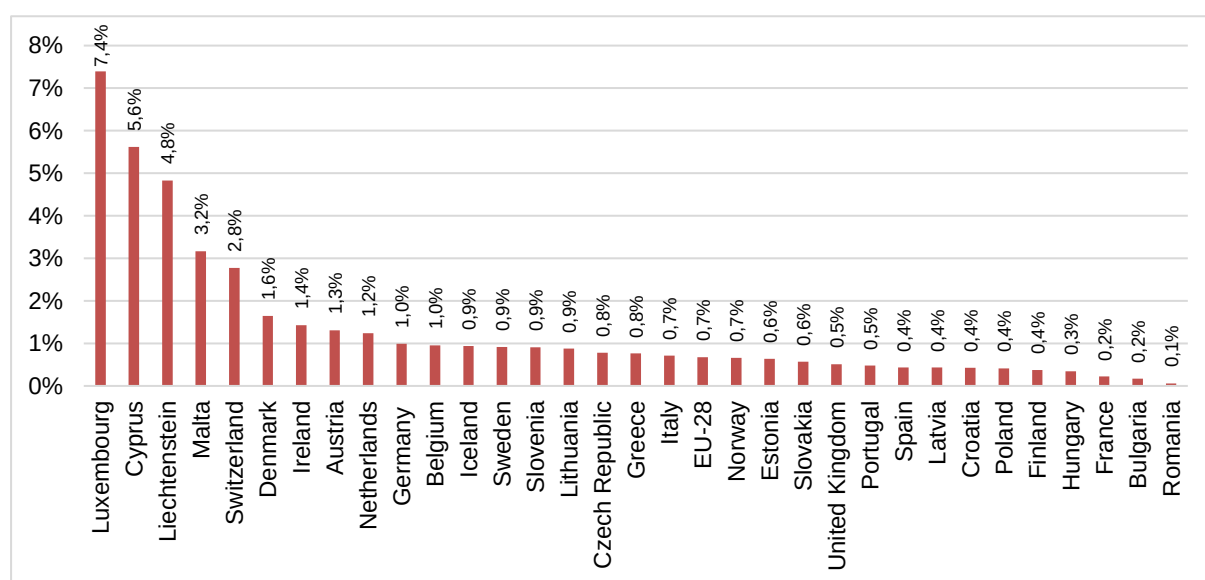
* Data extracted on 19 June 2019

** The EU-27 row presents updated data (as of 2020). It corresponds to the EU-28, minus the UK, taking its official exit from the EU into account

Source: Own elaborations based on Orbis

Figure 6 presents the share of companies with a foreign subsidiary from the total number of companies in the Member States. It showed that Luxembourg has a particularly high number of companies with a foreign subsidiary (7.4%), followed by Cyprus (5.6%) and Liechtenstein (4.8%).

Figure 6. Estimated share of companies with a foreign subsidiary of total number of companies



* Data extracted on 19 June 2019

Source: Own elaborations based on Orbis

Although it is not possible to analyse the exact location of the subsidiary (see Section 3.2.1), an analysis of the broad geographical region of the subsidiary showed that the countries with the highest share of companies with a subsidiary outside EU-28/EFTA were

located on the periphery, like Croatia and Cyprus (see Figure 14 in Annex A3.3.1)⁹². This is likely the case because the companies in these countries can more easily establish a subsidiary in a neighbouring country that is not a member of the EU-28/EFTA. It is also worth bearing in mind that it is very common for a company to have multiple subsidiaries in several countries. However, an in-depth analysis could not be conducted as part of this quantification exercise due to Orbis limitations (see Annex A3.1.3)⁹³.

An overview of the location of the foreign subsidiaries is provided in Table 9. In the EU-28, 20.8% of companies had a foreign subsidiary located outside the EU-28/EFTA. However, for all countries except Croatia and Cyprus, the majority of companies had a foreign subsidiary located in the EU-28 or EFTA. Unless stated otherwise, the data concerned companies located in the EU-28 with a foreign subsidiary located in the EU-28. It is difficult to find out whether there is any economic activity in a foreign subsidiary when this subsidiary is located outside the EU-28. This may be the subject of future research, especially when identifying companies with subsidiaries in tax havens or high-risk countries outside of the EU-28.

Table 9. Share of companies with a foreign subsidiary located in EU-15, EU-13, EFTA or non-EU/EFTA of total number of companies with a foreign subsidiary

	Share of companies with a foreign subsidiary located in EU-15	Share of companies with a foreign subsidiary located in EU-13	Share of companies with a foreign subsidiary located in EFTA	Share of companies with a foreign subsidiary located in non-EU/EFTA
Belgium	78.6%	7.5%	4.0%	9.8%
Bulgaria	30.5%	29.2%	0.8%	39.5%
Czechia	17.8%	66.7%	0.1%	15.5%
Denmark	63.1%	12.1%	16.9%	7.9%
Germany	57.4%	22.3%	8.1%	12.3%
Estonia	28.4%	49.0%	2.6%	20.0%
Ireland	80.0%	6.7%	2.1%	11.2%
Greece	15.8%	43.9%	1.1%	39.2%
Spain	52.1%	10.4%	2.1%	35.4%
France	64.5%	8.9%	7.8%	18.8%

⁹² This calculation was only possible for the companies with a foreign subsidiary whose location was known. Therefore the analysis below was not performed on the estimated 200 530 companies in the EU-28 with a foreign subsidiary (see Table 8), but on the 200 369 companies in the EU-28 whose location of the foreign subsidiary was available (see Table 24 in Annex A3.3.1).

⁹³ For companies located in Croatia with a foreign subsidiary outside of the EU-28/EFTA, this analysis was partly conducted to get an estimate of where most subsidiaries are located. Based on Table 24 in Annex A3.3.1, the number of companies with a foreign shareholder outside of the EU-28/EFTA can be extracted (= 745 companies with a foreign subsidiary – 321 companies with a foreign subsidiary in the EU-28 – 6 companies with a foreign subsidiary in EFTA = 418 companies with a foreign subsidiary outside the EU-28/EFTA). However, these 418 companies have a total of 923 foreign subsidiaries. In total, the number of subsidiaries of Croatian companies in 25 countries were analysed. This found that 30% of the 923 foreign subsidiaries outside the EU-28 were located in Serbia, 18% in Bosnia and Herzegovina, 5% in North Macedonia, 2% in Montenegro, and 1% in Kosovo (data extracted 7 August 2019).

	Share of companies with a foreign subsidiary located in EU-15	Share of companies with a foreign subsidiary located in EU-13	Share of companies with a foreign subsidiary located in EFTA	Share of companies with a foreign subsidiary located in non-EU/EFTA
Croatia	21.6%	21.5%	0.8%	56.1%
Italy	41.4%	22.5%	6.7%	29.4%
Cyprus	21.1%	24.3%	0.6%	54.0%
Latvia	20.0%	38.1%	2.2%	39.7%
Lithuania	14.3%	56.5%	2.2%	27.0%
Luxembourg	82.7%	9.6%	3.6%	4.1%
Hungary	23.0%	48.0%	0.3%	28.7%
Malta	68.7%	21.7%	1.2%	8.4%
Netherlands	69.9%	13.9%	4.0%	12.2%
Austria	50.3%	33.0%	4.8%	12.0%
Poland	34.5%	28.3%	1.6%	35.6%
Portugal	53.4%	5.9%	1.9%	38.9%
Romania	54.1%	20.3%	1.1%	24.5%
Slovenia	21.1%	36.7%	0.6%	41.7%
Slovakia	19.1%	63.8%	0.4%	16.8%
Finland	47.8%	27.6%	10.7%	13.9%
Sweden	55.5%	12.6%	28.6%	3.3%
UK	58.4%	13.4%	4.2%	24.0%
EU-28	54.4%	19.0%	5.9%	20.8%
EU-27**	53.8%	19.8%	6.1%	20.4%
Iceland	52.2%	10.8%	9.2%	27.8%
Liechtenstein	60.2%	20.4%	6.7%	12.6%
Norway	72.1%	14.3%	1.8%	11.8%
Switzerland	77.0%	8.6%	2.5%	11.9%

* Data extracted on 19 June 2019

** The EU-27 row presents updated data (as of 2020). It corresponds to the EU-28, minus the UK, taking its official exit from the EU into account.

Source: Own elaborations based on Orbis

3.2.2.2 By sector of activity

Table 10 provides an overview of the 20 most common NACE-codes for companies in the EU-28 with a foreign subsidiary in the EU-28, totalling 146 895 companies. The table shows both the absolute number and the share of the total number of companies with a foreign subsidiary, as well as the share of companies with a foreign subsidiary from the total number of companies with the NACE-code in question⁹⁴.

The same analysis was performed for companies located in the EU-28 with a foreign subsidiary located outside the EU-28 (see Annex A3.3.3). Of the 20 most common NACE-codes, 18 were identical for both groups. Moreover, the top three NACE-codes were similar and amounted to comparable shares. Therefore, the focus of the analysis will be on companies located in the EU-28 with a foreign subsidiary located in the EU-28.

A very large proportion of companies with a foreign subsidiary located in the EU-28 were active under NACE-code 6420 'Activities of holding companies'. When comparing Table 10 and Table 6, it is notable that 13 NACE-codes appeared in both the most common NACE-codes for companies with a foreign shareholder in the EU-28 and companies with a foreign subsidiary in the EU-28. Three of the top four selected NACE-codes matched (NACE-codes 6420, 7022 and 8299), meaning that these codes were common to both companies with foreign shareholders located in the EU-28 and those with foreign subsidiaries located in the EU-28.

In terms of share on the total number of EU-28 companies, NACE-codes 6420 'Activities of holding companies' and 7010 'Activities of head offices' represented the highest share, with 2.5% of the total number of EU-28 companies with these NACE-codes having a foreign subsidiary located in the EU-28. This means that not only were companies with a foreign subsidiary often active under these NACE-codes (18.7% of companies with a foreign subsidiary are active under NACE 6420 and 7.4% of companies under NACE 7010), but also that many companies with these NACE-codes had a foreign subsidiary (2.5% each). Indeed, as already stated in Section 3.2.1 and mentioned by the explanatory notes on the NACE-classification⁹⁵, these NACE-codes could be connected to letterbox companies.

Table 10. Top 20 NACE-codes of companies located in the EU-28 with a foreign subsidiary located in the EU-28

NACE-code	Number of companies with a foreign subsidiary	Column percentage (share in total number of companies with a foreign subsidiary)	Share in total number of EU-28 companies	Description of NACE-code
6420	19 419	18.7%	2.5%	Activities of holding companies
7010	7 729	7.4%	2.5%	Activities of head offices
7022	4 764	4.6%	0.6%	Business and other management consultancy activities
8290*	3 116	3.0%	0.6%	Business support service activities

⁹⁴ The analysis by sector of activity is performed on the companies located in the EU-28 with a foreign subsidiary in the EU-28. This does not equate to the estimated 200 530 companies in the EU-28 with a foreign subsidiary (see Table 8), but a subset thereof, namely 146 895 companies located in the EU-28 with a foreign subsidiary in the EU-28 (see Table 24 in Annex A3.3.1).

⁹⁵ Eurostat. (2008). NACE Rev. 2 Statistical classification of economic activities in the European Community. Available at <https://ec.europa.eu/eurostat/documents/3859598/5902521/KS-RA-07-015-EN.PDF>

NACE-code	Number of companies with a foreign subsidiary	Column percentage (share in total number of companies with a foreign subsidiary)	Share in total number of EU-28 companies	Description of NACE-code
8299	3 012	2.9%	0.6%	Other business support service activities
6820	2 287	2.2%	0.1%	Rental and operating of own or leased real estate
6499	1 774	1.7%	2.0%	Other financial service activities, except insurance and pension funding
6201	1 685	1.6%	0.7%	Computer programming activities
6619	1 591	1.5%	1.2%	Other activities auxiliary to financial services, except insurance and pension funding
7112	1 358	1.3%	0.4%	Engineering activities and related technical consultancy
4690	1 332	1.3%	0.7%	Non-specialised wholesale trade
6810	1 260	1.2%	0.3%	Buying and selling of own real estate
6430	1 138	1.1%	1.0%	Trusts, funds and similar financial entities
4669	1 045	1.0%	1.2%	Wholesale of other machinery and equipment
6202	973	0.9%	0.4%	Computer consultancy activities
7490	930	0.9%	0.4%	Other professional, scientific and technical activities
6209	914	0.9%	0.7%	Other information technology and computer service activities
5229	898	0.9%	1.3%	Other transportation support activities
4120	804	0.8%	0.1%	Construction of residential and non-residential buildings
6832	729	0.7%	0.3%	Management of real estate on a fee or contract basis

* Data extracted on 14 October 2019

Source: Own elaborations based on Orbis

In order to establish whether these NACE-codes are truly distinctive for companies with a foreign subsidiary, Table 10 compares the shares of companies located in the EU-28 with a foreign subsidiary in the EU-28 with EU-28 companies without a foreign subsidiary anywhere in the world. This suggests that nearly all of these NACE-codes were more common for companies with a foreign subsidiary than for those without a foreign subsidiary. The exceptions were companies active under NACE-codes 6820 'Rental and operating of own or leased real estate' and 4120 'Construction of residential and non-residential buildings', and to a lesser extent those active under NACE-codes 6810 'Buying and selling of own real estate' and 6832 'Management of real estate on a fee or contract basis', which were all more likely not to have a foreign subsidiary.

The remaining 16 NACE-codes, however, were all relatively more popular for companies with a foreign subsidiary. This was especially evident for the first three fields of activity. Only 3% of companies without a foreign subsidiary were active as a holding company (NACE-code 6420), whereas almost 19% of companies with a foreign subsidiary operated in this field. More than 7% of companies with a foreign subsidiary were active under NACE-code 7010 'Activities of head offices', while this share only reached 1% for companies without a foreign subsidiary. Finally, the difference between the share of companies with and without a foreign subsidiary in the field of 'Business and other management consultancy activities' amounted to 2%.

Table 11. Comparison of occurrence of top 20 NACE-codes of companies located in the EU-28 with a foreign subsidiary located in the EU-28, between companies with and without a foreign subsidiary

NACE-code	Share of companies with a foreign subsidiary*	Share of companies without a foreign subsidiary**	Description of NACE-code
6420	18.7%	2.6%	Activities of holding companies
7010	7.4%	1.0%	Activities of head offices
7022	4.6%	2.7%	Business and other management consultancy activities
8290	3.0%	1.9%	Business support service activities
8299	2.9%	1.8%	Other business support service activities
6820	2.2%	9.8%	Rental and operating of own or leased real estate
6499	1.7%	0.3%	Other financial service activities, except insurance and pension funding
6201	1.6%	0.8%	Computer programming activities
6619	1.5%	0.5%	Other activities auxiliary to financial services, except insurance and pension funding
7112	1.3%	1.1%	Engineering activities and related technical consultancy
4690	1.3%	0.6%	Non-specialised wholesale trade
6810	1.2%	1.3%	Buying and selling of own real estate
6430	1.1%	0.4%	Trusts, funds and similar financial entities
4669	1.0%	0.3%	Wholesale of other machinery and equipment
6202	0.9%	1.0%	Computer consultancy activities
7490	0.9%	0.8%	Other professional, scientific and technical activities
6209	0.9%	0.4%	Other information technology and computer service activities
5229	0.9%	0.2%	Other transportation support activities

4120	0.8%	2.1%	Construction of residential and non-residential buildings
6832	0.7%	0.8%	Management of real estate on a fee or contract basis

* Companies with a foreign subsidiary are companies located in the EU-28 with a foreign subsidiary located in the EU-28

** Companies without a foreign subsidiary are companies located in the EU-28 without a foreign subsidiary located anywhere in the world

*** Data extracted on 17 October 2019

Source: Own elaborations based on Orbis

A cross-analysis of the top four NACE-codes for EU-28 companies with a foreign subsidiary located in the EU-28⁹⁶, combining the sector of activity and the country of establishment showed that for NACE-code 8299 'Other business support service activities', almost 40% of the companies with a foreign subsidiary in the EU-28 were located in the UK (see full Table 26 in Annex A3.3.3). Austria and Germany were also popular locations for companies with a foreign subsidiary in the EU-28, with more than 15% of EU-28 companies located there.

In Czechia, Slovenia, Denmark, Slovakia, Sweden and Iceland, a large proportion of the companies with NACE-code 7010 'Activities of head offices' had a foreign subsidiary located in the EU-28. Most of the EU-28 companies with a foreign subsidiary in the EU-28 and this NACE-code were located in Germany, the UK and the Netherlands.

NACE-code 6420 'Activities of holding companies' was the most common NACE-code for companies with foreign subsidiaries in the EU-28, and more than 20% of the companies in Czechia and Liechtenstein that operate under this code had foreign subsidiaries in the EU-28, and the same applies for almost 20% of the companies in Malta and Switzerland. It is also noteworthy that more than 40% of the EU-28 companies with a foreign subsidiary in the EU-28 were located in the Netherlands.

Finally, for NACE-code 7022 'Business and other management consultancy activities', 10% and 5% of the companies located in Liechtenstein and Cyprus, respectively, had a foreign subsidiary in the EU-28. In total however, more than 20% of the EU-28 companies with a foreign subsidiary in the EU-28 were located in Belgium.

3.2.3 Number and profile of companies with a 'red flag'

This section aims to identify letterbox companies by using 'red flags' to characterise some of their features. As a first step, this includes the identification of indicators that can be used for the identification of certain 'red flags'. While an **indicator** is a variable and/or composition of variables that can be used to detect letterbox companies in a larger sample, '**red flags**' are criteria that, when met in the defined indicators, could indicate the existence of a letterbox company. Table 27 in Annex A3.4.2 provides an overview of all identified indicators and red flags, but only a limited number of these could be analysed in more detail using the Orbis database. The red flags were identified on the basis of existing EU legislation, jurisprudence, literature research and the risk analyses used by inspection services. An extensive overview of the literature and legislation on which the indicators and red flags are based, can be found in Annex A3.4.1.

The aim of identifying indicators and their red flags is to capture the fundamental element in the definition of letterbox companies, namely the lack of economic activity. In order to arrive at a proxy to measure the real economic activity of a company, relative figures are analysed, rather than absolute figures. Therefore, the absolute variables were divided by the number of employees to arrive at the relative indicator. For instance, absolute amounts

⁹⁶ NACE-codes 8299 'Other business support service activities n.e.c', 7010 'Activities of head offices', 6420 'Activities of holding companies', and 7022 'Business and other management consultancy activities' (see Table 10).

of turnover are not meaningful, as larger companies also have higher turnover. However, when normalising this financial figure with the number of employees, the larger companies are ruled out as outliers as they often also have a large number of employees and the indicator is no longer exceptional. The full analysis can be found in Annex A3.4.

One obstacle in trying to arrive at a proxy for the lack of economic activity in the country of residence is the inability in Orbis to see where turnover was created.⁹⁷ As a result, the defined proxies are often inadequate to truly capture the core elements that define letterbox companies. Nevertheless, this section presents indicators from all three categories (identification indicators, financial indicators, and corporate obligations), with a special focus on address and the availability of annual accounts, as they are the most significant in detecting possible letterbox companies.

Companies marked with a red flag cannot be automatically considered as letterbox companies. Indeed, such flags are only proxies of aspects of letterbox companies, and each company should be analysed individually and in more detail. Different indicators and 'red flags' could be used, depending on the abusive behaviour to be identified in each of the sectors of this study. The characteristics of companies used for tax evasion and money-laundering purposes would be similar, making it logical to combine information sources in both areas to enhance a risk assessment model. Non-financial data, such as address and information related to the company (data availability, filing information), may be even more important than financial indicators. In contrast, in the case of tax avoidance, financial indicators would be more suitable, as these would help to point to ATP. In the case of VAT carousel fraud, transaction data is used in the risk assessment process (see next section). Finally, using indicators on the numbers of employees or labour costs could be useful to identify abusive behaviour in the area of employment and social security law, including social dumping.

In addition to using different indicators depending on the sector, different sources should also be considered. Information on red flags could come from a wide range of sources, not solely company databases. An interesting example is the beneficial ownership registers at EU level, which were put in place by the 4th and 5th Anti-Money Laundering Directive (AML Directive) and which should be applicable as of 10 January 2020⁹⁸. These registers can serve as a useful source of information to identify letterbox companies, especially in the domains of money laundering and tax evasion. For instance, the larger the network and the longer the chain of controlling entities, the higher the risk of money laundering and tax evasion, as this makes it easier to disguise the true controlling entity. In these situations, registers provide a key tool to uncover the beneficial owner.

The number of letterbox companies in the EU could not be found on the basis of this exercise and this represents the most significant limitation of this analysis. In addition, not all risk indicators defined on the basis of European/national legislation and the literature review could be used in the Orbis database. There may also be a large difference between companies with one or more red flags detected on the basis of Orbis and the actual number of letterbox companies that are detected by inspection services in practice. In this respect, the analysis could be further developed by Member States to create a risk assessment model that uses information on abuses by letterbox companies within their own jurisdiction ('training data') to develop a model to identify risk characteristics or variables that would help to predict abusive behaviour by letterbox companies.

⁹⁷ In Orbis the variables 'export revenue' (i.e. turnover abroad) and 'Export revenue / Operating revenue' (turnover abroad is compared to the total turnover) are available. However, these data are only available for less than 1% of the companies.

⁹⁸ This is elaborated further on in section 6.2. Some Member States already have beneficial ownership databases or registers in place since some years ago (FATF, 2019) such as Spain for instance (FATF, 2018). European Commission (n.d). Anti-money laundering and counter terrorist financing. Available at https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counter-terrorist-financing_en. Accessed on 9 March 2020.

The effectiveness of such a model could be assessed by looking at how well it predicts such behaviour. Four possible outcomes are: 1) True positive (TP): when data correctly predicts that there is an abusive letterbox company; 2) True negative (TN): when data correctly predicts that there is no abusive letterbox company; 3) False positive (FP): when data falsely predicts that there is an abusive letterbox company but in fact there is not; 4) False negative (FN): when data does not alert the presence of an abusive letterbox company. Such models and their verification go beyond the scope of the current research.

Due to certain limitations in Orbis (see Annex A3.1.1 and A3.4.2), it is only possible to examine a limited number of indicators and red flags:

- Address: when multiple companies are located at the same address, it is possible that no substantial activities are going on at this location;
- Financial indicators: the lack of economic activity is captured by looking at the amount of turnover per employees, pre-tax corporate profit per employees, and loans per employees;
- Data availability and filing of annual accounts: when the reporting obligations are not fulfilled or certain information is missing from annual accounts, this could indicate the existence of a letterbox company.

These indicators were chosen as they could be analysed extensively in the Orbis database and represent all three groups of indicators that were identified (identification indicators, financial indicators, and corporate obligations).

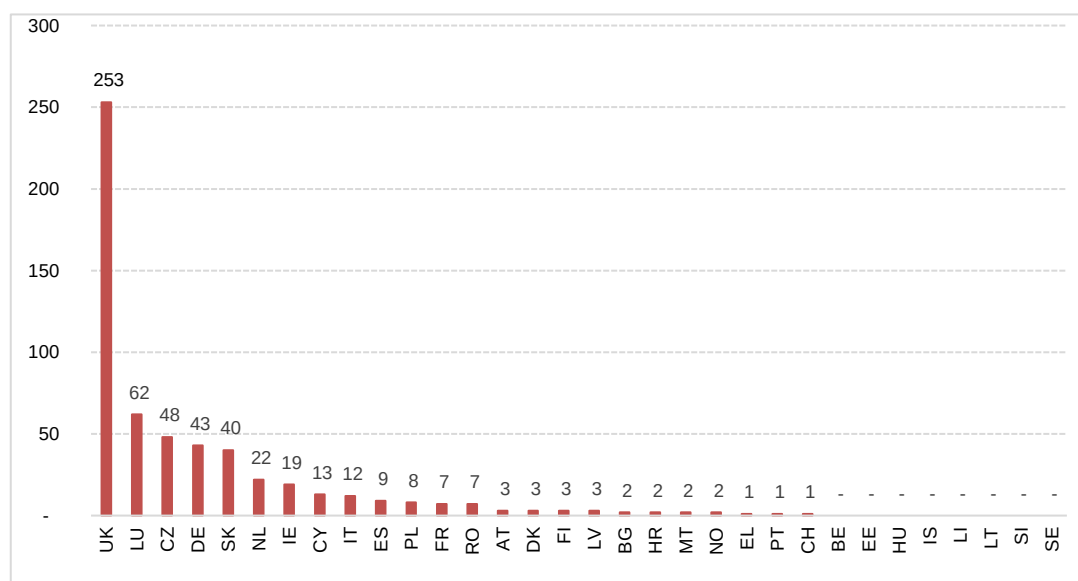
The analysis was performed on companies located in the EU-28 with a foreign majority shareholder located in the EU-28. The differences between this group and companies with a foreign majority shareholder outside the EU are relatively small (see Section 3.2.1). More importantly, this section on red flags only examines risk indicators to identify possible letterbox companies, without intending to provide an exact number. It is thus sufficient to perform the analysis on the dataset of companies located in the EU-28 with a foreign majority shareholder located in the EU-28.

3.2.3.1 Address

One of the relevant indicators to identify possible letterbox companies is the address of the company. When multiple companies are located at the same address, this could indicate that there are no substantial activities at the location and that the company merely functions as a letterbox.

An interesting overall view for the companies located in the EU-28 with a foreign majority shareholder in the EU-28 is presented in the two figures below. Figure 7 shows the number of addresses where more than 100 companies were located. The UK stands out, with more than 250 addresses with an abundance of companies registered there. Luxembourg, Czechia, Germany and Slovakia also had 40 or more addresses where more than 100 companies with a foreign majority EU-28 shareholder are located.

Figure 7. Number of addresses where more than 100 companies with a foreign majority shareholder in the EU-28 are located



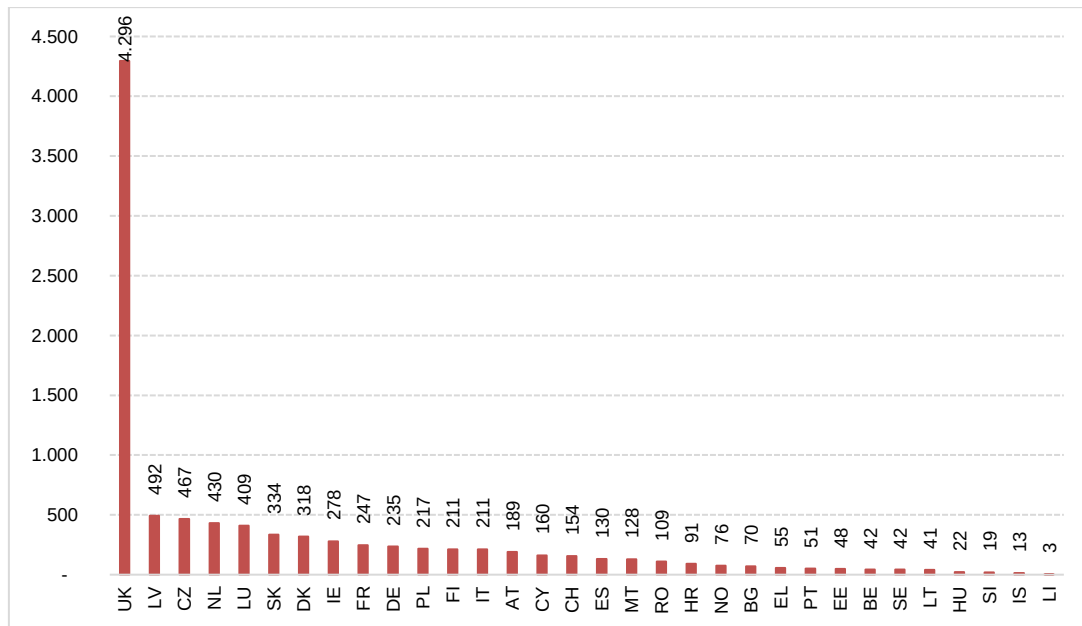
* Data extracted on 19 June 2019

Source: Own elaborations based on Orbis

Figure 8 shows the highest number of companies that are located at one particular address, for companies with a foreign EU-28 majority shareholder. Again, the UK was an outlier, with over 4 200 companies located at a single address. When looking at Figure 8 in combination with Figure 7, it is clear that the number of companies at the other 252 addresses in the UK where more than 100 companies are located will likely be in the vicinity of thousands rather than hundreds.

In Latvia, Czechia, the Netherlands, Luxembourg, Slovakia and Denmark, the addresses with the highest number of companies accommodated more than 300 companies. However, even on the right-hand side of the figure, an address with more than 20 companies is notable, as the numbers discussed here only entailed companies with a foreign majority shareholder located in the EU-28. Domestic companies, or companies with a foreign majority shareholder outside of the EU-28 are likely to be located at these addresses too, inflating the numbers further.

Figure 8. Highest number of companies with a foreign majority shareholder located in the EU-28 at a single address



* Data extracted on 19 June 2019

Source: Own elaborations based on Orbis

Annex A3.4.3 details the analysis of the address indicator for the two outlying Member States (Luxembourg, Slovakia) and the UK. The most significant findings are discussed below.

United Kingdom

In the UK, more than 15 000 companies appeared to be located at the same few addresses, with one address linked to more than 30 000 companies (see Annex 3 – section A3.4.3). This particular address also surfaced in the Paradise Papers, leaked files that exposed the offshore financial activities of multinationals and private persons to avoid taxes⁹⁹.

As to the companies with a foreign majority shareholder located at certain addresses, Figure 8 shows that in the UK, no less than 4 296 companies with a foreign majority shareholder were housed at the same address.

As discussed previously and shown in Figure 5, around 9.9% of companies located in the UK had a foreign majority shareholder. However, at the addresses that emerged from the research, this percentage was (much) higher. This means that addresses where many companies are located were disproportionately favoured by companies with a foreign shareholder. In the case of one address, almost 96% of the companies located there had a foreign majority shareholder.

A special focus can also be placed on companies with NACE-code 4941 'Freight transport by road', as companies active in this field need to comply with certain requirements set out in Regulation (EC) No 1071/2009, such as having an effective and stable establishment and having appropriate financial standing (see Annex A3.4.1.3 for detail). More specifically, companies with a foreign majority shareholder located in the EU-28 active under NACE-code 4941 were investigated. At certain addresses, more than 100 companies with this NACE-code were stationed, of which more than half sometimes had a foreign majority

⁹⁹ International Consortium of Investigative Journalists (2019). Offshore leaks database. Available at: <https://offshoreleaks.icij.org/nodes/58011078>. Accessed on 1 July 2019.

shareholder located in the EU-28. This analysis is further developed in the case study on road transport (see Annex 4). It is interesting to see that the same addresses surfaced in other studies examining possible letterbox companies. For instance, a study on the Belgian road freight transport sector within a European context encountered similar addresses to those in the present study¹⁰⁰.

Luxembourg

In Luxembourg, more than 100 companies were located at certain addresses, with many having a foreign majority shareholder. As can be seen in Figure 5, Luxembourg was the Member State with the highest share of companies (26.6%) with a foreign majority shareholder. Although this number is already high overall, the share of companies with a foreign majority shareholder of the total number of companies located at one address for the addresses that were investigated all exceeded 30%. This makes it clear that these addresses are particularly attractive for companies with a foreign majority shareholder compared to companies with a domestic majority shareholder.

Certain addresses that were investigated were also encountered in the Luxembourg leaks¹⁰¹. These leaked files showed how big companies had disclosed secret tax deals in Luxembourg. These confidential tax rulings from Luxembourg officials assured companies they would get favourable treatment for their tax-saving manoeuvres¹⁰².

Slovakia

Although in absolute numbers, the average total number of companies based at one address in Slovakia was lower than for the top addresses in the UK and Luxembourg, it is nevertheless striking to see several hundred companies located at the same address.

It is also noteworthy that some addresses seemed to be favoured more by companies with a foreign shareholder located in the EU-28, whereas other are favoured by companies with a foreign shareholder outside the EU-28. Overall, as was the case for the UK and Luxembourg, companies located at a commonly used address were disproportionately likely to be foreign-owned companies than domestic companies. In Slovakia, 14.5% of companies, on average, had a foreign majority shareholder (see Figure 5), whereas at some of the investigated addresses, the share of companies with a foreign majority shareholder surpassed 70%.

An analysis of companies with a foreign majority shareholder in the EU-28 active under NACE-code 4941 again showed that certain addresses are popular for companies in the transport sector, especially foreign-owned companies. In addition, these addresses are frequently encountered in literature about possible letterbox companies (see, for instance,

¹⁰⁰ De Wispelaere, F. and Pacolet, J. (2018) Economic analysis of the road freight transport sector in Belgium within a European context: Employees and employers in 'survival mode'? Report, HIVA-KU Leuven. Available at: <https://hiva.kuleuven.be/nl/nieuws/docs/hiva%20report%20economic%20analysis%20of%20the%20road%20freight.pdf>. Accessed on 23 May 2019.

¹⁰¹ Obermayer, B. (2014, December 5). Day in a Fiscal Paradise: Chasing Letterbox Leads in Luxembourg. International Consortium of Investigative Journalists. Available at: <https://www.icij.org/investigations/luxembourg-leaks/day-fiscal-paradise-chasing-letterbox-leads-luxembourg/>. Accessed on 10 July 2019.

¹⁰² Fitzgerald, A., and Walker Guevara, M. (2014, December 9). New Leak Reveals Luxembourg Tax Deals for Disney, Koch Brothers Empire. International Consortium of Investigative Journalists. Available at: <https://www.icij.org/investigations/luxembourg-leaks/new-leak-reveals-luxembourg-tax-deals-disney-koch-brothers-empire/>. Accessed on 10 July 2019.

a study about the Belgian road freight transport sector¹⁰³, or the black book by the Belgian transport union on social dumping in Slovakia¹⁰⁴)

3.2.3.2 Financial indicators

The financial indicators chosen for the analysis focus specifically on capturing the lack of economic activity, as they try to measure the 'substance' of companies. Other financial ratio indicators are widely used to identify tax avoidance and ATP but are not a focus here¹⁰⁵.

Several financial indicators were examined in order to capture the lack of economic activity: turnover per employees, pre-tax corporate profit per employees, and loans per employees. All three showed a clear difference between domestic companies and foreign-owned firms, with the average value always considerably higher for the latter. For instance, the median value of both turnover per number of employees and pre-tax corporate profit per number of employees for foreign-owned companies was more than double that of domestic companies.

This difference can also be explained by the different profiles of the companies. Companies with a foreign majority shareholder are more likely to be MNEs with a higher turnover and profit and greater loans, automatically causing them to have higher values for these indicators. They could also be active in certain sectors that result in high values for those variables. For instance, companies that are active as holding companies need substantially fewer employees than other companies.

The exhaustive analysis of the financial indicators (see Annex A3.4.4) shows that in general, a high share of companies with a foreign shareholder located in the EU-28 that were outliers for all three financial indicators were located in the UK, Ireland, Portugal and Belgium (see Figure 27 in Annex A3.4.4.4). They were active in the fields of real estate or building projects, activities of head offices, business support service activities and the production of electricity (see Table 38 in Annex A3.4.4.4). However, for certain activities it is plausible that the financial indicators are higher than normal (see Section 3.2.1). For instance, the average turnover per number of employees will be higher for a company in the financial sector than for companies in other sectors¹⁰⁶.

Overall, the analysis of financial indicators was not a clean capture of lack of economic activity and did not immediately identify possible letterbox companies. On the one hand, they only revealed one side of the company profile, such as the fact that companies with certain values of financial indicators are MNEs and/or active in certain sectors where these financial indicators are common (e.g. holding companies). On the other hand, much of the data was lacking, weakening the analysis. The unavailability of data can itself be an indicator and is discussed in the next section.

¹⁰³ De Wispelaere, F. and Pacolet, J. (2018) Economic analysis of the road freight transport sector in Belgium within a European context: Employees and employers in 'survival mode'? Report, HIVA-KU Leuven. Available at: <https://hiva.kuleuven.be/nl/nieuws/docs/hiva%20report%20economic%20analysis%20of%20the%20road%20freight.pdf>. Accessed on 23 May 2019.

¹⁰⁴ Belgische Transport Bond (2017). The road to Slovakia – Social dumping: this is how it works. Available at: https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek-2017-ENG-DIGITAAL.pdf. Accessed on 4 July 2019.

Belgische Transport Bond (2019). The road to Slovakia is still busy. The ABC of social dumping and how nothing has changed... The BTB continues to investigate. Retrieved from https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek_2019_EN_WEB.pdf

¹⁰⁵ For example, if gross profit margin or operating profit is low for a company compared to companies in its sector (See, for instance, OECD, 2017).

¹⁰⁶ A statistical analysis taking into account the NACE-code, country of incorporation, foreign ownership or not, MNE or not, etc. as independent variables and the financial ratio in question as the dependent variable would be useful in this regard. However, this goes beyond the scope of this report.

3.2.3.3 Data availability and the filing of annual accounts

Paradoxically, the companies that emerged with a red flag may not be those with the highest probability of being a letterbox company, as the companies that actively seek to stay under the radar are often those of greatest interest. When seeking to identify letterbox companies, it may be equally important to look at companies for which certain information is not available or for which there is no information at all – for letterbox companies engaging in abusive/illegitimate behaviours, not providing any information is a simple but efficient technique for concealment purposes.

It is very difficult to understand whether the lack of data on a company is a deliberate omission by the company or if this is because it is not required to provide that information. In the Orbis database, the uneven availability of data and the lack of ownership information is generally attributed to differences in filing requirements between the different countries.

Directive 2017/1132 specifies that limited liability companies need to disclose their annual accounts in the national business registers. It sets out that companies have to provide their accounting documents for each financial year, which are required to be published in accordance with Council Directives 86/635/EEC and 91/674/EEC and Directive 2013/34/EU of the European Parliament and of the Council. However, several exceptions can be found in Directive 2013/34/EU regarding the types of companies that fall within its scope. For instance, Article 14 sets out simplifications for SMEs regarding their balance sheets and loss account, and Article 23 states there are certain exemptions for consolidated financial statements and reports. Article 31 specifies simplifications for SMEs with regard to their profit and loss accounts and management reports, and Article 36 establishes that Member States may exempt micro-undertakings from certain filing requirements. It is worth noting that Member States can always go beyond the requirements set out in these Directives by requiring more information. Therefore, substantial differences exist between Member States; in the types of companies that must report and the kind of information that has to be filed. For instance, based on previous research¹⁰⁷ and the Orbis internet user guide¹⁰⁸, in Bulgaria, less than 10% of all active companies are legally obliged to file their accounts due to the existing filing requirement.

The annual accounts of small companies and subsidiaries are often more limited, as they have less strict filing obligations in terms of content and scope, as also discussed in Section 5.1. It is noted that the filing of more details on financial accounts often occurs on a voluntary basis when firms fall below a certain size threshold, in order to reduce the administrative burden¹⁰⁹. An example is Belgium, where smaller companies only have to file a shortened annual account, excluding certain information¹¹⁰.

Orbis relies on administrative information in business registers which are very comprehensive in some countries but more limited in others. In terms of overall coverage, it is found that larger firms were often better represented in the Orbis database¹¹¹. This conclusion was shared further when considering companies located in low-income jurisdictions or no-corporate-tax jurisdictions as they are less likely to be included in the

¹⁰⁷ Kalemli-Ozcan, S., Sorensen, B., Villegas-Sanchez, C., Volosovych, V., and Yesiltas, S. (2015). How to construct nationally representative firm level data from the Orbis global database, NBER Working Paper series. Available at: <https://www.nber.org/papers/w21558.pdf>. Accessed on 28 June 2019.

¹⁰⁸ Bureau van Dijk. (2017). Orbis Internet User Guide. Available at: <https://www.bib.uni-mannheim.de/fileadmin/ub/pdf/Fachref/BWL/OrbisInternetUserGuide.pdf>

¹⁰⁹ Rungi, A., Morrison, G., and Pammolli, F. (2018). Global Ownership and Hierarchies of Firms. 'What is essential is invisible to the eye'. Available at: <https://www.aeaweb.org/conference/2019/preliminary/paper/rbKyH49Y>

¹¹⁰ Merlevalde, B., De Zwaan, M., Lenaerts, K. and Purice, V. (2015). Multinational Networks, Domestic, and Foreign Firms in Europe. Working Paper: University of Ghent. Available at: http://wps-feb.ugent.be/Papers/wp_15_900.pdf

¹¹¹ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

Orbis database¹¹². The companies included in Orbis are on average larger, older and more productive¹¹³.

With regard to ownership information, while providing information on shareholders is compulsory in some jurisdictions¹¹⁴, there is no general requirement at EU-level to publicly disclose shareholders, which could be one of the reasons for this information sometimes being missing. In particular, intermediate ownership links are not completely observable in Orbis¹¹⁵. As a result, it is not possible to see whether the global ultimate owner of a firm owns this firm directly or through an intermediary company, possibly in another country. An example is provided in a research, according to which 'the dataset may report that firm A controls 100% of firm B, and that firm B controls 100% of firm C. This implies that A also controls 100% of firm C, but this link may not always be reported in the original ownership tables'¹¹⁶. Finally, the ownership indicator is not time varying, meaning that changes in ownership cannot be detected¹¹⁷. Each year, approximately 5-10% of firms enter the Orbis ownership data and up to 4% leave¹¹⁸. Thus, while the data coverage improves substantially over time, there are certain challenges with measuring changes in ownership over time.

Aside from the varying filing requirements, it is possible that companies deliberately do not file their annual accounts, which can be a sign that the company is only active on paper – a 'ghost company'¹¹⁹. In itself, a dormant company is not fraudulent, but can be considered the ideal vehicle for fraud¹²⁰. Some studies mention that dormant companies are often a cover-up for tax fraud, drug trafficking and the financing of terrorism¹²¹. These ghost companies are often found to present a serious threat to the economy¹²².

In this regard, it might be useful to look at data available in Orbis. The classification used in the Orbis database gives the following definition of 'Active (dormant)' companies: 'The company is still registered but has no significant activity (and no significant accounting transactions during the accounting period). Companies may be dormant for various reasons, for example, to protect a company name, in readiness for a future project, or to

¹¹² Nakamoto, T., Chakraborty, A. and Ikeda, Y. (2019). Identification of key companies for international profit shifting in the Global Ownership Network. *Applied Network Science* 4(58), pp. 1-26. <https://doi.org/10.1007/s41109-019-0158-8>

¹¹³ Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C., & Timmis, J. (2020). Coverage and representativeness of Orbis data. *OECD Science, Technology and Industry Working Papers* 2020/06. <https://doi.org/10.1787/18151965>

¹¹⁴ Rungi, A., Morrison, G., and Pammolli, F. (2018). Global Ownership and Hierarchies of Firms. 'What is essential is invisible to the eye'. Available at: <https://www.aeaweb.org/conference/2019/preliminary/paper/rbKyH49Y>

¹¹⁵ Cravino., J. and Levchenko, A. (2016). Multinational Firms and International Business Cycle Transmission. Working Paper 22498. Available at: <https://www.nber.org/papers/w22498.pdf>

¹¹⁶ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017:48). Tax planning by multinational firms: firm-level evidence from a cross-country database. *OECD Economics Department Working Papers*, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

¹¹⁷ Cravino., J. and Levchenko, A. (2016). Multinational Firms and International Business Cycle Transmission. Working Paper 22498. Available at: <https://www.nber.org/papers/w22498.pdf>

¹¹⁸ Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C., & Timmis, J. (2020). Coverage and representativeness of Orbis data. *OECD Science, Technology and Industry Working Papers* 2020/06. <https://doi.org/10.1787/18151965>

¹¹⁹ Greydon estimated the number of ghost companies in Belgium at around 350 000, while the federal administration counted around 130 000 (Lusysteman, 2018). In addition to looking at companies that did not file their annual accounts, Greydon analysed parameters such as the availability of a telephone number, website or email address, whether the same annual account is filed each year, and employee recruitment.

¹²⁰ Van den Broele, E. (2017, November 13). Overheid moet zich beter wapenen tegen spookbedrijven. Graydon. Available at: <https://graydon.be/blog/overheid-moet-zich-beter-wapenen-tegen-spookbedrijven>

¹²¹ Bové, L. (2018, September 12). Gerecht houdt klopjacht op tienduizenden spookbedrijven. *De Tijd*. Available at <https://www.tijd.be/politiek-economie/belgie/algemeen/gerecht-houdt-klopjacht-op-tienduizenden-spookbedrijven/10048432.html>. Accessed on 8 August 2019.

¹²² Ibid. Van den Broele, E. (2017, November 13). Overheid moet zich beter wapenen tegen spookbedrijven. Graydon. Available at: <https://graydon.be/blog/overheid-moet-zich-beter-wapenen-tegen-spookbedrijven>

hold an asset or intellectual property. A company can remain dormant for as long as necessary – indefinitely if, for example, its purpose is just to prevent the name being used by another company. However, there are expenses associated with keeping a company on the register¹²³.

Table 12 provides an overview of the number of companies that were dormant compared to the total number of active companies. The column on the right includes all active companies, which encompasses multiple subsections¹²⁴, while the second column presents the truly active companies. It is clear that foreign-owned companies were more often classified as dormant than domestic companies, at 6% and 2% of the total number of active companies, respectively.

Table 12. Share of companies located in the EU-28 with a foreign majority shareholder located in the EU-28 (foreign-owned companies) and companies located in the EU-28 without a foreign majority shareholder (domestic companies)

	Active	Active (dormant)	All active companies
Foreign-owned companies	93.1% (n = 688 278)	5.9% (n = 43 434)	100.0% (n = 739 346)
Domestic companies	97.1% (n = 25 112 510)	2.2% (n = 575 183)	100.0% (n = 25 873 070)

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

Despite the significant difference between domestic and foreign-owned companies, this result should be interpreted with some caution, as definitions of dormant companies differ between countries (Bureau van Dijk, personal communication, 12 July 2019). The Orbis definition is general rather than practical, as it does not refer to any illegal use of the dormant status. It also does not include any specific time variable. For instance, in Belgium, a law on ghost companies¹²⁵ makes it possible for the court to request the dissolution of a company when seven months after the deadline, the annual report has still not been filed¹²⁶. As this time variable differs between Member States, it is not possible to draw a general conclusion.

However, the filing of annual accounts can be an important indicator to identify possible letterbox companies. For instance, companies that do not file accounts although they have the legal requirement to do so could be an indication of fraud, concealment or financial difficulties (see Section 5.1.5.2).

¹²³ Orbis. (n.d.). Company status definitions. Orbis. Available at: https://help.bvdinfo.com/LearningZone/Products/orbis4.1/Content/I_Data/Company/CompanyStatus.htm?Highlight=active

¹²⁴ The group of Active companies consists of Active, Active (rescue plan), Active (default of payment), Active (insolvency proceedings), Active (reorganisation) and Active (dormant).

¹²⁵ Law amending various laws in order to supplement the judicial winding-up procedure for companies of 17 May 2017 (*Wet tot wijziging van diverse wetten met het oog op de aanvulling van de gerechtelijke ontbindingsprocedure van vennootschappen*), available at: https://www.ejustice.just.fgov.be/cgi_loi/loi_a.pl?N=&sql=%28text+contains+%28%27%27%29%29&language=nl&rech=1&tri=dd+AS+RANK&value=%3D&numero=1&table_name=wet&cn=2017051711&caller=image_a1&fromtab=wet&la=N.

¹²⁶ Previously, a Belgian company could only be classified as sleeping when it did not file the annual account three years in a row. Partly as a result of this new law, 15.8% more companies were declared bankrupt in the first half of 2019 compared to 2018 (Moijsman, 2019). Moijsman, R. (2019, July 2). Faillissementsrecord verbroken. De Standaard. Available at https://www.standaard.be/cnt/dmf20190701_04488607. Accessed on 8 August 2019.

A study conducted on behalf of the European Commission analysed data availability in different databases, including Orbis and the Amadeus database, which is the European subset of Orbis¹²⁷. This study found that the use of local databases versus Amadeus or Orbis did not have a material impact on the search and that the availability of data had consistently increased since 2010. The study showed that for 69% of companies in the EU-28, the independence indicator¹²⁸, turnover data and operating profit data was available, although this level varied widely across Member States, ranging from 25% to 89%¹²⁹.

The analysis presented in this study shows that data on turnover was available for 37% of all EU-28 companies with a foreign shareholder in the EU-28 and the data on profit or loss before tax is available for 39% (see Table 13). This could possibly be connected to Article 31 of the Accounting Directive, which allows small companies not to disclose their turnover. However, the sample analysed in the two studies is different, as the analysis under this study included all EU-28 companies with a foreign EU-28 shareholder, while the above-mentioned study¹³⁰ only examined EU-28 companies with sales of over EUR 5 million. One recommendation made in the study mentioned above was further harmonisation, which could improve the quality and availability of data¹³¹.

Table 39 in Annex A3.4.5 compares the availability of annual accounts of foreign-owned and domestic companies. It is notable that for 3 056 foreign-owned companies and 208 872 domestic companies, equalling to 0.4% of total foreign-owned companies and 0.8% of total domestic companies, 2010 were the latest annual accounts available. This indicates that the lack of accounts is a problem for both groups. The annual accounts of 2016 were available for 53% of foreign-owned companies and 38% of domestic companies. Furthermore, 25% of foreign-owned companies had annual accounts available in the years 2010 until 2016, whereas this share dropped to 16% for domestic companies, again indicating that the (non-)availability of annual accounts is a general problem and not only reserved for foreign-owned companies. Proportionally more domestic firms do not file their annual accounts (compared to foreign-owned companies), but the reasons for this are not clear. This unavailability of annual accounts also contributes to the lack of data in Orbis.

In addition to the filing of the annual accounts, it is interesting to look at the information available in the accounts. Table 13 presents the number of companies located in the EU-28 with a foreign majority shareholder in the EU-28 for which a certain variable was not available in the Orbis database. For some variables, the lack of information is clear. For turnover, number of employees and profit or loss before tax, more than 60% of companies did not have data available. Even for variables where data availability is sufficient overall, not all companies had data available. For example, there were over 2 500 companies whose country of establishment was not known/recorded. This is not solely due to a breach in reporting obligations but could stem from exemptions in certain regulations. It is also possible that this data is reported but not taken up by the Orbis database.

¹²⁷ Peeters, R., Noben, S., and Laurent, I. (2016). Study on comparable data used for transfer pricing in the EU. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/d16d2635-c685-11e6-a6db-01aa75ed71a1>. Accessed on 14 October 2019.

¹²⁸ This indicator was created by Bureau van Dijk and assists users in identifying independent companies, showing the degree of independence of a company with regard to its shareholder. This variable was not employed in the current research.

¹²⁹ Peeters, R., Noben, S., and Laurent, I. (2016). Study on comparable data used for transfer pricing in the EU. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/d16d2635-c685-11e6-a6db-01aa75ed71a1>. Accessed on 14 October 2019.

¹³⁰ Ibid.

¹³¹ Ibid.

Table 13. Number of companies located in the EU-28 with a foreign shareholder in the EU-28 for which certain information was not available

Variable	Number of companies with no information available	Share of total number of companies
ISO code – country of incorporation	2 517	0.4%
NACE-code	43 625	6.5%
Address	13 820	2.1%
Postcode	48 847	7.3%
City	11 498	1.7%
Last year available – annual accounts	165 257	24.5%
Date of incorporation	14 675	2.2%
Turnover	423 776	62.9%
Number of employees	439 039	65.2%
Profit/loss before tax	409 449	60.8%
Loans	329 705	48.9%
Total number of companies	673 577*	100.0%

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

When looking at companies located in the EU-28 with a foreign shareholder in the EU-28, there were 216 207 companies that did not have any financial variable available (turnover, profit or loss before tax, loans and number of employees, see Annex A3.4.5) in the Orbis database. In absolute terms, most of these companies were located in the UK, Luxembourg, the Netherlands and Romania (see Figure 29 in Annex A3.4.5). In relative terms, compared to the total number of companies with a foreign majority shareholder in the EU-28, Cyprus, Luxembourg and the Netherlands stood out. In these Member States, more than 50% of the total number of foreign-owned companies did not have information available on turnover, employees, loans, and pre-tax profit or loss. In the UK, Austria, Bulgaria and Croatia, more than 30% of the companies with a foreign majority shareholder in the EU-28 did not have this information available. Finally, almost 18% of these 216 207 companies did not have a NACE-code available (see Table 40 in Annex A3.4.5) and almost 13 000 companies in this sample were active in the road transport sector.

3.3 Main findings

The analysis shows that it is not possible to present a single figure for the number of letterbox companies located in the EU. Firstly, the set-up and use of letterbox companies often differs depending on the context, sector, and area of law (see Section 4). For instance, letterbox companies used for tax avoidance and those used to circumvent social security law might look very different. To identify the former, the focus should be on financial indicators, while the latter require attention to be paid to indicators such as the number of employees or labour costs.

Secondly, and while it is possible to define indicators and their respective red flags - which could help identifying possible letterbox companies - only a few could be analysed through the Orbis database. This is largely due to the fact that some data is not available in the Orbis database, which, inter alia, could be caused by the exemptions regarding the annual accounts in Member States (e.g. micro companies might be exempted from disclosing the number of employees). Nor was it always possible to establish red flags. For instance, investigating the cross-border element of letterbox companies needs information on where the turnover of a company was created, information that the Orbis database cannot provide.

Overall, the **analysis sheds light on the likelihood of the presence of letterbox companies in certain Member States and fields of activity**, while highlighting the limitations of the research method adopted. The findings could be further used to develop a risk assessment model to detect letterbox companies to explore and quantify certain meaningful indicators and their respective red flags. As noted earlier, companies with a red flag cannot be automatically considered to be letterbox companies, but multiple red flags could provide a strong indication for such classification.

Further efforts to quantify the phenomenon would require better information collection, recording and processing, as well as the creation of linkages between different sources. **Further harmonisation** of some aspects related to annual accounts would already make a significant difference. The main issue here is the absence of data and values for certain companies, meaning it could be useful to further streamline the filing of accounts and better follow-up the quality of the data provided. This would allow for better monitoring of risks. Models for risk monitoring should be tailored to the specific requirements of each Member State and take into account the different indicators for the types of letterbox companies in each case (tax evasion, tax avoidance, social security dumping, etc.).

Finally, improvements could be made concerning data to **measure the defined indicators and red flags**. Firm data on the creation of turnover divided by country of incorporation and abroad would be worthwhile,¹³² for example, as it would allow the competent authorities to investigate where turnover was created and thus truly capture the lack of economic activity.

Finally, capturing the phenomenon in a single figure would oversimplify its complexity, in terms of its interwovenness in a complex network of companies established in different countries and sectors, as well as its detection and prevention. Seeing that letterbox companies come in all sizes and shapes, a sectoral approach is thus warranted.

¹³² Currently, such data are to a very limited extent available in Orbis.

4 Uses of letterbox companies

This section explores the way letterbox companies operate and builds on the previous sections that described the phenomenon¹³³.

The focus here is on the different uses that can be made of letterbox companies, starting with a discussion of the Single Market, its four fundamental freedoms and, more specifically, **the role of the freedom of establishment** and its interpretation when assessing the phenomenon of letterbox companies. It is followed by a description of the various **circumstances impeding the clear distinction between the uses** of letterbox companies and an overview of the different existing types of uses of letterbox companies.

4.1 The EU Single Market and the interpretation of the freedom of establishment in distinguishing between abusive and non-abusive uses

Over the past decades, the development of the Single Market has been the cornerstone of European integration and a key driver of economic growth. Its creation paved the way for a peaceful and stable future in Europe, bringing with it social and political benefits. At the same time, it yielded distinct economic benefits, including cost reductions through the elimination of border tariffs and regulatory barriers. This offered possibilities for companies to take advantage of larger markets and optimise their cross-border productive structures and logistics, resulting in important economies of scale, as well as efficiency gains due to competitive pressure. Lastly, the Single Market boosted labour and capital mobility, reducing financial transaction costs¹³⁴.

The Single Market is based on the four fundamental Treaty freedoms (freedom of movement of goods, services, capital and persons) and combines both **negative and positive integration** measures to ensure its proper functioning¹³⁵.

Articles 49 and 54 of the Treaty guarantee the **freedom of establishment** in the EU. Article 49 TFEU provides that 'restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited' and Article 54 clarifies that companies 'formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union' enjoy the freedom of establishment in the same way as EU nationals'. The definition of companies (and other firms) includes those 'constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law'. Consequently, any company validly formed under the laws of any Member State is to be treated the same way as a natural person and is entitled to exercise its freedom of establishment¹³⁶. It is settled case-law that all measures that prohibit, impede or render less attractive the exercise of freedom of establishment must be

¹³³ Letterbox companies as entities not performing any economic activity in the country of incorporation, either because i) they do not conduct any - or hardly - economic activity at all, or because ii) they are solely active in another country than the country where the company is registered, thus performing cross-border activities.

¹³⁴ Bertelsmann Stiftung, *Estimating economic benefits of the Single Market for European countries and regions*, Position paper, 2019, available at:

https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/EZ_Study_SingleMarket.pdf; LE Europe, *The EU Single Market: Impact on Member States*, Study for the American Chamber of Commerce to the EU, 2017, available at: http://www.amchameu.eu/sites/default/files/amcham_eu_single_market_web.pdf; Micossi, S., 'Thirty Years of the Single European Market', in BEEP N° 41, 2016.

¹³⁵ Pelkmans, J., 'The economics of Single Market regulation', in BEEP N° 25, 2012.

¹³⁶ C-182/83 Robert Fearon and Co Ltd v Irish Land Commission [1984] ECR 3677, [8].

considered to be restrictions on the freedom of establishment¹³⁷, which can only be applied if duly justified and proportionate (see discussion below).

While there is no clear and complete legal definition of the **concept of 'establishment'**¹³⁸, the CJEU has specified the scope of this freedom in its extensive case-law. According to the CJEU case-law, the concept of 'establishment' within the meaning of these articles is very broad, allowing Union nationals and companies covered by Article 54 to participate, on a stable and continuous basis, in the economic life of another Member State and to profit therefrom¹³⁹.

It involves the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period¹⁴⁰. In order to claim freedom of establishment, it is generally necessary to have secured a permanent presence in the host Member State¹⁴¹. This case-law can, generally speaking, be translated as 'no freedom of establishment without establishment'¹⁴².

One area in which the CJEU has had to repeatedly define the extent of this freedom is company law. Over the past two decades, the Court has made a series of decisions to clarify the extent to which companies can exercise their freedom of establishment. In the **Centros decision**, the Court held that **a company validly incorporated in a Member State can enjoy freedom of establishment**¹⁴³ and that **it is immaterial that the company was formed in one Member State only for the purpose of establishing itself in another Member State**, where its main or entire business is to be conducted. The right to form a company in accordance with the law of a Member State and to set up branches in other Member States is inherent to the exercise of the freedom of establishment guaranteed by the Treaty¹⁴⁴. The CJEU's jurisprudence means that a company enjoys the freedom of establishment as long as it complies with all incorporation requirements for the formation of the company in the Member State of registration and provided that it also observes the requirements for its continued existence¹⁴⁵. In this context, CJEU jurisprudence makes it clear that the connection between a company and the jurisdiction of incorporation does not have to go beyond what is required under the relevant (national) company law. As the Court already explained in its *Segers* judgment¹⁴⁶, and reiterated in *Centros*, the mere fact that a company does not conduct any business in the country of incorporation '*is not sufficient to prove the existence of abuse or fraudulent conduct*'.

¹³⁷ European Parliament, Study for the JURI Committee: The Polbud judgment and the freedom of establishment for companies in the EU (2018), available at:

[https://www.europarl.europa.eu/RegData/etudes/STUD/2018/608833/IPOL_STU\(2018\)608833_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2018/608833/IPOL_STU(2018)608833_EN.pdf)

¹³⁸ Ryszka, J., *Social dumping and letterbox companies – interdependent or mutually exclusive concepts in European Union law?* 2016, available at: doi: 10.7420/pyil2016j.

¹³⁹ Gebhard C-55/94 para. 25 and Almelo C-470/04 para. 26.

¹⁴⁰ Factortame and Others, C-221/89, para. 20 and Commission v United Kingdom, C-246/89, para. 21.

¹⁴¹ Centro di Musicologia Walter Stauffer, C-386/04, para. 19 and Schmelz, C-97/09, para. 38

¹⁴² CJEU in Centro di Musicologia Walter Stauffer, C-386/04, para. 19 and Schmelz, C-97/09, para. 38

¹⁴³ For a recent discussion, see Gerner-Beuerle et al., 'The illusion of motion: corporate (Im-) mobility and the failed promise of Centros', *European Corporate Governance Institute-Law Working Paper*, 2019, 458.

¹⁴⁴ Centros C-212/97 para. 17.

¹⁴⁵ On the latter requirement, see judgments in *Daily Mail* (Case 81/87) and *Cartesio* (C-210/06). See, for example, Korom, V. and Metzinger, P., 'Freedom of establishment for companies: the European Court of Justice confirms and refines its Daily Mail decision in the Cartesio Case C-210/06', *European Company and Financial Law Review*, Vol. 6, 2009, p. 125.

¹⁴⁶ CJEU ruling of 10 July 1986. - D. H. M. Segers v Bestuur van de Bedrijfsvereniging voor Bank, Case 79/85: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:61985CJ0079&from=EN>

Overall, the CJEU's jurisprudence accepts that regulatory arbitrage regarding general company law is legitimate, at least in principle, and indeed 'inherent in the exercise, in a Single Market, of the freedom of establishment'.

The *Centros* ruling had a significant effect: research shows that the number of companies incorporated in one Member State but whose headquarters are located in another Member State or which operate exclusively in that other Member State (also referred to as foreign-incorporated or 'pseudo-foreign') grew significantly in the aftermath of the ruling¹⁴⁷. The case-law thus had a profound impact on the existence of letterbox companies¹⁴⁸, i.e. those that do not conduct any economic activity in the jurisdiction where they are incorporated, while carrying out at least some activity in another Member State.

However, it could be argued that this effect was mostly limited to host countries which traditionally follow a version of the real seat theory¹⁴⁹, and that clarifications brought by *Centros* and subsequent aligned case-law did not affect the freedom already given by incorporation theory Member States. Indeed, this second category of Member States allow undertakings to incorporate within their jurisdictions regardless of whether or not they carry out activities within their territories¹⁵⁰ enabling as such entrepreneurs to incorporate a company in one Member State and have business activities in another.

It is also worth pointing out that the immediate real-life effect of this ruling on all but the smallest businesses was limited by two additional factors. Firstly, even before *Centros*, especially within corporate groups, organisational measures have always allowed companies to easily incorporate in all or most Member States. Where national law requires a physical presence in the state of incorporation, for instance, such requirements are unlikely to pose a significant obstacle for businesses of sufficient size (see Section 5.1.5). Secondly, and perhaps more importantly for the purposes of this study, companies with little or no business activity beyond holding assets are permissible under all national company laws in the EU, and neither substantive company law nor private international law rules restrict the formation of such companies (see Section 5.1).

The CJEU in its 2017 ***Polbud* judgment reinforced the freedom of establishment principle in the cases of cross-border conversions**¹⁵¹. Here, the Court ruled that the freedom of establishment applies to the transfer of the registered office of a company from one Member State to another Member State, for the purposes of its conversion, in accordance with the conditions imposed by the legislation of the other Member State, into a company incorporated under the law of the latter Member State, when there is no change in the location of the real head office of that company¹⁵².

¹⁴⁷ See Ringe, W-G, 'Corporate mobility in the European Union—a flash in the pan? An empirical study on the success of lawmaking and regulatory competition', ECRF Vol. 10, 2013, pp. 230–267; Gerner-Beuerle et al., 'Why do businesses incorporate in other EU Member States? An empirical analysis of the role of conflict of laws rules', International Review of Law and Economics, Vol. 56, 2018, pp. 14–27; Armour, J., 'Who should make corporate law? EC legislation versus regulatory competition', *Current Legal Problems*, Vol. 58, 2005, p.369; Becht et al., 'Centros and the Cost of Branching', *Journal of Corporate Law Studies*, Vol. 9 No. 1, 2009, pp.171-199; Braun et al., 'Does charter competition foster entrepreneurship? a difference-in-difference approach to European company law reforms', *Journal of Common Market Studies*, Vol., 51. No. 3, 2013, pp.399-415; Gerner-Beuerle et al., *Study on directors' duties and liability*, LSE Enterprise Limited, London, UK, 2013, available at: http://eprints.lse.ac.uk/50438/1/_Libfile_repository_Content_Gerner-Beuerle%2C%20C_Study%20on%20directors%E2%80%99%20duties%20and%20liability%28Isero%29.pdf

¹⁴⁸ For a recent review of the relevant empirical research, see Gerner-Beuerle et al., 2018.

¹⁴⁹ See Section 5.

¹⁵⁰ As long as these undertakings are validly incorporated.

¹⁵¹ Judgment of the Court (Grand Chamber) of 25 October 2017, C-106/16, *Polbud - Wykonawstwo sp. z o.o.*, EU:C:2017:804.

¹⁵² *Idem* (para 33) "...Freedom of establishment therefore encompasses the right of a company or firm formed in accordance with the legislation of a Member State to convert itself into a company or firm governed by the law another Member State (see, to that effect, judgment of 27 September 1988, *Daily Mail and General Trust*, 81/87, EU:C:1988:456, paragraph 17), provided that the conditions laid down by the legislation of that other Member State

Companies can thus transfer their registered offices, even if the reason for the transfer is to benefit from a more suitable legal framework or taxation regime¹⁵³. A study of this judgment prepared for the European Parliament examined whether the *Polbud* decision could have the effect of facilitating 'forum and tax shopping'¹⁵⁴. It notes that, '*Moving the registered office into another Member State without having any real business there, with the sole purpose of exploiting a more favourable legislation or tax regime, has been traditionally seen as an abuse or fraudulent conduct, even though the CJEU has clarified that the very fact that the company does not conduct any business in the host Member State is insufficient to prove the existence of abuse or fraudulent conduct.*'¹⁵⁵. The study highlighted the possibility of abuse of freedom of establishment for the purposes of tax avoidance or fraud and in particular was of the view that the judgment provided a '*highly favourable position*' from a fiscal point of view that '*would not fail to encourage low-tax regime shopping*', entailing the risk that the EU freedom of establishment '*might be invoked as a shield for abusive schemes, like letterbox companies, seeking to minimise tax liability by establishing domicile with a mailing address in a country that is more tax-friendly, while conducting business elsewhere*'¹⁵⁶. It is worth bearing in mind, however, that in the area of company law, 'forum shopping' at the formation stage had – based on *Centros* – already been accepted as a legitimate motive for the exercise of the freedom of establishment.

This discussion does not mean that the Treaty automatically insulates all forms of cross-jurisdictional regulatory arbitrage from intervention at national level. The question of whether or not a company exists under the relevant company law rules is only one element relevant to this study. In ***Cadbury Schweppes***, for example, the Court accepted that **tax measures related to structures that may validly exist under national company law rules may be made subject to (restrictive) anti-abuse rules**.

Even though it clarified that EU law, in principle, precludes Member States from introducing and applying anti-abuse measures that restrict the freedom of establishment, it also held that a restriction may be justified by the **need to counter tax avoidance** if the domestic measure specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned. In particular, the specific objective of such a measure must be 'to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory'¹⁵⁷. For such restrictive anti-abuse measures to be upheld by the Court, they must be limited in their scope to only cover such 'wholly artificial arrangements'¹⁵⁸.

The Court in *Cadbury Schweppes* also cited its earlier *Eurofood* decision, in which the CJEU referred to 'letterbox companies' as companies 'not carrying out any business in the territory of the Member State in which its registered office is situated'¹⁵⁹.

are satisfied and, in particular, that the test adopted by the latter State to determine the connection of a company or firm to its national legal order is satisfied".

¹⁵³ The Member State of destination may require its own incorporation requirements to be fulfilled. Consequently, if the Member State of destination follows the real seat theory (and requires a close connection between a company and its place of management and operations, such as the presence of an actual economic activity from the undertaking wishing to incorporate), said company will have to meet this requirement (*Polbud*).

¹⁵⁴ European Parliament, Freedom of establishment for companies in the EU, 2018, available at: [http://www.europarl.europa.eu/RegData/etudes/STUD/2018/608833/IPOL_STU\(2018\)608833_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2018/608833/IPOL_STU(2018)608833_EN.pdf)

¹⁵⁵ *ibid.*, p.6.

¹⁵⁶ *ibid.*, p.16.

¹⁵⁷ CJEU, 12 September 2006, *Cadbury Schweppes*, C-196/04, § 51-55.

¹⁵⁸ See, for example, Garcia Prats et al, 'Anti-avoidance measures of general nature and scope – GAAR and other rules', IFA Cahiers, Vol. 103, 2018.

¹⁵⁹ CJEU, 2 May 2006, *Eurofood*, C-341/04, § 35.

In *Cadbury Schweppes*, the Court applied its criterion of 'wholly artificial arrangements' to determine the instances in which Member States are exceptionally allowed to apply **anti-abuse measures that restrict the freedom of establishment** (i.e., when they are justified). In order to determine whether such a wholly artificial arrangement is used to escape 'the tax normally due on the profits generated by activities carried out on national territory'¹⁶⁰, the Court requires a **subjective element**, i.e., the intention to obtain a tax advantage, as well as objective circumstances showing that despite formal observance of the conditions of European law, the objective pursued by the freedom of establishment has not been achieved. Indeed, the Court concluded that the mere fact that a resident company establishes a secondary establishment, such as a subsidiary, in another Member State does not constitute a presumption of tax avoidance.

In other words, a domestic anti-abuse measure should not apply where, despite the existence of tax motives, the arrangement set up by the taxpayer reflects economic reality. Applied to the incorporation of a company, that criterion entails that such incorporation must correspond to an actual establishment intended to carry on genuine economic activities in the host Member State. If, on the other hand, a company is a fictitious establishment devoid of genuine economic activity in the territory of the host Member State, it qualifies as a wholly artificial arrangement which, according to the Court, is particularly so the case of a 'letterbox company'¹⁶¹.

The CJEU also established that determining whether the incorporation of a company corresponds to an actual establishment intended to carry on genuine economic activities in the host country, must be based on objective factors, ascertainable by third parties. According to the CJEU, those factors concern, in particular, the extent to which the company physically exists in terms of premises, staff and equipment¹⁶². Considerable weight is attached by the CJEU to the physical presence in the host state (often referred to as substance requirements), such as premises, staff and equipment.

In *Cadbury Schweppes*, the CJEU held that: 'If checking those factors leads to the finding that the CFC [controlled foreign company] is a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a "letterbox" or "front" subsidiary (see Case C-341/04 Eurofood [...] paragraphs 34 and 35).'

In the **area of tax law**, the Court's view of what defines a letterbox company is not necessarily a company that uses no (or limited) office space or that has no (or limited) staff, but **that the premises, staff etc. has to be appropriate in relation to the activity of the company**¹⁶³. It is possible that the activity being carried out is of a very specific nature (e.g., holding activities, financing activities, asset management) or that it is carried out exclusively for group companies and in compliance with group policies set by the parent company. Such activities do not necessarily require a large office space or a considerable number of staff. As a result, the criterion itself cannot be sufficient to conclude that an entity is a letterbox company. What is relevant in determining whether an entity is 'wholly artificial' in this context is that the premises and staff are adequate to reasonably carry out the activity and that the staff are qualified and competent to conduct the activity and take the necessary decisions.

The Opinion of Advocate General (AG) Léger, of 2 May 2006, in the *Cadbury Schweppes* case¹⁶⁴, is important here. In addition to the substance requirements, the AG refers to the 'genuine nature of the activity', i.e., 'the competence of the [company's] staff in relation

¹⁶⁰ CJEU, 12 September 2006, *Cadbury Schweppes*, C-196/04, § 51-55.

¹⁶¹ *ibid.*, § 68.

¹⁶² CJEU, 12 September 2006, *Cadbury Schweppes*, C-196/04, § 65-68

¹⁶³ De Broe, L., *International Tax Planning and Prevention of Abuse*, IBFD: Amsterdam, 2008.

¹⁶⁴ C-196/04, § 113

to the services provided and the level of decision-making in carrying out those services. If, for example, the [company] proves to be nothing but a mere tool of execution because the decisions necessary to carry out the services it is paid for are taken at another level, it is also right to consider that the subjection of those services to the tax sovereignty of the host State constitutes a wholly artificial arrangement'. Similarly, in the Opinion of AG Kokott, of 19 January 2017 in the *Eqiom* case¹⁶⁵ : 'an artificial arrangement can be assumed if the company is only a fictitious establishment in the form of a 'letterbox' company. But even where there is a physical presence, one might conclude, in light of the financial and staffing set-up, that the arrangement is artificial. In this regard, what appears to be relevant is, for instance, the actual authority of the company organs to take decisions, to what extent the company is endowed with own financial means and whether any commercial risk exists'¹⁶⁶.

Finally, in the recent CJEU judgment of 29 February 2019 related to Directives on company taxation (joined cases C-116/16 and C-117/16 concerning the application of the Interest and Royalty Directive¹⁶⁷, and joined cases C-115/16, C-118/16, C-119/16 and C-299/16 on the Parent-Subsidiary Directive¹⁶⁸), the Court confirmed the abuse of rights principle which can be used by Member States to withdraw a tax benefit derived from EU legislation, provided the company is regarded as having the characteristics of an artificial arrangement and has as its main - or at least one of its main - objectives, the derivation of an unwarranted tax benefit from EU legislation.

More precisely, in the **C-116/16** (*T Denmark*) case, the Court was asked to decide on a number of issues involving potential tax abuse in the context of cross-border dividend payments. The Court's decision stated that a Member State must refuse to grant the benefit of EU law provisions if there is abuse (i.e., where those provisions are relied upon in a manner which is not consistent with their objectives). Consequently, the benefits of the Parent-Subsidiary Directive must be refused if financial arrangements are set up with the essential aim of obtaining those benefits. The Court specified that a group of companies may be regarded as an artificial arrangement where the conduit subsidiary is not set up for reasons that reflect economic reality, its structure is purely one of form, and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of the applicable tax law (e.g. where a conduit entity is interposed in the structure of the group between the company that pays dividends and the entity, which is its beneficial owner, so that dividend withholding tax is avoided). The fact that a company acts as a conduit company may be established where its sole activity is the receipt of dividends and its transmission to the beneficial owner or to other conduit companies.

In other words, according to this joint case-law, group of companies may carry on genuine economic activities but nevertheless be considered in breach of company tax directives provided they set up schemes (such as conduit company referred above) aimed at benefiting under a company tax directive. The absence of actual economic activity must, in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating to the management of the company, its balance sheet, the structure of its costs and expenditure actually incurred, the staff that it employs and its premises and equipment. The conclusion that an arrangement is artificial can also be based on the fact that the conduit company is unable to have economic use of

¹⁶⁵ C-6/16, *Eqiom*, § 57

¹⁶⁶ Opinion of AG Kokott delivered on 19 January 2017- Case C-6/16, Request for a preliminary ruling from the Conseil d'État (Council of State, France)) - par.57, page 10. Available at : <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62016CC0006&from=PL>

¹⁶⁷ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003L0049&from=EN>

¹⁶⁸ Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011L0096&from=EN>

the dividends received, either because of legal obligations or because in substance it does not have the right to use and enjoy those dividends.

Similarly, in the **N Luxembourg 1 case**¹⁶⁹, the Court reached the same conclusion with respect to the benefits of Directive 2003/49/EC (the Interest and Royalty Directive). More specifically, that case-law states that **Member States are obliged to refuse entitlement to rights provided under EU law** (e.g., the benefits provided for under the Parent-Subsidiary and Interest and Royalty Directives), even in the absence of domestic or agreement-based abuse provisions, for instance **where a company acts as a conduit company in relation to dividend or interest payments**.

Some authors have argued that the Court in T Denmark and N Luxembourg 1 (see Section 4.1) has lowered the threshold for when abuse may be present. They observe that it is no longer required that a 'wholly artificial arrangement' is present for there to be abuse. Instead, certain transactions might qualify as abusive, even if the company involved has a degree of economic substance in the state where these transactions are challenged. That position is based on the fact that the Court does not refer to the concept of 'wholly artificial arrangement' and suggests that the mere presence of a certain degree of economic activity is insufficient to claim entitlement to benefits under a Directive.

Other authors, however, take the position that the judgments do not imply a change in the approach of the Court towards assessing tax abuse, notably because the Danish cases concerned the Parent-Subsidiary Directive and the Interest and Royalty Directive and not the fundamental freedoms. From the perspective of the objective of the freedom of establishment, economic substance is essential, which explains its importance in the Court's abuse-approach in that context. The purposes of the Parent-Subsidiary Directive and the Interest and Royalty Directive are different, meaning that the mere fact that an interposed company carries on a considerable economic activity and has commercial substance does not necessarily mean that there is no abuse of the Directives. Under that interpretation, the 'wholly artificial' criterion is still decisive, and the Danish cases offer a specific interpretation of that criterion in a matter involving the Parent-Subsidiary Directive and the Interest and Royalty Directive. Moreover, the Court itself has also relied on the 'wholly artificial' criterion in a case decided on the same day as the decisions in the Danish cases.

Annex 5 (in particular A5.1.2.2 and A5.1.6) provides additional details on the introduction of the general anti-abuse rule (GAAR), and its consequences for the domestic situation in Denmark.

4.2 Overview and types of uses made of letterbox companies

When discussing the phenomenon of letterbox companies, a clear differentiation needs to be made between the existence of letterbox companies that enjoy the freedom of establishment guaranteed in the Treaty (as long they are incorporated in accordance with the Member State's law) and the actual use of the letterbox company, which only becomes problematic and at risk of losing the protection of the fundamental freedoms where it is illegal and/or abusive.

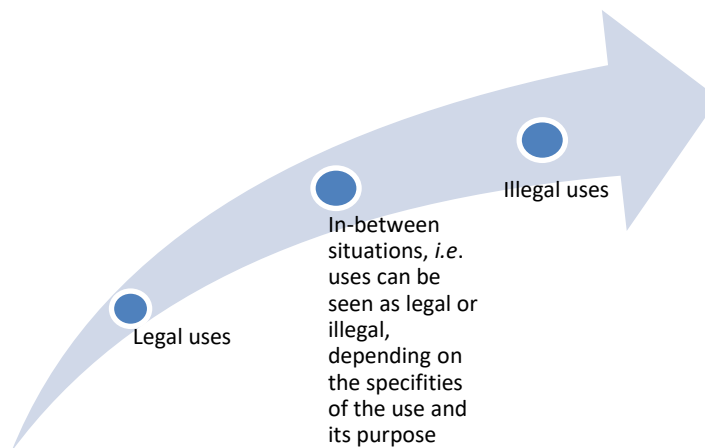
Based on the research undertaken for this study, it is not possible to describe the different uses of this multifaceted phenomenon *in abstracto*. Instead, the different uses are examined on a case-by-case basis, with different categories or sub-categories of uses distinguished to the extent possible, according to the area/ sector of activity and the different purposes behind their use. Sections 4.2.2 and 4.2.3 give a non-exhaustive

¹⁶⁹ C-115/16.

description of the uses of letterbox companies. Broadly speaking, the following distinction can be made regarding the use of letterbox companies, with each described in detail below.

- **Legal uses**, including for tax planning; to transfer assets; to support cross-border operations and joint ventures; to avoid double taxation; as flags of convenience; for intellectual property and trademark purposes; to facilitate specific operations.
- **Illegal, fraudulent and abusive uses**, covering all the activities of letterbox companies that violate existing laws to an extent that they will be subject to regulatory or administrative sanctions. This concerns, in particular:
 - Uses that are specifically and intentionally used to perpetrate criminal activities such as hiding criminal activities, money laundering, terrorist financing, corruption and bribery;
 - Letterbox companies used for illegal fiscal practices, such as tax evasion, and for abusive practises, such as tax avoidance.

Figure 9. The spectrum of use of letterbox companies



4.2.1 Difficulties of distinguishing the uses

While the case-by-case analysis provided here shows that letterbox companies can serve both legal and illegal purposes, it also shows that a classification is not always evident and depends on several considerations and circumstances. It is clear that legal reasons can only be ranked as such where they lie within a framework set by the legislator. Once a use goes beyond legally established boundaries, it is considered illegal. However, letterbox companies are often observed to be used in a way that is not just black or white, legal or illegal. The most pertinent elements contributing to difficulties in distinguishing between and classifying the uses of letterbox companies are:

- **No commonly agreed definition** of letterbox company, with different terms being used alongside one another. As mentioned in Section 2, although the term 'letterbox company' is commonly used across the EU and worldwide, there is no single and common understanding, but rather a variety of concepts. Numerous terms are used alongside that of 'letterbox company' and there is no commonly agreed definition of the term. The basic idea of the principle of legality 'nullum crimen, nulla poena sine lege certa' (there can be no crime and no penalty without well-defined law establishing it) shows that without sufficient determination there cannot be punishable conduct. Hence, as long as letterbox companies and their specific uses are not clearly defined and framed by laws, and as long as legislators do not specify

the prohibited uses, it is difficult to distinguish and penalise them, even when they are abusive.

- **Varying national legislative frameworks.** Classification of uses of letterbox companies can vary from a Member State to another, depending on where these undertakings operate. It is likely even more varied between EU Member States and third countries. Some uses might occur across the board in all or most countries, while others only appear in some Member States. This can be rooted in different legal frameworks at international, EU, national and local level, but also in the fact that some uses would not be beneficial or even feasible in certain jurisdictions. For instance, while letterbox companies used for the purpose of dissimulating the identity of their ultimate beneficial owner(s) are illegal in the EU¹⁷⁰, such an approach is currently legal in the US state of Delaware¹⁷¹, where no beneficial ownership disclosure requirements exist¹⁷².

In addition, as described in Section 4.1 above, patterns of use of companies aiming to take advantage of more favourable legal regimes are sometimes encouraged by countries in whose interest it is to establish a favourable legal framework to attract the incorporation of companies on their territory or to avoid losing their own companies to foreign jurisdictions. Regulatory competition can increase the existence of legal gaps that might then be used by letterbox companies. While such uses are considered undesirable by some stakeholders, choosing the most attractive legal order is fully in line with the freedom of establishment and the relevant case-law. Even more, it is inherent to the Single Market, creating tensions between regulatory arbitrage and legitimate competition between legal orders as long as no full harmonisation exists.

- **Multiple interpretations** rooted in historical, political, economic, cultural and traditions/ custom-related differences. Such differences also contribute to the heterogeneous classification of letterbox companies' uses. In practice, this can lead to uses of these corporate structures being classified as legal in one jurisdiction but not in others, adding to the complexity of establishing whether the letterbox company acted within or outside the law. Existing legislative frameworks might not always be clear and exhaustive, leaving too much room for interpretation, which can result in a more permissive understanding than foreseen by the legislator. These

¹⁷⁰ Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (AML Directive 5).

¹⁷¹ In October 2019, the House of Representatives passed a landmark bipartisan Bill, the Corporate Transparency Act, to end corruption and crime enabled by anonymous companies, including beneficial ownership disclosure requirements at the moment of the formation of a company. The Bill also directs the US Treasury to make this information available to law enforcement and other authorities as a part their efforts to combat corruption, crime and money laundering (See: <https://www.globalwitness.org/en/press-releases/historic-bipartisan-bill-end-anonymous-companies-passes-us-house-representatives/>). The Bill has been welcomed by the White House Administration which believes that this legislation represents important progress in strengthening national security, supporting law enforcement, and clarifying regulatory requirements (https://www.whitehouse.gov/wp-content/uploads/2019/10/SAP_HR-2513.pdf). These recent developments could indicate the State's acknowledgment of problems entailed by anonymous shell companies (see also: <https://maloney.house.gov/media-center/press-releases/house-passes-maloney-bill-to-crack-down-on-anonymous-shell-companies>).

¹⁷² See, for example, Bartels, J., 'Discreet Delaware: why corporate secrecy and money laundering have thrived in the US', *Business Information Industry Association Asia Pacific*, 2019; It is noted that since 11 May 2018, Delaware financial institutions are required to undertake customer due diligence measures aimed at identifying the beneficial owner of legal entity customers and taking reasonable measures to verify the identity of the beneficial owner of account holders. This recent measure only applies if a corporation wishes to open an account within a financial institution in the US (Customer Due Diligence Requirements for Financial Institutions, *Federal Register* Vol. 81, 11 May 2016, available at: <https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf> codified in chapter 31 of the Code of Federal Regulations, Parts 1010, 1020, 1023, 1024, and 1026).

differences and inconsistencies across legislation may cause legal loopholes and gaps that can be intentionally used to obtain advantages.

- **Differences in stakeholder perceptions.** Stakeholders consulted for this study confirmed the importance of differentiating between the existence of letterbox companies, which as such is not an illegal phenomenon, and their actual use, which only becomes problematic when illegal or abusive. When examining how letterbox companies are referred to in public discourse, it can be observed that this distinction between letterbox companies (not illegal *per se*) and how they are actually used is not always made. This becomes apparent when examining the various existing terms and concepts, with some attaching a negative connotation to LBCs, irrespective of their specific use (see Section 2.2).

The variety of stakeholder perceptions is apparent in the public and political debates around the phenomenon of letterbox companies and sometimes leads to inconsistent discussions. Depending on the type of stakeholder, the economic sector to which they belong, the social 'side' they represent (e.g., employer and employee) and thus their main purposes and concerns, they may judge the letterbox company phenomenon as a whole or may judge each specific use of a letterbox company differently. This reflects the 'two sides of the same coin': a certain use of a letterbox company will regularly constitute a benefit for some stakeholders while entailing a detriment for others.

For example, the use of letterbox companies to benefit from national schemes with lower social security contributions or lower minimum wages has long been perceived as an undesirable and sometimes even an illegal use of a letterbox company by stakeholders whose purpose is to protect existing labour and social standards (e.g., employees, trade unions, labour organisations). Such practices nevertheless remain acceptable to some employers or business associations, who consider it essential for companies in an increasingly competitive global environment.

- **Differences in the classification between areas of law and economic sectors.** Finally, the classification of the uses of letterbox companies not only varies from one jurisdiction to another but also differs depending on the area of law within which the use falls, or, if applicable, the specific economic sector. This is because some uses of letterbox companies will appear in one area of law/specific sector but not in another (where it would not be beneficial). Some specific uses might be explicitly punishable in one area of law or in a specific economic sector because they only pose a problem there and have thus been on the political agenda. In assessing the specific use of letterbox companies, it is therefore crucial to consider the area and sector of activity in which it takes place.

It is also necessary to assess the main purpose behind a letterbox company's use. For example, is the main purpose the avoidance of social security payments and the circumvention of existing rules of labour law or social security, or is the letterbox company designed so as to benefit from legal exemptions and lower its overall costs? Depending on the case, the latter would probably be legal, whereas the use of a letterbox company to transfer employees and liquidate a company in order to evade labour law provisions would be illegal.

Another example of this fine line - and indeed the difficulties in distinguishing between the uses *in abstracto* - are letterbox companies used in the context of tax law.

Box 3. Fiscal practices: tax planning, tax avoidance and tax evasion¹⁷³

¹⁷³ Allain et al., *Facing tax fraud in the European Union – Challenges and perspectives*, 2016, available at: http://www.ejtn.eu/Documents/THEMIS%202016/Semi%20A/France2_TH_2016_01.pdf

- **Tax planning** refers to legal practices applied to reduce tax liability through planning the use of allowances, deductions or exemptions, among others.
- **Tax avoidance** refers to practices that are intended to reduce a taxpayer's tax liability and that are, strictly speaking, legal but are nevertheless usually contrary to the intent of the legal rules they purport to follow¹⁷⁴.
- **Tax evasion** (or tax fraud) refers to the deliberate illegal evasion of taxes, which is generally punishable under criminal law or a punishable offence.

While letterbox companies used for tax planning intentions are legal (see Section 4.2.2), those that are employed with a view to evading taxes are considered criminal (see Section 4.2.3). Legal from a technical point of view, the notion of tax avoidance is not statutorily defined and emanates from a legal principle of abuse of general or specific anti-avoidance rules¹⁷⁵, making it - to a certain extent - a 'grey zone' that can be delimited negatively, i.e., as neither tax planning nor tax evasion¹⁷⁶.

Box 4. Aggressive tax planning

Recent initiatives (for example at EU level) often refer to the notion of 'aggressive tax planning'. ATP is generally described as the use by multinational enterprises of the opportunities to reduce the tax burden that exist in an international context and due to the interaction of the tax rules of different jurisdictions¹⁷⁷.

In its Recommendation of 2012, the European Commission defined ATP as 'taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. Aggressive tax planning can take a multitude of forms. Its consequences include double deductions (e.g., the same loss is deducted both in the State of source and residence) and double non-taxation (e.g. income which is not taxed in the source State is exempt in the State of residence)'¹⁷⁸.

The status of ATP as an autonomous concept remains unclear. It could be seen as an umbrella notion, referring to operations in the grey area between tax planning and tax avoidance and that, depending on the context, could cover either tax planning and tax avoidance, or tax planning alone¹⁷⁹. It has been argued that the notion of ATP is not intended to serve as an autonomous legal concept but rather as a tax policy concept that could form the basis for focus for new (international) tax rules¹⁸⁰. A recent working paper from the European Commission¹⁸¹ clearly states that 'active management of tax affairs by corporations does not in itself result in aggressive tax planning'. According to that paper, companies' activity of tax planning can be visualised as a continuum, with fuzzy boundaries between tax planning, ATP and tax evasion.

¹⁷⁴ OECD, Glossary of tax terms, available at: <http://www.oecd.org/ctp/glossaryoftaxterms.htm>.

¹⁷⁵ Dourado, A. P., 'Tax Avoidance Revisited in the EU BEPS Context', *International Tax Law: New Challenges to and from Constitutional and Legal Pluralism*, IBFD: Amsterdam, 2017.

¹⁷⁶ *ibid.*

¹⁷⁷ Dourado, 2017.

¹⁷⁸ European Commission, Commission Recommendation of 6 December 2012 on aggressive tax planning, 2012/772/EU, 2012, available at :

<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012H0772&from=HR>

¹⁷⁹ Dourado, 2017.

¹⁸⁰ Calderón, J. and Quintas, A., 'The concept of "Aggressive Tax Planning" launched by the OECD and the EU Commission in the BEPS era: redefining the border between legitimate and illegitimate tax planning', *Intertax*, Vol. 44, No. 3, 2016, p. 210.

¹⁸¹ European Commission, *Aggressive tax planning indicators. Final Report*, Working paper No 71, 2017, available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp_.pdf

Different countries have different approaches to tax avoidance. The UK courts, for example, consider tax avoidance to be an unlawful activity, where unlawful¹⁸² is not understood as a synonym of illegal but, rather, denotes that activities are 'ineffectual in law because they involve acts which, although not illegal, i.e., positively forbidden, are disapproved of by the law, and are therefore not recognised as the ground of legal rights, either because they are immoral or because they are against public policy'¹⁸³. Although tax avoidance is not positively prohibited, public policy is very clearly opposed to it, on the grounds that it generally aims to exploit gaps and loopholes in the law. In practice, this means that the courts can determine that a tax avoidance scheme has no effect and that the advantage that any taxpayer sought to gain is reverted¹⁸⁴. In Poland, a new anti-abuse clause referring to tax avoidance was introduced in 2016. It applies to legal activities performed by the taxpayer that reduce tax revenues and do not meet the purpose of the tax act. The clause does not apply to illegal activities, which are fiscal crimes or offences falling within the scope of the Fiscal Penal Code.

In the Netherlands, tax avoidance is, in principle, legal, but there are a number of exceptions¹⁸⁵. For instance, tax avoidance coming from a letterbox company that does not conduct obvious business activity can still be regarded as illegal. As tax avoidance is regularly considered abusive, this practice is assessed under Section 4.2.3. 'Illegal and abusive uses of letterbox companies'.

The above demonstrates that **distinguishing the uses of letterbox companies** requires **close examination of the corporate structure and its specific use**. Another example illustrating how letterbox companies may be legally established yet used for illegal purposes is that of undertakings used for the strategic location of intellectual property rights and trademarks (non-financial intangible assets). Letterbox companies can, for example, be used legally to temporarily conceal the development of a new product until its release, or to invest in a new technology without alerting competitors. At the same time, they could be established and used in a way that is less clearly legal. For example, royalty and licence companies that have been assigned ownership of intellectual property rights or trademarks by their parent companies are sometimes used to collect royalties as fees on licences (or other types of intellectual property)¹⁸⁶. The revenues are then passed on to the parent company. In principle, this practice is legal as long as it remains within the boundaries of tax planning. If the main purpose, however, is to concentrate group receipts of royalties and similar flows received from intellectual property rights and trademarks by strategically moving them to countries imposing comparably low taxes to evade paying higher corporate income taxes, then this may be considered illegitimate. However, there exist specific instruments at EU and OECD level to counteract such abusive arrangements (e.g., having substance rules for the patent box). As such, shifting intangible assets between jurisdictions through artificial arrangements is not illegal¹⁸⁷.

The above discussion suggests that the various circumstances are interlinked, which contributes to the difficulties in distinguishing between the uses of letterbox companies. Several conclusions can be drawn, however. Firstly, when determining and classifying the use made of such companies, it is necessary to assess all relevant circumstances (to the extent possible). Secondly, the abusive feature is not inherent to letterbox companies

¹⁸² See https://www.taxwatchuk.org/is_tax_avoidance_legal/

¹⁸³ See Black's legal dictionary on "unlawful", Available online: <https://thelawdictionary.org/unlawful/>.

¹⁸⁴ https://www.taxwatchuk.org/is_tax_avoidance_legal/

¹⁸⁵ See <https://romkens.nl/belastingontwikking-en-belastingontduiking/>

¹⁸⁶ United Nations Economic Commission for Europe (UNECE), Special purpose entities, 2016, p.42, available at: https://www.unece.org/fileadmin/DAM/stats/groups/wggn/GuideByChapters/Chapter_04.pdf

¹⁸⁷ HIS, CPB and Dondena, 'Aggressive tax planning indicators', Taxation Working Paper No.71, 2017, p.2, available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp_.pdf

themselves. The latter are generally not abusive or illegal *per se* but the specific use that is made of them may be abusive or illegal.

4.2.2 Legal uses of letterbox companies

One possibility to classify the use of letterbox companies is to base the assessment on the *a contrario* argument, whereby all uses that are not illegal or abusive are considered legal.

Yet, the classification of uses as illegal or abusive is not always straightforward. This subsection first examines the different legal uses, on a case-by-case basis, distinguishing to the extent possible between different types of use and different types of letterbox companies, and considering the area of law and economic sector of activity, where relevant. Some uses of letterbox companies focus on a **specific form** (e.g., SPE or holding company), others on a **specific purpose** (e.g., tax planning, avoidance of double taxation or facilitating specific operations). However, the determination of uses is not always clear and overlaps can occur. A specific use of letterbox companies might be attributed to more than one form or target more than one of the described purposes at the same time.

The following main types of legal uses (under certain conditions) have been identified from the literature and the research carried out at national level. Each is described in more detail below.

- Uses by means of SPEs (for risk-sharing, financing, raising capital, securitisation of loans and other receivables, assigning intellectual property and trademark rights, corporate mergers and joint ventures);
- Uses by means of holding companies;
- Uses by means of investment vehicles and fund industry;
- Fiscal practices, including tax planning and avoiding double taxation;
- Protecting (while not concealing) the identity of the company or its shareholders;
- Flags of convenience;
- Facilitating other operations, such as:
 - Protecting assets from currency fluctuations;
 - Protecting the finances of small companies or individual entrepreneurs;
 - Ensuring a quick start up of economic activity;
 - Lowering costs for setting up a company.

Uses by means of Special Purpose Entities (SPEs)

While there is no commonly agreed definition of SPEs (also called Special Purpose Vehicles (SPVs)), leaving room for interpretation¹⁸⁸, generally speaking, they are legal entities created to fulfil narrow, specific or temporary objectives¹⁸⁹, such as risk-sharing, financing, raising capital and the securitisation of loans and other receivables. SPEs are frequently, although not always, letterbox companies. They might, for instance be designed as financing and holding companies that channel funds within a group on behalf of a parent

¹⁸⁸ The System of National Accounts (SNA) (2008) clarifies that although there is no common definition of an SPE list some characteristics that may apply: 'Such units often have no employees and no nonfinancial assets. They may have little physical presence beyond a "brass plate" confirming their place of registration. They are always related to another corporation, often as a subsidiary, and SPEs in particular are often resident in a territory other than the territory of residence of related corporations. In the absence of any physical dimension to an enterprise, its residence is determined according to the economic territory under whose laws the enterprise is incorporated or registered. Entities of this type are commonly managed by employees of another corporation which may or may not be a related one. The unit pays fees for services rendered to it and in turn charges its parent or other related corporation a fee to cover these costs. This is the only production the unit is involved in though it will often incur liabilities on behalf of its owner and will usually receive investment income and holding gains on the assets it holds' (paragraphs 4.55 - 4.57). Report available at: <https://unstats.un.org/unsd/nationalaccount/docs/SNA2008.pdf>

¹⁸⁹ UNECE, 2016; Trade Finance Global (TFG), Introduction to legal trade finance/SPV financing, available at: <https://www.tradefinanceglobal.com/legal/spv-financing/>.

company¹⁹⁰. In the Netherlands, financing and holding companies form by far the largest group of SPEs¹⁹¹. This shows the fluidity of the determination of uses and the existence of overlaps.

In both Germany and Poland, letterbox SPEs are observed to be used to securitise loans by spreading/ 'tranching' the credit risk associated with exposure or a pool of exposures, which is considered a legal practice generally. Letterbox SPEs also regularly appear in the context of asset transfers. In Germany, where this practice often occurs, this is generally legal¹⁹². Where the transfer of certain assets is complicated or particularly burdensome, a company could opt to create an SPE to own these assets, which can subsequently be sold as a whole, self-contained package, or used in mergers and acquisition (M&A) processes. For example, two companies can structure a merger under a third, 'neutral' letterbox company. In Poland, letterbox SPEs are used to support cross-border restructuring operations by serving as a vehicle to transfer assets¹⁹³. Generally speaking, SPEs – letterbox ones included – are used to facilitate the transfer into a joint venture¹⁹⁴. In multinational transactions, many companies prefer to seat their international joint-venture company in a neutral jurisdiction to ensure that no company receives preferential legal treatment¹⁹⁵.

Luxembourg is one of the biggest hosts of SPEs, typically in the form of holding companies, used for asset management and asset transfers¹⁹⁶. They primarily channel capital through to other countries, without generating any significant real economic activity or employment. In fact, the majority of inward and outward FDI – which in Luxembourg are amongst the highest in the EU (see Section 3.1.1) – are linked to SPEs¹⁹⁷. To channel tax-driven financial flows to other jurisdictions, multinationals often make use of *Sociétés de participations financières* (SOPARFIs)¹⁹⁸ (financial participation companies in Luxembourg) as a vehicle for the management and holding of financial interests in other resident and non-resident companies¹⁹⁹. The popularity of their use can be explained by the advantageous tax regime applied to SOPARFIs, which under certain conditions, exempts them from any tax on the receipt of dividends or capital gains on the sale of shares (Luxembourg or foreign). While anti-abuse provisions were introduced in Luxembourg as

¹⁹⁰ UNECE, 2016.

¹⁹¹ *ibid.*, p.42. The report indicated that 'The economic relevance of SPEs in terms of their contribution to GDP is generally small, but they may have large income flows and large financial stocks and flows. In the Netherlands, for example, their balance sheets at end-2007 exceeded €1.6 trillion, equivalent to almost three times Dutch GDP.'

¹⁹² Findings from the country research in Germany.

¹⁹³ Findings from the country research in Poland.

¹⁹⁴ European Parliamentary Research Service (EPRS), An overview of shell companies in the European Union, 2018, available at:

http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf

¹⁹⁵ van der Does de Willebois et al., 'The Puppet Masters – How the corrupt use legal structures to hide stolen assets and what to do about it', International Bank for Reconstruction and Development / World Bank, 2011.

¹⁹⁶ Findings from the country research in Luxembourg.

¹⁹⁷ OECD, *International investment stumbles into 2014 after ending 2013 flat*, April 2014, available at: <http://www.oecd.org/daf/inv/FDI-in-Figures-April-2014.pdf>

¹⁹⁸ European Commission, Country report Luxembourg 2015, Commission Staff Working Document, SWD(2015) 35 final/2, 2015, p. 15, available at: http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_luxembourg_en.pdf

¹⁹⁹ A SOPARFI is a fully taxable company that may carry out all kinds of activities and can have different legal forms: SA (public limited company), SARL (limited liability company), SCA (limited partnership with shares) or cooperative organised in the form of a public limited company. The SOPARFI is not a particular company form (such as SA, SARL, SCA, etc...) but rather a special tax regime open to financial participation companies (*Sociétés de Participations Financières*). SOPARFIs may not carry on a commercial activity or participate in the management of another company, and may not own real estate, intellectual property or grant financing with interest. Thus, any Luxembourg SA or LLC is eligible for the SOPARFI status on the condition that it holds financial interests (subsidiaries) and manages them in the medium or long term.

a result of the transposition of the Anti-Tax Avoidance Directives 1 and 2, the participation exemption does not appear abusive if limited by the attached conditions²⁰⁰.

Letterbox SPEs are also commonly used for making investments, for example in real estate, M&A transactions, or through crowd-funding platforms^{201,202}. Other legal reason for establishing and using letterbox SPEs are financing of a new venture (without increasing the debt burden of the sponsoring firm and without diluting existing shareholders), relocating risks (of a venture from the parent company) or by financial institutions to raise additional capital at more favourable borrowing rates²⁰³.

SPEs can furthermore comprise royalty and licence companies that have been assigned ownership of intellectual property or trademark rights by their parent companies. In some cases, those subsidiaries might not have any employees or production but will solely produce services by holding those rights, giving rise to receipts of fees or royalties. In this case, these companies are letterbox companies. Whether the use of letterbox SPEs in this way is legal or not can only be determined by looking at the individual specificities and purpose (see Section 4.2.1).

Uses by means of holding companies

While not all holding companies are letterbox companies, this is often the case. Holding companies are typically corporate structures that own shares of other (subsidiary) companies or their stock, and as such may not be directly involved in production of goods or services or undertaking any management activities²⁰⁴. They are frequently structured as limited liability companies or partnerships and can be used in multiple legal ways. As described above, some SPEs can be holding companies but not all holding companies are SPEs (or vice-versa).

The formerly permissive legal framework regarding holding companies and the associated tax benefits, as well as the friendly administrative and regulatory environment of Luxembourg could have contributed to the widespread use of letterbox holding

²⁰⁰ a) the subsidiary (that distributes the dividend to the SOPARFI) is an entity within the scope of Article 2 of the EU Parent-Subsidiary Directive 2011/96/EU as amended, or (ii) an entity that is subject in its country of residence to corporate income tax corresponding to Luxembourg corporate income tax; and (b) at the time of the dividend distribution, SOPARFI has held (or commits to hold) (i) for an uninterrupted period of at least 12 months (ii) a participation representing at least 10% of the share capital of the Subsidiary or which has been acquired at a cost of at least EUR 1.2 million. Operating expenses economically connected with exempt income are not deductible except if and insofar as they exceed the exempted income. This rule implies that interest charges in relation to the exempted participation are deductible only to the extent that they exceed exempt dividend income. However, in order to avoid hybrid mismatches and/or abusive practices, the following apply: If the Subsidiary is an EU subsidiary within the scope of the EU Parent-Subsidiary Directive, the following have to be considered: (a) Dividends/profit distributions which are tax deductible in the hands of the Subsidiary may not benefit from the participation exemption; and (b) Dividends/profit distributions may not derive from an arrangement of a series of arrangements that have been put in place for the main purpose of obtaining a tax advantage that defeats the object or purpose of the participation exemption regime, and are not genuine in light of all the relevant facts and circumstances.

²⁰¹ Based on findings from the country research in Estonia, this is reported to be the most common legal way to use a letterbox company

²⁰² Findings from the country research in Switzerland show that SPEs are used particularly in the form of collective investment schemes. Yet, SPEs are hardly mentioned in the literature in connection with the phenomenon of domicile companies and seat companies in Switzerland. Following the French and Luxembourg model, the Federal Act on Collective Investment Schemes offers a variant of the classic public limited company, the SICAV, the investment company with variable capital, for legal ownership of collective investment schemes.

²⁰³ Trade Finance Global (TFG), Introduction to legal trade finance/SPV financing, available at: <https://www.tradefinanceglobal.com/legal/spv-financing/>.

²⁰⁴ UNSTATS, 2008.

companies²⁰⁵, both for tax planning purposes and asset transfer²⁰⁶. In the context of holding companies, tax rulings used to be standard practice in Luxembourg and in the past tax authorities were willing to issue them, allowing holding companies to qualify as beneficial owners and thus entitling them to double tax Treaty benefits. The implementation of BEPS Actions in 2017 seems to have changed this. In a questionnaire from 2017, Luxembourg answered that 'Implementation in 2017 of the outcomes of significant parts of BEPS Actions 8-10 into domestic law has triggered a reset of the domestic Advance Pricing Agreement (APA) practice rendering existing APAs, due to a change in legislation, void of legal force'²⁰⁷. How this development affects the use of letterbox holding companies is unclear, however.

Setting up letterbox holding companies is common practice in some other Member States, too²⁰⁸. Reasons include the fact that establishing private limited companies is a quick and relatively easy process, after which they may then be used for the acquisition and holding of shares of other companies²⁰⁹, or for benefiting from a Member State's attractive taxation regime for holdings that can result in the fact that dividends from abroad are almost tax-free²¹⁰. In France, holdings set up as simplified joint stock companies – a specific legal form introduced and employed in France – can be convenient for foreign investors because of their flexibility in organisation (meetings, management) and relations between shareholders (approval clauses, pre-emption clauses when transferring corporate rights)²¹¹. Literature also indicates that holding companies are used legally to hold personal or family assets or to serve as a personal holding company^{212,213}.

Uses by means of investment vehicles and fund industry

Letterbox companies are used in the context of investment vehicles and fund industry. For example, venture capital or private equity funds may legally take advantage of more developed domestic corporate legislation in another Member State as a way to protect investors' interests. In Luxembourg, for instance, several forms of investment vehicles exist that have made the Member State attractive to investors throughout the EU (and beyond), who choose to establish themselves formally in Luxembourg although their economic activities are in other Member States: the *Société d'investissement en capital à risqué* (SICAR), which are private equity and venture capital investment companies, the Specialised Investment Fund (SIF), a fund that can invest in all types of assets and the Reserved Alternative Investment Fund (REIF)²¹⁴.

²⁰⁵ A Luxembourg holding company is not characterised by its legal form, but rather by its tax treatment. It may take the form of an SA (public limited liability company), SAS (simplified stock company), SARL (private limited liability company), SARLS (simplified private limited liability company), SCA (partnership limited by shares) or cooperative. In most cases, however, a holding company is an SA or an SARL.

²⁰⁶ Findings from the county research in Luxembourg, which show holding companies were regularly used as an intermediary step for international tax planning.

²⁰⁷ EU Joint Transfer Pricing Forum, Statistics on APAs in the EU at the end of 2017, available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/statistics_on_advance_pricing_agreements_2017_en.pdf

²⁰⁸ Findings emerging from the country research show that is the case in Denmark, Germany, Estonia, France and Finland.

²⁰⁹ For example, in Estonia. Findings from the country research.

²¹⁰ Findings from the country research in Germany: This practice is called 'box privilege' (*Schachtelprivileg*), see § 8b Abs. 4 KStG).

²¹¹ For example, in France. Findings from the country research.

²¹² A personal holding company is a corporation in which five or fewer persons control at least half of the company's stock and in which at least 60% of the company's income is passive income from companies it owns' (Farlex Financial Dictionary, 2009, available at:

<https://financial-dictionary.thefreedictionary.com/Personal+Holding+Company>).

²¹³ van der Does de Willebois et al., 2011.

²¹⁴ Based on country research in Luxembourg.

The relationship between funds and substance is complicated by the interaction between the investor, a holding company and the investment itself. In general, funds aim to have a tax-neutral fund vehicle where investors pool their money. This can be achieved by using a tax transparent structure often in a low-tax jurisdiction (an OFC)²¹⁵. Based on the country research, fund vehicles are a popular form for alternative investment funds, given their flexibility and track record of use, in the Netherlands, Ireland and Luxembourg²¹⁶, where special regimes are in place, exempting certain kinds of funds from taxes²¹⁷. Offshore finance funds can also be used to instigate a hostile takeover of a company for a beneficiary in another jurisdiction²¹⁸.

Fiscal practices

In an international context and within EU Member States' domestic tax systems, 'residence for tax purposes' is used as the connecting factor with respect to corporate income tax liability. However, the way in which tax residence is defined differs between Member States²¹⁹. More specifically, a company is generally subject to corporate income tax on its worldwide income (comprehensive taxation) in a given Member State if it is a tax resident of that Member State. Whether that is the case depends on domestic tax law, as Member States are free to define the criteria that they use to define residence. Broadly speaking, there are two approaches in Member States' domestic tax laws. The first is based on formal criteria, such as the place of incorporation or statutory seat. The second is based on substantive criteria, such as the place of management or the principal place of business. Several use both criteria, so that, for instance, a company is a resident if it is either incorporated in the country or effectively managed there.

As Member States are free to decide which criteria to use when defining domestic tax law (and because they may simultaneously use different criteria), it is possible that two or more Member States may consider the same company to be resident for tax purposes in their territory. As a result, there is a risk that that company would be subject to comprehensive taxation in more than one Member State. In order to mitigate that risk, tax treaties provide for a tie-breaker rule to resolve conflicting jurisdiction claims.

Box 5. Tax treaties

One of the main functions of tax treaties is to allocate taxing powers between the two countries that are party to the treaty. For different types of income, a tax treaty will determine which of the States is entitled to tax. With regard to the business profits of a company, the general rule is that only the State of which the company is tax resident (as defined in the treaty) is entitled to tax the income (except in case where the company has a permanent establishment in the other State). Tax treaties generally define the term 'resident of a Contracting State' as 'any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature'. As noted above, however, it is possible that the two States use different criteria to determine whether a company is liable for tax there. For that reason, tax treaties also provide for a tie-breaker rule that determines which of the two States is considered to be the residence state for the purposes of the tax treaty.

²¹⁵ Funds structuring for substance, available at: <https://www.collascrill.com/documents/factsheets/funds-funds-structuring-for-substance/>

²¹⁶ SIF can be used to invest in all types of assets. SIFs that appoint an EU Alternative investment fund manager (AIFM) benefit from a passport allowing the AIFM the marketing of shares, units or partnership interests to EU-based eligible investors (Association of the Luxembourg Fund Industry: [https://www.alfi.lu/en-GB/Pages/Setting-up-in-Luxembourg/Alternative-investment-funds-legal-vehicles/SIF-\(Specialised-Investment-Funds\)](https://www.alfi.lu/en-GB/Pages/Setting-up-in-Luxembourg/Alternative-investment-funds-legal-vehicles/SIF-(Specialised-Investment-Funds))).

²¹⁷ *Ibid.*

²¹⁸ van der Does de Willebois et al., 2011.

²¹⁹ For example, Articles 1(1) and 4 of the OECD Model Tax Convention.

Traditionally, the OECD model used the place of effective management as the tie-breaker criterion. Where both contracting States consider a company resident under their domestic law, the OECD model provided that only the State where that company's place of effective management was situated could be considered the residence state for tax treaty purposes. Since the 2017 update of the OECD model, however, that approach has been changed and the model now recommends that dual residence conflicts be solved by mutual agreement between the contracting States. In the absence of such agreement, the dual resident company is in principle not entitled to relief or exemption under the tax treaty. That new approach was introduced in order to prevent the use of dual resident companies to claim tax treaty benefits in inappropriate circumstances, but it has not yet been included in all applicable tax treaties.

The OECD model provides an exception from the general rule that a company's business profits are only taxable in its State of residence in case the company has a permanent establishment (PE) in the other State. In such a situation, the other State (the PE state) can tax the profits that are attributable to the PE. The PE concept can be seen as a threshold that must be met in order for a State where a non-resident company conducts activities to be able to tax the profits generated from those activities. Examples of PEs include an office, a factory, a mine and, under certain circumstances, a dependent agent acting on behalf of the company. In order to prevent companies from using strategies to circumvent the PE definition (and consequently avoid taxation in the State where the activities are conducted), BEPS Action 7 suggested several changes to the PE definition in the OECD model. Those changes were incorporated in the 2017 update of the OECD model.

As there is no common approach to the connecting criteria used to define residence for tax purposes in Member States' domestic laws, the resulting discrepancies can be used to obtain tax benefits. For instance, if a Member State that uses incorporation as the decisive criterion for determining residence for tax purposes has a favourable tax regime, a company could be incorporated there for tax reasons while being managed and/or conducting its activities elsewhere.

Tax planning and avoiding double taxation

Despite the lack of a statutory definition of the concept of tax planning, there is arguably consensus that it refers to legal practices applied to reduce tax liability through planning the use of allowances, deductions or exemptions. In the countries examined in-depth in this study, tax planning is one of the most frequent and common legal uses identified for letterbox companies. Apart from special forms (such as SPEs or holding companies for tax purposes), there are several other ways in which letterbox companies are used for tax planning purposes. Whether a use is legal or not depends on the use, purpose and specificities of the respective national taxation system.

For example, the use of letterbox companies for tax planning is common in Germany and is generally considered legal as long as the tax planning aspect is not the sole reason for the company's existence²²⁰. Provision § 42 of the tax code (*Abgabenordnung*) specifies that 'the tax law cannot be circumvented by misusing the possibilities for shaping the law'. A common practice in Germany is the use of a letterbox company to structure real estate 'share deals' (purchase of companies owning real estate) to reduce liability for real estate purchase tax (*Grunderwerbsteuer*) by planning and applying deductions and exemptions. This is because any share purchase representing less than 95% of a company holding the real estate does not trigger the tax. This process is typically applied by large real estate companies and often involves letterbox companies from other EU countries, particularly Cyprus.

²²⁰ Findings from the country research in Germany.

Letterbox companies used for tax planning (e.g., for social security and income tax) are considered a borderline issue in Estonia, as in many cases there is a fine line between tax planning and tax evasion. To avoid paying income tax, for example, natural persons (for whom the tax rate is 20%) channel their transactions through a letterbox company, for example to sell shares to a third party²²¹. As long as the avoidance of tax is not the sole purpose for setting up the company, however, the transaction could be considered legal.

Based on findings from the national research for this study, the use of artificial undertakings for tax planning is a legal and frequent practice in some other Member States²²². These artificial corporate structures are indeed sometimes used to achieve a more favourable tax law interpretation from tax authorities (and facilitate tax planning), or to conduct services for other entities generating costs (e.g., letterbox companies using intellectual property to reduce tax liability by shifting income offshore)²²³. In Switzerland, literature on domicile companies suggests that they are chiefly established and used for tax reasons, which is generally considered legal²²⁴.

One business association interviewed flagged that letterbox companies are used to avoid double taxation²²⁵ e.g., by making use of tax exemptions to the parent company, eliminating the risk that the same income is taxed in the Member State of the subsidiary and Member State of the parent company.

Protecting the identity of the company or its shareholders

Another use discussed in the literature is the practice to establish a letterbox company to protect the identity of either the company itself or the shareholders. Setting up an artificial corporate structure to increase anonymity is frequently used in the US, where it facilitates the protection of privacy of wealthy individuals, including hiding personal wealth to diminish the risk of kidnapping (among others)²²⁶. This practice can also be useful for well-known companies when buying or renting property or land to protect them from price increases by the sellers, which are likely to occur if the latter knew the true identity of the buyer²²⁷. In principle, protecting someone's identity in order to be treated equally is legal unless this practice conceals the identity of the ultimate beneficial owner and funding sources, which runs contrary to the AML Directives (see Section 6).

Based on the country research, in both Germany and the US, letterbox companies are legally used to temporarily conceal the development of a new product until its release and to protect trade and business secrets, e.g., in order to secretly enter into a new market or make an investment in a new technology without alerting competitors.

Flags of convenience²²⁸

Establishing and using letterbox companies is a common procedure in the maritime and fishery, and lately also the aviation, sectors. Vessels are regularly registered in one or

²²¹ Findings from the country research in Estonia.

²²² This seems to be the case in Belgium, Cyprus (in both countries, national experts reported that tax planning was the main legal reason for using LBCs), Estonia, Germany, France and Poland. In France, taxation laws take account of the head office (*lieu de l'établissement principal*) in order to subject a company to French tax.

²²³ Findings from the country research indicate that this is the case in Poland, where such a practice is legal.

²²⁴ Findings from the country research in Switzerland.

²²⁵ Interview No.2.

²²⁶ Findings from the country research in the US.

²²⁷ EPRS (European Parliamentary Research Service), An overview of shell companies in the European Union, 2018, available at:

http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf

²²⁸ At the time of finalisation of this report, the European Commission has published a Study on social aspects within the maritime transport sector, June 2020, which is available at: <https://op.europa.eu/en/publication-detail/-/publication/a14413d7-bf30-11ea-901b-01aa75ed71a1/language-en>

several territories in which the taxation, social security and/or other regimes are more favourable, called 'flags of convenience'. The ships and aeroplanes are subject to the jurisdiction and control of their flag state and have to comply with that country's laws and regulations covering the standards of vessel construction and equipment, and the manning of ships, including the labour conditions onboard, safe navigation and the protection of the environment²²⁹. Historically, this practice has been used for security purposes (to avoid acts of piracy). Nowadays, however, legal and economic reasons prevail, including bilateral shipping agreements with other countries, shipping services support (e.g., government presence at main international ports), along with lower taxes. Some Member States²³⁰ are among the countries that are frequently chosen by companies to register their ships²³¹. To register a ship in a Maltese or Cypriot ships' registry (especially for EU-based companies), letterbox companies are frequently used, including because of existing local agent companies. Finnish shipping companies are also known to regularly register their ships through foreign letterbox companies often in countries that seem advantageous for tax²³² (such as Liberia, Panama, Marshall Islands).

Other legal uses of letterbox companies

The literature indicates that letterbox companies are used legally to **facilitate other operations**, for instance to **ease inheritance** through a letterbox company based in another jurisdiction, to sequester liabilities, to create distinctive equity or debt tranches in a single asset²³³. The literature discusses other generally legal uses of letterbox companies, such as **protecting assets from currency fluctuations** (a retiring person, for example, wishing to move abroad could see the value of their assets depreciate with the local currency fluctuations and to avoid so, place assets in a company based in another jurisdiction)²³⁴. Especially in emerging markets, letterbox companies are used to **protect the finances of small companies or individual entrepreneurs** against arbitrariness and corruption, thus ensuring the survival of the business²³⁵.

Letterbox companies established in readiness for a future project, enabling entrepreneurs and other stakeholders to **start their economic activity immediately** and not only after having completed a lengthy registration process has also been identified as a legal reason by one business association interviewed²³⁶. People who want to conduct business immediately can make use of a company that was set up previously but did not perform any economic activity (regularly dormant/sleeping or shelf company). This use is often observed among start-up companies. Moreover, letterbox companies are often used to **lower costs for setting up a company**. Entrepreneurs - especially start-ups - may have an interest in making use of the law of a Member State that make the set-up of a company less costly and with more protective standards with regard to liability protection for the

²²⁹ Hamad, H.B., 'Flag of convenience practice: a threat to maritime safety and security', *Journal of Social Science and Humanities Research*, p.221; Jorens et al., 'Atypical Forms of Employment in the Aviation Sector', *European Social Dialogue*, European Commission, 2015.

²³⁰ In the context of the research carried out for this study, this seems to be the case in Cyprus, Finland, Malta and, to a lesser extent, France and Germany.

²³¹ International Transport Workers' Federation, available at: <http://www.itfglobal.org/en/transport-sectors/seafarers/in-focus/flags-of-convenience-campaign/>

²³² Findings from country research in Finland.

²³³ van der Does de Willebois et al., 2011.

²³⁴ European Parliament, The impact of schemes revealed by the Panama Papers on the economy and finances of a sample of Member State, 2017, available at:

http://www.europarl.europa.eu/RegData/etudes/STUD/2017/572717/IPOL_STU%282017%29572717_EN.pdf

²³⁵ *ibid.*

²³⁶ Interview No.2.

owner compared to the country where the actual business take place, or the service will be provided²³⁷.

4.2.3 Illegal and abusive uses of letterbox companies

Determining which uses of letterbox companies are illegal or abusive depends on many circumstances, particularly the jurisdiction and policy area in which the use takes place. Alongside the fulfilment of objective elements that define an offence, the assessment seems to very much strongly depend on the existence of a subjective element, namely the intention of the person using the letterbox company to obtain undue advantage²³⁸. The assessment of the intended purpose of a company also varies from one jurisdiction to another, in terms of verification, authorities involved and the available information²³⁹ (see Section 5).

Illegal uses of letterbox companies appear to be most widespread in the following areas:

- **Organised and white-collar criminal activities**, in particular to conceal or launder proceeds of crime, terrorist financing, corruption related offences, organised VAT-fraud, sidestepping contractual obligations (such as anti-competition clauses and insider dealing prohibitions).
- **Illegal and abusive fiscal practices**, which distinguish between illegal tax evasion and tax fraud, and abusive tax avoidance.
- **Activities in the context of labour and social security law** with the purpose of avoiding social contributions or the payment of wages.

4.2.3.1 Financial crime

Letterbox companies appear to be used in the context of different types of crimes and offences, including money laundering²⁴⁰, terrorist financing²⁴¹, corruption and VAT fraud. An OECD report from 2001 points out that a common feature of the companies involved in such activities seems to be the guaranteed anonymity of the company's ultimate beneficial owner²⁴². Jurisdictions with lax financial secrecy laws and practices have therefore been found to attract criminals and terrorists²⁴³. A 2010 study, which undertook an experiment to assess the process of forming anonymous letterbox companies²⁴⁴, concluded that while company service providers (TCSPs) in small island offshore centres refused to proceed with company incorporation without proof of identity, TCSPs in high-income countries (UK, US,

²³⁷ A well-known example is the use of UK limited liability companies by German start-ups up until 2008. In response, German company law underwent a reform in 2008 and a special limited liability company (UG – mini-GmbH) has been introduced that provides for similar characteristics to the UK's LLC.

²³⁸ van der Does de Willebois et al., 2011.

²³⁹ Interview No.2.

²⁴⁰ European Commission, Assessment of the risk of money laundering and terrorist financing affecting the internal market and relating to cross-border activities, SWD(2019) 650 final, 2019, p.53, available at: https://ec.europa.eu/info/sites/info/files/supranational_risk_assessment_of_the_money_laundering_and_terrorist_financing_risks_affecting_the_union_-_annex.pdf

²⁴¹ *ibid.* p.106

²⁴² OECD, *Behind the corporate veil: using corporate entities for illicit purposes*, 2001, pp. 33-37.

²⁴³ Pacini et al., 'The role of shell entities in fraud and other financial crimes', *Managerial Auditing Journal*, 2018, available at: <https://doi.org/10.1108/MAJ-01-2018-1768>.

²⁴⁴ Sharman, J.C., 'Shopping for anonymous shell companies: an audit study of anonymity and crime in the international financial system', *Journal of Economic Perspectives*, Vol. 24, No. 4, 2010, pp. 127–40, available at: <https://doi.org/10.1257/jep.24.4.127>.

Spain) agreed²⁴⁵. While much has changed in the EU since then²⁴⁶, a recent American study demonstrates that in most states in the US, it was easier to register a company than to obtain a library card, with none of the states requiring proof of beneficial ownership or address, or application in person, and very few requiring contact information and data on management²⁴⁷. As well as helping to hide the ultimate beneficial ownership of the company in the context of criminal activities, letterbox companies can also help to conceal and launder the proceeds of crime²⁴⁸ and as well as conceal the illegal origin of funding (e.g. in the case of terrorism financing)²⁴⁹.

Money laundering

Organised crime groups usually rely on the services of professional money launderers to launder the proceeds of crime²⁵⁰. In the context of money laundering, LBCs/shell companies can, together with other tools, be used at the different stages of money laundering. A typical scheme used in professional money laundering includes the following steps²⁵¹:

Step 1: the criminal proceeds are transferred (or deposited) to accounts opened in the name of shell companies controlled by the money launderers or operating on their behalf.

Step 2: Funds are moved through a complex chain of accounts established by domestic shell companies under fictitious contracts. The funds from different clients are mixed within the same accounts.

Step 3: Funds are then transferred to shell companies abroad, using fictitious trade contracts, loan agreements, securities purchase agreements between the shell companies.

Step 4: Funds are moved through a chain of accounts set up in the name of shell companies around the world. Professional launderers may operate these accounts from overseas, while they are locally managed by service providers and nominal directors.

Step 5: Funds are then returned to the accounts of legal companies controlled by the initial clients, again based on fictitious contracts.

(See the relevant case study in Annex 4 for more detail, together with some specific examples of investigated cases.)

Criminals may take advantage of intermediaries, such as accountants, legal professionals, and especially TCSPs to launder money²⁵² and the use of letterbox or shell companies in money laundering schemes is common. One frequent abusive scheme that has been

²⁴⁵ *ibid.*

²⁴⁶ In Spain for instance, this no longer seems to be the case (see FATF (2018), available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/fur/Follow-Up-Assessment-Spain-2019.pdf>).

²⁴⁷ Global Financial Integrity, *The library card project: the ease of forming anonymous companies in the United States*, 2019, available at: <https://secureservercdn.net/45.40.149.159/34n.8bd.myftpupload.com/wp-content/uploads/2019/03/GFI-Library-Card-Project.pdf?time=1596933159>

²⁴⁸ EPRS, Study on tax evasion, money laundering and tax transparency in the EU overseas countries and territories, 2017.

²⁴⁹ Findley, M., Nielson, D. and Sharman, U., *Global Shell Games: Experiments in Transnational Relations, Crime, and Terrorism*, Cambridge: Cambridge University Press, 2014; Gordon, R.K., 'Laundering the proceeds of public sector corruption', SSRN Scholarly Paper, Rochester, NY: Social Science Research Network, 2009, available at: <https://papers.ssrn.com/abstract=1371711>

²⁵⁰ Europol, *Serious and Organised Crime Threat Assessment*, 2017, p.18; FATF, Laundering the proceeds of corruption, Report, 2011.

²⁵¹ FATF, 2018, p. 18, available at: <http://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf>

²⁵² FATF, Money laundering using TCSPs, 2010, available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/Money%20Laundering%20Using%20Trust%20and%20Company%20Service%20Providers..pdf>

identified is the case of 'pre-constituted' companies, where TCSPs may play a role in obscuring the beneficial owners. In these cases, EU-based TCSPs may register a company locally in the EU in the name of a beneficial owner, which is initially a shell company registered and owned by a foreign-based TCSP. This foreign-based TCSP in turn may transfer the ownership or 'sell' the shell company to another beneficial owner, who may be involved in criminal activities and money laundering. This underscores the need for continued due diligence and up-to-date information on a company's beneficial owner - while the establishment of a shell company may not reveal anything suspicious, the company may subsequently be misused to launder money²⁵³.

Box 6. Money laundering cases and uses of letterbox companies

Case 1: In November 2019, a cybercrime network was dismantled by the Bulgarian General Directorate for Combating Organised Crime (GDCOC). The criminals used a vast network of letterbox companies to carry out the crime, i.e. to steal money from companies and launder it. The cyber-criminals stole about EUR 60 million from 50 companies based in the US, Canada and the EU. They infiltrated the communication between accounting departments of such companies and their business partners. By creating a sophisticated system of fake email accounts, they managed to divert bank transfers from these companies to a wide network of letterbox companies. In the first layer, intermediaries for the criminal group's leader established 90 letterbox companies in Bulgaria by recruiting homeless or socially disadvantaged persons, in whose names the companies were registered. A second intermediary recruited and managed another layer of 'financial mules' who registered letterbox companies in China and Hong Kong. The stolen funds were transferred from the Bulgarian letterbox companies to the Chinese/Hong letterbox companies. Finally, these companies laundered and transferred the money back to the criminals either via cryptocurrencies or via transfer through another layer of letterbox companies in offshore jurisdictions²⁵⁴.

Case 2: Operation Snake was initiated following suspicious transaction reports from Spanish banks. A group of Chinese nationals and related (mostly shell) companies made small cash deposits followed by transfers to China of a total value of more than EUR 6 million. The investigators established that all were members of an organised criminal group, who imported counterfeit goods or committed customs crime by avoiding import taxes on consumer goods. The participants used 'smurfing' – making multiple deposits by low-level associates (trafficked workers), using fraudulent documents, into personal and shell company bank accounts. The shell companies were also registered in the names of trafficked workers. The shell companies then transferred the money back to China. Some of the cash was also transferred in other ways – by mid-level cash curriers or via a Chinese informal cash transfer mechanism - Feich'ien (Chinese Hawala). In total, 126 companies were indicted for laundering EUR 300 million²⁵⁵.

The case study presented in Annex 6 shows how investment funds and special purpose entities through which trillions of euros in assets pass can experience difficulties in monitoring all investors and their activities due to the volumes of operations and transactions. External oversight is also a challenge due to the fact that the volume of assets

²⁵³ *ibid.* p.40.

²⁵⁴ GDCOC, Press conference 5 December 2019, available at: <http://news.bnt.bg/bg/a/povdignakha-obvineniya-na-shestima-ot-grupata-s-fishing-izmami>

²⁵⁵ Austrian Delegation and Europol, *The role of criminal "Hawala" and other similar service providers (HOSSPs) in illegal immigration, money laundering and terrorism financing – recommendations for changes and other initiatives*, 2017, p.9, available at: <https://www.statewatch.org/media/documents/news/2017/sep/eu-council-austria-europol-hawala-money-transfer-crime-12005-17.pdf>

in such institutions surpasses GDP, as in the cases of Ireland and Luxembourg. The case study shows how Section 110 SPEs have been abused in Ireland for the purposes of money laundering.

VAT fraud

Cross-border VAT fraud schemes, sometimes using letterbox companies, can be designed and operate in multiple ways (missing trader fraud, carousel fraud, reduced rate fraud, e-commerce fraud)²⁵⁶, thus largely contributing to revenue losses, commonly referred to as the VAT gap (the difference between expected VAT revenue and VAT actually collected).

Criminal organisations register letterbox companies in one Member State, with the intention of committing VAT fraud in another Member State. The MTIC fraud scheme²⁵⁷ uses the letterbox company in the role of a missing trader (mostly) or buffer company in a typical carousel fraud scheme. In its simplest form, the MTIC scheme involves the sale of goods from company A in Member State 1 to Company B in Member State 2. In such a transaction, according to EU rules, no VAT is paid when goods are exported from one Member State to another. Then, Company B sells the goods to Company C in the same Member State. Company C pays for the goods plus the 20% VAT. Company B, instead of transferring this money to the tax authorities, steals it and typically closes after a few months. When authorities attempt to recover the VAT, they find that Company B is a missing trader²⁵⁸.

These companies usually do not have staff, assets or business capacity. They commonly register with a non-existent address. Missing traders are registered in the names of foreign nationals, another letterbox company registered offshore, or socially disadvantaged persons.

Other criminal schemes

Virtual currency wallet/exchange services. In recent years letterbox companies have also appeared in fraud cases involving virtual currency wallet/exchange service providers. After obtaining a licence to provide such services, the letterbox companies start to operate as a legal virtual currency/exchange service provider offering money in exchange for virtual currency. However, once the virtual currency/exchange service provider receives the virtual currency from its clients, it fails to provide any real currency in return. Thereafter, the companies cease all contact with their clients and disappear. As the regulation around such companies is relatively weak, the scheme is seen as a lucrative opportunity to earn money.

4.2.3.2 Illegal and abusive fiscal practices

Although there is no legal definition of these concepts, it is generally accepted that **tax evasion** (or tax fraud) refers to the deliberate illegal evasion of taxes, which is generally punishable under criminal law or tax law. This includes evasion of taxes by hiding income or information from the tax authorities or by falsifying information. Tax fraud is illegal, although Member States differ in their definitions of what constitutes such fraud.

²⁵⁶ European Parliament, VAT fraud: economic impact, challenges and policy issues, TAX3 Committee, 2018.

²⁵⁷ Definition available at: <https://www.europol.europa.eu/crime-areas-and-trends/crime-areas/economic-crime/mtic-missing-trader-intra-community-fraud>; Lamensch, M. and Ceci, E., VAT Fraud, European Parliament, 2018, p.15, available at:

<https://www.europarl.europa.eu/cmsdata/156408/VAT%20Fraud%20Study%20publication.pdf>

²⁵⁸ Interview No. 6.

Tax avoidance involves activities intended to reduce a taxpayer's tax liability. Although technically this is not illegal, it is contrary to the intent of the legal rules and is thus abusive²⁵⁹.

Distinguishing between legal, abusive and illegal practices when it comes to fiscal matters is not always an easy task (see Section 4.2.1). Within the concept of tax avoidance, what is abusive or not can be determined using the abuse test (subjective and objective element) developed by the CJEU (see Section 4.2.1).

Tax considerations can play an important role in the decision to set up the letterbox company. Depending on the set-up and objectives of the structure, the following distinctions can be drawn:

- Letterbox companies used as '**base companies**';
- Letterbox companies used as '**conduit companies**';
- Letterbox companies used to **exploit differences or mismatches** between different countries' tax legislation.

A **base company** may be used for both tax evasion and tax avoidance purposes. The distinction between tax evasion and tax avoidance depends on the nature of the activities undertaken.

When the base company takes the form of an undertaking situated in a low-tax or non-tax country used to shelter income and reduce taxes in the taxpayer's home country, this implies **tax evasion**. Instead of making the investment or carrying out the activity directly, the taxpayer sets up a base company to make the investment or carry out the activity. The objective is to avoid being subject to tax for the income from the investment or activity in the controlling shareholders' home country. Instead, it is hidden in the residence country of the base company.

Base companies are typically set up in a country that imposes little or no tax on the income earned and that has a favourable treaty network with the state(s) from which that company income is generated. In addition, this state usually has no transparency requirements for tax purposes, such as exchange of information (automatic or request-based) in place. A base company can be a letterbox company but that is not always the case if it carries out activities.

A base company may also be set up with the intention to **avoid taxes** and requires the involvement of more than two jurisdictions (a practice referred to as 'treaty shopping'). Indeed, **treaty shopping** 'connotes a premeditated effort to take advantage of the international tax treaty network and a careful selection of the most favourable tax treaty for a specific purpose'²⁶⁰. More specifically, if a tax resident of Member State (A) intends to carry out an activity in another Member State (B), the profits made would be subject to tax in the first Member State (A) (depending of the tax treatment in Member State B). However, to avoid that, the same resident could set up a base company in a third Member State (C), a country which exempts foreign income for instance, and then use that base company to conduct business in Member State (B). The profits would then be sheltered from taxation in Member State (A) (and would also be exempt in Member State C due to the exemption in that country for foreign-source income). In such a case, the base company can be characterised as a letterbox company, as it does not develop any activities in its state of establishment (Member State C) and is incorporated there solely for tax reasons.

²⁵⁹ Dourado, 2017; Allain et al., *Facing tax fraud in the European Union – challenges and perspectives*, 2016, available at: http://www.ejtn.eu/Documents/THEMIS%202016/Semi%20A/France2_TH_2016_01.pdf

²⁶⁰ Rosenbloom, H.D., 'Tax treaty abuse: problems and issues', *Law and Policy in International Business*, Vol. 15, 1983, p. 766.

This approach (treaty shopping) also appears in situations where a tax resident of a given state who is not entitled to the benefits of a tax treaty establishes a conduit company in another state in order to obtain those treaty benefits that would otherwise not be available to them.

A **conduit company** is interposed between its controlling shareholder(s) and an income stream in order to claim the benefits of a tax treaty or an EU directive (directive shopping) in relation to that income²⁶¹. This form of use of letterbox companies is especially relevant to companies incorporated in the EU, as the application of the Parent-Subsidiary Directive (with respect to dividends) and the Interest Royalty Directive (with respect to interest and royalties) would grant such companies access to important withholding tax exemptions on payments received from or made to other companies established in the EU. The most straightforward example is a situation where a person resident in state X expects to receive a dividend from state Y and sets up a company in state Z that will receive that dividend in a more tax-favourable way than if the income were paid directly to the state X resident.

Assume for instance that parent company P, resident in country X, has a subsidiary S in country Y. Under its domestic law, country Y levies a withholding tax of 30% on dividend distributions, but that rate is reduced to 15% under the tax treaty between countries X and Y. Consequently, if S distributes a dividend to its parent company P, country Y will levy withholding tax at the treaty rate of 15%. Now assume that country Z does not levy withholding taxes on dividend distributions under its domestic law and has a tax treaty with state Y that reduces the withholding tax rate on dividends to 0%. In order to reduce its tax burden, the group could consider setting up a letterbox company in country Z and transferring the shares in subsidiary S of the parent company P to the letterbox company. If S then distributed a dividend, that distribution would be exempt under the tax treaty between country Y and country Z. The subsequent distribution by the letterbox company to parent company P would be exempt in accordance with the domestic law of country Z.

Conduit companies regularly have little or no economic activity beyond holding assets. They are sometimes used to implement a limited activity that the tax authorities regularly do not recognise as a real activity. More specifically, a parent company establishes a subsidiary that has little or no activity (letterbox subsidiary) and transfers its company debt or tax liabilities to the subsidiary with the objective of evading stricter tax standards in one country and exploiting favourable tax rules in another. Those companies are used to transfer funds (e.g. dividends) from a subsidiary to a parent company via an intermediate holding company (the company without any economic activity), which is regularly established in a third country²⁶².

Finally, letterbox companies can be set up to **exploit differences or mismatches between the tax legislation of different jurisdictions**. A letterbox company could, for example, be incorporated in country A (which links tax residency to the place of effective management) but have its place of effective management in country B (which links tax residency to the place of incorporation). In such a case, a situation of double non-taxation could potentially be achieved (dual non-residence mismatch)²⁶³, leading to no taxation of

²⁶¹ De Broe, L., *International tax planning and prevention of abuse*, IBFD, 2008, p. 5.

²⁶² Sørensen, K. E., 'The fight against letterbox companies in the internal market', *Common Market Law Review*, Vol. 52, No. 1, 2015, pp. 85-118.

²⁶³ Conversely, a letterbox company could be incorporated in country A (which links tax residency to the place of incorporation) but have its place of effective management in country B (which links tax residency to the place of effective management). Depending on the wording of the tax treaty between country A and country B, a situation of dual residence could arise, which would allow the company to benefit from the advantages applicable to residents under the domestic law of country A without being subject to reciprocal obligations (e.g. being able to shift its foreign losses to another resident company under a domestic law group relief system while claiming treaty protection against taxation of its foreign profits). In this regard, reference can be made to the recent change to the OECD Model Convention described earlier.

income²⁶⁴ or a double deduction (e.g., expenses that are tax deductible in two high-tax countries at the same time or generating taxable interest income in two low-tax jurisdictions at the same time)²⁶⁵. Both practices would be tax avoidance and be considered abusive. However, since 2017, the OECD, through its G20 BEPS project (see Section 6.1), envisages a set of anti-abuse rules intended to discourage treaty shopping by precluding treaty benefits for companies where there is no sufficient link between a company and its country of residence²⁶⁶. While it is too early to draw any conclusion on the effectiveness of this initiative (provisions started to take effect with respect to some treaties as of 1 January 2019), treaty networks are expected to be adjusted such that undesirable effects of treaty abuse should lessen in the coming years. Furthermore, in an EU context, the 2016 ATAD obliged EU Member State to introduce a GAAR for corporate income tax purposes which may also target abuse of tax treaties and could thus be used as a tool to counter treaty shopping in some cases (fully discussed under Section 6.1).

A recent court case provides an example of a Luxembourgish SOPARFI established to take advantage of the more favourable tax regime available under Luxembourg legislation, even if overall SOPARFIs can legally be used as vehicles for the management and holding of financial interests in other resident and non-resident companies (see Section 4.2.2). In this case, an Italian court (Florence Court of Appeal) examined the specifics of the activity and the corporate purpose of Luxembourg SOPARFI holding interests in Italian companies to understand whether the 'creation of a purely artificial situation' existed²⁶⁷. It found that the Luxembourg SOPARFI had no indicators of activity in the traditional sense (little organisational structure, little administrative expenditure, little invoicing, etc.).

Another example of letterbox company used to exploit differences or mismatches between the tax legislation of different jurisdictions are those that are established to acquire income collected as royalties on intellectual property and trademark rights. As examined above, this is legal in principle, as long as it happens within the borders of what is considered legal tax planning. In cases in which their use is solely to evade the payment of taxes, this would be illegal.

Moreover, a letterbox company can be used illegally to evade liability, to create secret monopolies that would breach competition provisions, or for abusive transfer mispricing or transfer pricing manipulation²⁶⁸ when two related parties (two subsidiaries of a single parent group) intentionally distort the price of a trade to minimise the overall group's tax bill. In these cases, the company's activities could fall under the illegal category.

4.2.3.3 Abusive practices in the context of employment and social security

Letterbox companies may be set up to take advantage and exploit labour mobility and freedom to provide services. In this context, the existing legal framework in relation to the free movement of workers, freedom to provide services and rules governing the posting of workers across the EU, as well as the coordination of social security schemes are relevant.

²⁶⁴ Ruchelman, S.C., 'Holding companies of Europe – tax planning for European expansion in a changing Europe', *Insights*, Special Edition, year unavailable, pp.28-29, <https://www.uria.com/documentos/publicaciones/5823/documento/InsightsHoldCo2018.pdf?id=7921> (accessed: 24.10.2019).

²⁶⁵ See also Johansson et al., 2017, p.7.

²⁶⁶ OECD, BEPS Action 6: <https://www.oecd.org/tax/beps/bepsactions/action6/>. The proposal includes both a specific anti-abuse rule in the form of a limitation on benefits (LOB) clause, as well as a general anti-abuse rule referred to as a principal purposes test (PPT), now included in Article 7(8)-(13) of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (2017).

²⁶⁷ Spet, L., Annotated case law, criminal law and criminal procedure (*Jurisprudence commentée, Droit Pénal et Procédure Pénale*), 2018, Legitech; Ruling Court of Appeal of Florence, 3rd corr. ch., May 11, 2018 (Arrêt CA Florence, 3e ch. corr., 11 mai 2018), n° 2424, Reg. Sent. n° 2010/007904 N.R.

²⁶⁸ See Tax Justice Network, available at: <https://www.taxjustice.net/topics/corporate-tax/transfer-pricing/>

Private international law rules contained in Articles 8 and 9 of Rome Regulation I²⁶⁹, in addition with the Posted Workers Directive²⁷⁰ (PWD) and the Enforcement Directive²⁷¹, and the Regulations on the coordination of social security schemes (the Coordination Regulations²⁷²) provide the legal framework applicable to mobile workers within the EU.

In relation to cross-border mobility, determining the national legal framework applicable to a worker's situation is not always straightforward. Article 8(2) of Rome Regulation I prioritises the habitual place of work which, in case of uncertainty, is replaced by Article 8(3), which applies the law of the country where the contracting business/employer is located. Finally, if the work contract is more closely connected with another country, it is the law of that country which may apply (the 'escape clause').

According to the PWD, workers are allowed to be sent by their employers to temporarily work in another Member State in order to provide services but remain covered by an employment relationship with the posting company in their home country²⁷³. According to the Social Security Coordination Regulations, posted workers²⁷⁴ remain subject to the social security scheme of their home country, albeit for a limited period of time only.

In practice, letterbox companies may be used for fraudulent or abusive purposes, in particular for employers to benefit from more favourable national schemes.

For example, letterbox companies can be used to circumvent rules and avoid more restrictive legal obligations than in the home country²⁷⁵. This is the case where a letterbox company is set up and used to hire more affordable labour and/or to circumvent labour costs. Literature shows that letterbox companies are often established in a Member State with low(er) social contributions and post workers exclusively to another Member State (with higher social contributions), with the ultimate objective of paying lower social contributions for those posted workers²⁷⁶. Such arrangements often involve complex, multi-level arrangements between a number of companies established in several Member

²⁶⁹ Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I), OJ 2008, L 177/6.

²⁷⁰ Directive 96/71/EC concerning the posting of workers in the framework of the provision of services, OJ L 1997/18, 1 as amended by Directive 2018/957, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0957&from=EN>

²⁷¹ Directive 2014/67/EU on the enforcement of Directive 96/71/EC concerning the posting of workers in the framework of the provision of services and amending Regulation (EU) No 1024/2012 on administrative cooperation through the Internal Market Information System (IMI Regulation), OJ L 2014/159, 11.

²⁷² Regulation 883/2004 on the coordination of social security schemes and Regulation 987/2009 laying down the procedures for implementing Regulation 883/2004.

²⁷³ Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services as amended by Directive 2018/957. It should be kept in mind that core terms and conditions of employment of the host Member State apply if they are more favourable to the worker and no matter which law applies to the employment contract.

²⁷⁴ As per Article 12(2) of Regulation 883/2004, the definition of posted workers encompasses self-employed persons temporarily posted in another Member State, while self-employed are excluded from the definition of posted workers as provided in the Posted Workers Directive. It is noted however that the proposal of the Commission to revise the Regulations on the coordination of social security systems (COM(2016) 815 final) aimed to, among others, clarify the relationship between the Coordination Regulations and the Posting of Workers Directive. Notably, Article 12 of the Basic Regulation was amended to clarify that the term 'posted worker' should be given the same meaning it is given within the Posting of Workers Directive (more details in: '60 years of social security coordination from a workers' perspectives', Y. Jorens and F. De Wispelaere, (2019) <https://socialsecuritypr.belgium.be/sites/default/files/content/docs/fr/publications/rbss/2019/rbss-2019-1-fr.pdf#page=115>).

²⁷⁵ Hastings and Cremers, 2017.

²⁷⁶ European Parliament, 2019.

States, a complexity of relationships that makes genuine control by public authorities very difficult²⁷⁷.

Letterbox companies can be used to create fraudulent contractual arrangements between firms and fraudulent subcontractors with a view to benefit from cost savings (*i.e.* lower-cost labour/tax regulations of the Member State where the subcontractor is established). For example, some companies establish intermediary (letterbox) entities to subvert from the employment and working conditions of the higher cost Member State. Given that such companies are difficult for labour inspectorates to detect, they often engage in abusive working practices, such as setting extremely low wages, illegal overtime and punitive work conditions²⁷⁸.

The road **transport sector** is particularly exposed and impacted by letterbox companies. Regulated by a specific set of rules, the road transport sector has been at the heart of lengthy debates and political negotiations for several decades and is, finally, undergoing major reform. After years of discussions, the Mobility package I was adopted in July 2020 and contain three sets of measures aimed at modernising the sector (see more detail about this sector in Annex 4).

Following the 2004 accession of Eastern European Member States to the European Union, Western European operators regularly form companies in one or more Eastern European Member States, where costs are significantly lower in terms of salaries, social contributions and taxation compared to the EU15 countries.²⁷⁹ Remunerated at a lower rate than their Western European counterparts, Eastern European drivers usually earn from 300 to 950 Euro (against 950 to 3,300 Euro for Western Europeans).²⁸⁰ This difference in wages and salary levels, coupled together with the ease of establishing a letterbox company, has contributed to the fraudulent use of the letterbox companies in the sector. In addition, Member States had become more permissive with such letterbox companies. As a result, some companies no longer need to be physically based in a Member State, as long as they have a contract with a company that may provide them with the services or facilities to fulfil the conditions of Regulation 1071/2009.

A study describes the following real-life cases of fraudulent letterbox company practices²⁸¹. In Italy, various cases of illegal cabotage operations by letterbox companies were identified in the Marche region. Several international transport companies have set up their logistics headquarters in the Marche region, but employ Eastern European drivers (mainly from Bulgaria, but also from Poland and Ukraine) under the letterbox companies established there. Such drivers operate either within Italy or from Italy to other European countries (but never to their countries of origin, which could be expected to be their intended use of establishing the company in Bulgaria or Poland) and drive trucks that are registered in Bulgaria or Poland. According to the authors of that study, such practices enable transport companies to offer transport prices that are between 20% and 25% lower than the minimum tariff set by the national legislation in Italy, with disruptive effects on the market, mainly to the detriment of other transport undertakings that do not have letterbox companies in Eastern Europe.

However, such use of transport companies is not confined to cases between Eastern and Western European countries. German letterbox companies have been observed to perform their activity in Denmark, Belgium and the Netherlands. Analysts have established, based

²⁷⁷ Voss, E. et al., Posting of Workers Directive: current situation and challenges, Ssrn, 2016, doi: 10.2139/ssrn.2817462.

²⁷⁸ *ibid.*

²⁷⁹ Pastori, E. and Brambilla, M. (2017), Road Transport Hauliers in the EU: Social and Working Conditions. [online] Available at: <http://www.trt.it/wp/wp-content/uploads/2013/04/EST92453.pdf> [Accessed 1 July 2019].

²⁸⁰ Pastori, E. and Brambilla, M. (2017), Road Transport Hauliers in the EU: Social and Working Conditions. [online] Available at: <http://www.trt.it/wp/wp-content/uploads/2013/04/EST92453.pdf> [Accessed 3 September 2018].

²⁸¹ *ibid.*

on the views from the Member State authorities, that letterbox companies in this sector have an average cost advantage of around 30%, due to their savings on social security and labour costs²⁸². Other existing estimates are much higher, as they show that letterbox companies can save as much as 90-95% on labour costs and social contributions²⁸³.

4.3 Main findings on how letterbox companies operate

Building on the findings of the previous sections (Sections 2 and 3), which outlined that letterbox companies consist of corporate structures lacking economic activity in their country of incorporation, either as a result of a complete absence of genuine activity or because they carry out their activities solely in another country, this section explored the different ways in which these artificial undertakings are being used.

Often depicted as and associated with abusive and/or illegal activities, letterbox companies require further analysis, particularly in a Europe striving for an internal market that protects its citizens.

The absence of a commonly accepted definition of letterbox companies complicates this exercise. Without a clear delineation of the phenomenon, it is difficult to draw clear-cut conclusions on the legitimacy of these companies. It is therefore easier to undertake a sectoral analysis, examining each policy area in turn.

The creation of the Single Market, characterised by its four fundamental freedoms, offers companies and workers the possibility to incorporate and move freely within the Union. Seen as the cornerstone of the EU integration and a key driver for growth, the Single Market allows companies to operate cross-border and take advantage of economies of scale. This translates to situations where companies will incorporate or move to jurisdictions offering more favourable fiscal, legal and social settings.

It is settled case-law that measures that prohibit or limit the exercise of freedom of establishment must be considered restrictions on the freedom of establishment unless justified and proportionate. European and national legislators recognise the existence of abusive behaviours and allow, under certain conditions, for restrictive measures.

As outline in Section 2, the *modus operandi* of letterbox companies varies from one sector to another and the way they are perceived depends on political and historical considerations, as well as stakeholders' views (see Section 2).

In the area of taxation, letterbox companies are often used for regime shopping. With a view to benefiting from more advantageous fiscal regimes and/or avoiding taxation (thanks to agreements that may exist between two or more jurisdictions), some undertakings will decide to incorporate in one country and operate in another. Depending on the way the letterbox company operates to obtain benefit, the qualification of the behaviour observed will range from legal to illegal. A wide array of tax-driven practices are employed by letterbox companies, some deemed legal (SPEs, holdings, tax planning, conduit companies, flags of convenience, etc.) while others clearly falling within the illegal practices' category (tax evasion and tax fraud).

The distinction between the legal and abusive/illegal practices of these companies is not always obvious and the legal classification will often depend on the underlying **intention**.

Letterbox companies can be also used as conduits to channel funds, a mechanism commonly used by money launderers as the anonymity of the company's ultimate beneficial owner makes it easier for criminals to operate through hidden letterbox companies. In this case, the establishment of a letterbox company will not be illegal, but it will be used illegally to launder money.

²⁸² Gibson et al., Ex-post evaluation of Regulation (EC) No 1071/2009 and Regulation (EC) No 1072/2009, Ricardo, Report for the European Commission, 2015.

²⁸³ ETF, An ETF manifesto for the improvement of working conditions of professional drivers in Europe, 2012.

The way letterbox companies operate in the **employment and social security area** is another example of the complex distinctions between legal and illegal uses. Artificial undertakings may be used to avoid the payment of social contributions or the payment of higher wages. These arrangements are often complex, involving a number of companies established in several Member States, which makes control by public authorities difficult.

The illustrative descriptions provided in Section 4 show that classification is not readily evident and that letterbox companies operate in a way that is not black or white. Section 6 shows that several measures aimed at tackling abusive and illegal uses already exist and continue to be developed in the various policy fields concerned.

5 The role of company law

The European Economic Community was established with the goal, *inter alia*, of forming a genuinely common market between Member States. There are now around 27 million companies in the EU²⁸⁴ and they play a crucial role in promoting economic growth, creating jobs and attracting investment in the EU. Achieving a common market entails the removal of barriers to trade and competition and other less direct obstacles²⁸⁵, as well as allowing companies to establish themselves freely in any part of the EU. Articles 49, 50, and 54 of the TFEU form the legal basis for European company law.

Problems encountered as a result of the diverse national solutions in company law formed the original impetus for the programme of European company law harmonisation, which was started in the 1960s and gained steam in the late 1990s²⁸⁶. The Commission successfully harmonised some areas of company law, especially those that impact on cross-border mobility and operations of companies, such as disclosure and restructuring²⁸⁷. Given the risks often associated with competition and different regulatory philosophies across Member States, finding political consensus for broader harmonisation of company laws, including corporate governance, has proven to be more difficult. With the exception of disclosure and nullity requirements²⁸⁸, most of the substantive legal rules on the formation of companies and the requirements to be fulfilled for a company to maintain its legal status under national law (existence requirements) are not harmonised. While a number of substantive incorporation requirements (e.g. minimum capital requirement, requirement to have a registered and head office in the same Member State) are harmonised for the European Company (*Societas Europaea* - SE)²⁸⁹, a special European company law form, those which are not covered by EU legislation follow the national provisions for public limited liability companies in Member States.

This section examines the national differences in company law and their potential consequences for the phenomenon of letterbox companies. It explores whether a link exists between substantive company law requirements regarding the incorporation of companies and the maintenance of their status, and the use and availability of letterbox companies.

5.1 Substantive company law requirements applicable to limited liability companies

The CJEU has observed that companies are 'creatures of national law'²⁹⁰. Member States have the authority to establish their own substantive company law requirements, determining the conditions under which companies can be incorporated, exist and be recognised as subjects of rights and obligations in their territory. As discussed above,

²⁸⁴ Estimation based on Eurostat data from 2016.

²⁸⁵ See Preamble and Articles 2 and 3 EC.

²⁸⁶ Armour, 2005.

²⁸⁷ The various harmonisation measures are now largely codified in Directive 2017/1132 relating to certain aspects of company law, codifying a large part of EU company law. This Directive was amended in 2019 by Directive 2019/2121 as regards cross-border conversions, mergers and divisions and Directive 2019/1151 as regards the use of digital tools and processes in company law. See also Commission Implementing Regulation (EU) 2015/884, establishing technical specifications and procedures for the system of interconnection of business registers (BRIS), Directive 2009/102/EC, providing a framework for setting up single-member companies, the Shareholders' Rights Directive 2007/36/EC, setting out certain rights for shareholders in listed companies, amended by Directive (EU) 2017/828, which aims to encourage more long-term engagement of shareholders, and the Takeover Directive 2004/25/EC, setting out minimum standards for takeover bids (or changes of control) involving securities of EU companies.

²⁸⁸ Initially harmonised as part of the First Company Law Directive (Directive 68/151/EEC), now codified as part of the general EU Company Law Directive (Directive 2017/1132/EU).

²⁸⁹ Council Regulation (EC) No. 2157/2001 on the Statute for a European Company.

²⁹⁰ CJEU, *Daily Mail*, C- 81/87 § 19, 1998, reiterated in *Cartesio*.

companies that are formed in accordance with the law of one Member State enjoy the freedom of establishment, and thus cannot be unjustifiably subjected to the substantive company law requirements of another Member State merely because of the location of the company's headquarters or central management there²⁹¹.

The combination of the freedom of establishment and the incomplete harmonisation not only in the area of company law but in other areas such as taxation, employment and social security, have created an environment in which some of the differences between Member State legal frameworks might make it easier for letterbox companies to be established and used.

To determine the interplay between substantive company law requirements and the availability and existence of letterbox companies, this section compares selected national substantive company law provisions in the 15 Member States and four third countries analysed in-depth in this study and reviews the national requirements for a company to be considered incorporated in their country and to maintain that link throughout the company lifecycle. It also seeks to shed light on the effect of technological developments on substantive company law and examines the effect of enforcement of the relevant incorporation requirements at national level on letterbox companies.

5.1.1 Relevant incorporation requirements

5.1.1.1 Different types of incorporation requirements

Incorporation requirements stipulate the conditions for a company to be incorporated in a certain jurisdiction. In the absence of harmonisation, each Member State is free to determine the conditions under which domestic companies can be incorporated. Article 54 TFEU states that 'Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.'

The relevant decisions of the Court of Justice in this context include *Daily Mail* and *Cartesio*. In *Daily Mail*, the Court interpreted a UK tax rule and held that requirements which establish a connection to the country of incorporation, at least those that are in line with Article 54 TFEU, do not constitute a restriction under the Treaty, and thus do not have to be justified, even if they result in a company being unable to relocate its headquarters. In *Cartesio*, the Court confirmed this view, repeating that it is in line with EU law for Member States to apply the real seat-like requirements, for instance by requiring the maintenance of a company's headquarters or other physical presence in the home State's territory. Having the full power to define the substantive connecting factor, Member States are free to prevent a company from maintaining its status in their territory in cases where that company moves its seat to the territory of another Member State²⁹² and thus to determine that any departure from their territory breaks that connection.

This power to define the substantive connecting factor does not imply that national legislation is exempted from the EU rules on freedom of establishment and, in particular, cannot justify a Member State preventing a company from converting itself into a company

²⁹¹ See, for example, *Inspire Art*; Gerner-Beuerle et al., 2019; Gerner-Beuerle, C., and Schuster, E., 'The costs of separation: friction between company and insolvency law in the single market', *Journal of Corporate Law Studies*, Vol. 14, No. 2, 2014, pp. 287-332; Kersting, C., Corporate choice of law - a comparison of the United States and European systems and a proposal for a European Directive, *Brook. Journal of International Law*, Vol. 28, No.1, 2002; Allmendinger, C., Company law in the European Union and the United States: a comparative analysis of the Impact of the EU freedoms of establishment and capital and the US Interstate commerce clause, *William and Mary Business Law Review*, 4, 2012, p. 67.

²⁹² CJEU, 16 December 2008, *Cartesio*, C-210/06, para. 110.

governed by the law of another Member State to the extent that it is permitted under that law to do so²⁹³.

In *VALE*, the Court repeated that the choice of a connecting factor is in line with the freedom of establishment and that the Member State of incorporation 'has the power to define [...] the connecting factor required of a company if it is to be regarded as incorporated under its national law [...]'²⁹⁴. According to the Court's conclusions in the *VALE* case, 'Articles 49 TFEU and 54 TFEU must be interpreted - in the context of cross-border company conversions - as meaning that the host Member State is entitled to determine the national law applicable to such operations and thus to apply the provisions of its national law on the conversion of national companies governing the incorporation and functioning of companies, such as the requirements relating to the drawing-up of lists of assets and liabilities and property inventories. However, the principles of equivalence and effectiveness, respectively, preclude the host Member State from refusing, in relation to cross-border conversions, to record the company which has applied to convert as the 'predecessor in law', if such a record is made of the predecessor company in the commercial register for domestic conversions, and refusing to take due account, when examining a company's application for registration, of documents obtained from the authorities of the Member State of origin'.

15 Member States and 4 third countries (including UK) assessed in-depth for the purpose of this study can roughly be classified into **three broad groups** in relation to their substantive requirements establishing a connection between limited liability companies and the country of incorporation. These groups are based on the different levels of **connection between companies** and the **country of incorporation**²⁹⁵.

- i. The first group contains jurisdictions, following the **incorporation theory** under substantive company law, i.e., those which only have **minimal requirements** (registered office address/mailbox) for a factual connection between companies formed under their laws and their own territory. Belgium, Bulgaria, Denmark, Ireland, Cyprus, the Netherlands, Romania, Finland, the UK; most corporate law jurisdictions in the US and Panama company law only require companies to have a registered office in the country.
- ii. The second group consists of jurisdictions in which substantive law requirements are in place which not only require the company to have its registered office in the country of incorporation, but which also require a **more significant factual connection** to that jurisdiction, e.g. by obliging companies to have their headquarters, central administration (i.e. the place from where it is effectively managed and/or operated) or principal place of business in the country or even at the place of its registered office. Spain, Luxembourg and Austria fall within this group and follow the **real seat theory** under substantive company law.
- iii. The third group consists of jurisdictions which require some **factual connection** beyond the registered office **but** where the **exact requirements** are at least somewhat **ambiguous**. 'Mixed' systems with different features can be found in company law in Germany, Estonia, France, Poland and Switzerland.

These different groups are discussed in detail below.

²⁹³ CJEU, 16 December 2008, *Cartesio*, C-210/06, para. 112.

²⁹⁴ CJEU, 12 July 2012, *VALE Építési kft.*, C-378/10, para. 29.

²⁹⁵ Based on the country report findings.

i. Countries following the incorporation theory under substantive company law

Company law in all of the countries analysed has provisions requiring companies to establish and maintain their '**registered office**'²⁹⁶ in the country of incorporation. It is worth bearing in mind that the terms 'registered office' and 'place of incorporation' are often used interchangeably, since all (registered) companies in the EU must have a registered office, and all Member States and the UK require the registered office to be located in the jurisdiction of incorporation²⁹⁷.

Requiring companies to maintain a registered office in the country of incorporation means, in effect, that companies must indicate an **address** (*i.e.* that of the registered office) that is then entered into the business register, although it does not have to be the place where the company has physical premises. For example, in the Netherlands and the UK, it is possible to indicate a trust office or business centre as the address, often leading to hundreds or even thousands of companies using the same registered office address (see Section 3.2.3). This means that companies can simply use a **mailbox** (or a mail forwarding service) in the country of registration, where letters addressed to the company can be delivered and received.

In incorporation-theory countries, a company can have its registered office in the country of registration without having the centre of administration, the principal place of business or any activity in the same place²⁹⁸. The mere requirement to establish and maintain a registered office in the country of incorporation thus does not prevent the creation of companies that do not perform any economic activity in this country. On the contrary, it seems that unless other more substantive incorporation requirements exist, incorporation-theory countries could facilitate the set-up of letterbox companies.

Indeed, in some incorporation countries, high numbers of companies have registered their offices at the same address²⁹⁹ (see section 3.3.3). This fact could possibly indicate that there are no substantial activities going on at this location, which could point to the existence of letterbox companies. While all countries require companies to maintain their registered office on their territory, of the 19 countries examined in this study, 11 do not require any factual connection beyond this formal and minimal obligation. Among them are Belgium, which recently changed its company law accordingly, as well as Bulgaria, Denmark, Ireland, Cyprus, Netherlands, Finland, Romania, the UK, the US and Panama. However, it should be noted that there are differences between countries in this group. Some countries have some additional requirements beyond the registered office, such as *e.g.*, that a board member should be resident in the EEA, as mentioned in sections below.

Emerging concepts such as 'e-residency' and the increasing availability of fast and simple online registration of companies, combined with light registered office requirements, may have the effect of lowering the barriers to the formation of letterbox companies and reducing the associated costs.

²⁹⁶ Or at least an agent fulfilling registered office functions; see section 50(3) of the Irish Companies Act 2014.

²⁹⁷ Gerner-Beuerle et al., 2016, p. 28.

²⁹⁸ For instance, Swiss company law in principle requires companies to maintain an address at the place where their seat (legal domicile) is registered. For domicile companies, it is sufficient to maintain an address at an alien legal domicile, which will be considered the legal domicile of a 'domicile holder'.

²⁹⁹ Orbis data presented in Figure 3.9. shows that in the UK, Czechia, Slovakia, the Netherlands and Ireland, which all are incorporation countries, there is a substantial number of addresses where multiple companies are registered, possibly indicating that there are no substantial activities going on at those locations. This has been identified as a red flag that might indicate the existence of a letterbox company.

ii. Countries requiring a more significant factual connection to the country of incorporation under substantive company law

The jurisdictions in the second group require companies to establish a more significant factual connection to the country of incorporation, going beyond a registered office. These more substantiated incorporation requirements can, for example, consist of obliging companies to have their:

- Head office, headquarters, central administration or place of effective management³⁰⁰ in that country;
- Economic activity in that country, or even at the place of registered office, principal place of business (i.e. the place where the most significant part of the company's operations are conducted).

Those requirements are used by countries following the **real seat theory**. In general, there is no single, accepted definition of what constitutes a real seat approach, as requirements, definitions and the relevant factual patterns differ significantly between Member States.

In this study, the **real seat** is understood as the **head office, headquarters, central administration, place of effective management, principal place of business or economic activity**, typically referring to the **place which has the closest connection to a company's management and operations**.

In many jurisdictions, those requirements are not detailed and thus open to interpretation, which can lead to legal uncertainty and to differences in the activity required. In addition, the term "seat" (*Sitz/siège/siedziba*) can have different meanings across the Member States³⁰¹. Some jurisdictions tend to use the term 'seat' to describe both the registered and the head office³⁰².

Of the 19 jurisdictions analysed, those of Spain, Luxembourg and Austria require companies under substantive company law to maintain a real, factual connection beyond a registered office.

- To establish and maintain the required connection to Spain's territory, a company's registered office must be at its real seat, which is either where the main administration or management is located, or at its principal establishment, and it must be specified in the statutes whether it is one or the other. Spanish Company Law (article 9 of Ley Sociedades de Capital) also provides that Limited Liability Companies whose principal establishment (main place of business) is within Spanish territory must have their registered office in Spain, regardless of where their centre of effective administration and management are located. Finally, in the case of discordance between the registered office and the real seat (i.e. the place of principal establishment or the location of effective administration and management), third parties may consider either of them as the company office (Article 10 Ley Sociedades de Capital).

³⁰⁰ National concepts described by these terms often overlap and the terms are frequently used interchangeably in the relevant international literature. See, for example, Gerner-Beuerle et al., 2016; Ringe, 2007.

³⁰¹ See in detail recently, Mucciarelli, F. M., 'E pluribus unum? Language diversity and the harmonisation of company law in the European Union', *Maastricht Journal of European and Comparative Law*, 2019.

³⁰² Gerner-Beuerle et al., 2016, p. 28.

- Luxembourg's company law requires the maintenance of a real seat-like residence³⁰³, defining the company's seat as the company's central administration (before 2006 it was effective management). However, no statutory definition of the concept of 'central administration' exists, which thus leaves this concept open for interpretation. In national jurisprudence, the company's central administration or place of effective management refers to the place where essential decisions concerning the general management of a company are adopted and where the central administration's functions are performed³⁰⁴. The latter is determined by the place where the general meetings of shareholders and the meetings of the board of directors take place and is presumed to be the place of the registered office (statutory seat), unless rebutted and evidence is shown to the contrary³⁰⁵. Companies in Luxembourg must provide actual premises at their registered office where they can receive mail and hold meetings. While it is possible to use a fiduciary's services (*société de domiciliation*) to comply with this requirement³⁰⁶, these are obliged to verify whether the requirements of the Luxembourgish Act from 1999 are fulfilled. The goal of this arrangement is to avoid letterbox companies³⁰⁷.
- In Austria, domestic companies are required to establish a factual link by (i) having their registered office, at least initially, at the same place as their permanent establishment or operations, (ii) their headquarters or (iii) their central administration in Austria. It follows that at least some part of an Austrian company's economic activity must be located in Austria. This, however, may also be a (very) minor part of the company's overall business. In addition, Austria requires that at least one of the directors must be resident on Austrian territory.

iii. Countries belonging to the third group, i.e. with 'mixed' systems.

Jurisdictions belonging to this third group also require some **factual connection** to the country of incorporation beyond the registered office, but these **do not allow for a clear allocation to the first or second group of jurisdictions**. Five of the 19

³⁰³ Despite the clear reference to a real seat-like criterion in Luxembourg's company law, one author suggests that *de facto* the incorporation theory is applied in practice. (See Prüm, A., Baums, Th., Couret, A., Hannigan, B., De Kluiver, H.J., Kurcz, B., Loesch, J., Simonart, V., Strine, L. and Szpunar, M., 'Concurrence réglementaire/ regulatory competition', *Cent ans de droit luxembourgeois des sociétés*, Collection de la Faculté de Droit, d'Economie et de Finance de l'Université du Luxembourg, Bruxelles, Larcier, 2016, p. 558.). The emphasis placed on the location of the meeting of the bodies in the jurisprudence approach has been criticised in literature, stating that the place from where the company is actually managed should be determining. (See Conac, P-H., 'Le siège social en droit luxembourgeois des sociétés', *Journal des tribunaux Luxembourg*, No. 1, 2009, p. 4). Especially in big corporations, the directors enjoy a certain degree of autonomy by reference to the shareholders and the general meeting of shareholders might take place at a third location. If the statutory seat does not correspond to the real seat of the company, the latter will be 'fictitious' (*siège social fictif*). The restriction of the latter on the maintenance of the link in practice, however, seems to be low. This can be seen when looking at the very common practice of domicile facilities in Luxembourg, allowing companies to establish their headquarters in Luxembourg with a domicile agent (third party) which will then provide services to the company, such as access to meeting rooms or small office spaces where they can hold their general meetings or board of directors' meetings. The use of the domicile regime does not qualify the company's seat as fictitious since it is presumed that the company can operate therefrom.

³⁰⁴ CJEU, 28 June 2007, case C73-06, *Planzer Luxembourg S.ar.l. vs Bundeszentralamt fuer Steuern*.

³⁰⁵ Martins Costa, C., Richter, D., Geber-Lemaire, M. and Marchand, A., 'Regulation No 1346/2000 on insolvency proceedings: the difficult COMI determination, the treatment of groups of companies and forum shopping in light of the CJEU's and domestic case law, and the modernisation of the Regulation', *Droit Bancaire et Financier au Luxembourg*, 2014, para. 168.

³⁰⁶ See country report for Luxembourg in Gerner-Beuerle et al., 2019.

³⁰⁷ *ibid*.

countries analysed fall into this third category, namely Germany, Estonia, France, Poland and Switzerland.

- In Germany, a provision determining that the seat (*Sitz*, the place of the company's registered office) needed to be the place where the business establishment or where the management or the central administration was located, was removed from company law in 2008³⁰⁸. However, some legal scholars argue that it could constitute an abuse of law if there is no factual connection to the registered office at all³⁰⁹.
- In Estonia, although the details are unclear, companies need to establish and maintain some link between their activity and the registered office location. Under Estonian law, the seat (of a legal person) is defined as 'the location of the management board'³¹⁰. While not explicitly stated, only companies located in Estonia can (and have to) be entered into the commercial register, effectively resulting in 'location in Estonia' being the required connection. How this location is determined remains open³¹¹. In practice, this requirement (to the extent it applies) is not enforced by the register³¹². According to §29(1) GPCCA, the location of the company is 'a place from which the administration of the company is carried out'.

Since 2014, the e-residency programme is in place in Estonia and digital ID-cards are issued to non-residents, e.g., for the benefit of foreign entrepreneurs who own or want to establish a company in Estonia. Estonian e-residence allows non-Estonians secure access to services such as company formation, payment processing, and taxation. In addition, e-residents can establish their companies without having to pay a third-party representative or hire a local director³¹³. While Estonian domestic companies must maintain an address in the country, company founders are not obliged to be physically present at the registered address (as is the case in most countries traditionally following the incorporation doctrine). Moreover, e-residents are not obliged to ever come to the country of issuance. This could be seen as an aspect that facilitates the remote management of companies, or the establishment of companies without any economic activity in the country of incorporation. As recently outlined by an Estonian public broadcaster, around 5 000 businesses have been found to be registered at just three addresses in Tallinn³¹⁴. This strongly suggests that no substantial activities are undertaken at this location and that the companies function as 'letterboxes' at this address. Since the launch of the programme, the number of e-residences has grown to over 62 000, and e-residents have established over 10 100 companies in Estonia³¹⁵. Some view these

³⁰⁸ Act to modernise the Limited Liability Corporation Act and fight abuse (*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen – MoMiG*), 23 October 2008.

³⁰⁹ See country report for Germany in Gerner-Beuerle et al., 2019; Hüffer, U. and Koch, J., *AktG*, Munich: Beck 12th edition, 2016, s 5 para 8; Zöllner, W. and Noack, U, 2017, in Baumbach and Hueck's *GmbHG*, Munich: Beck 21st edition, 2017, s 4a para 4.

³¹⁰ 29(1) GPCCA (Estonian General Part of the Civil Code Act -*Tsiviilseadustiku üldosa seadus*).

³¹¹ See country report for Estonia in: Gerner-Beuerle et al., 2019.

³¹² Study on the law applicable to companies, 2016, p. 110, <https://op.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1>.

³¹³ Everis, *Study on digitalisation of company law*, European Commission, DG Justice and Consumers, 2017, p. 62, available at: https://ec.europa.eu/info/sites/info/files/dg_just_digitalisation_of_company_law_final_report.pdf.

³¹⁴ Findings from national research. See also EEE News (Estonian Public Broadcasting), 'E-residents, address services behind most letterbox companies' 2018.

³¹⁵ *ibid*.

developments as potentially linked to the surge in the establishment of letterbox companies in the country^{316,317}.

- French substantive company law does not explicitly restrict the choice of registered office, but the company's seat corresponds to the effective seat of the management of the company, which is characterised by the place where the corporate bodies meet. According to some commentators, choosing a registered seat that does not coincide with the real seat/is unconnected to the company's activities, may be treated by the courts as abuse of law; there also does not seem to be much case law on this issue³¹⁸.
- Poland requires the registration of the company's seat (*siedziba*, effectively where the registered office is) to incorporate a company. The place of the company's seat must be mentioned in the company's articles of association and disclosed in the commercial register (registry court). The registered seat refers to a specific city/ town/ village that must be within Polish territory³¹⁹. It is unclear if the Polish company law requires a link between the registered office and the company's activity, and this remains a constant point of discussion among scholars. Some argue that the registered office can be any place in Poland, not necessarily connected with the company's economic activity³²⁰ and that no links beyond the registered office are necessary. Others take the view that the general rules of the Civil Code should be applied, which would mean that the registered office should be the same place where the management board is located and where crucial decisions regarding the business activity of the company are adopted³²¹. Overall, legal doctrine seems to tend towards the understanding that the registered office shall be a place somehow associated with the company's activity (e.g., location of production plants or other business premises)³²². This does not necessarily need to be the seat of the management board, however. In practice, business registers do not scrutinize upon registration whether the company in fact conducts any of its business activity in a place of its registered seat³²³.
- In Switzerland, based on Article 56 of the Swiss Civil Code, '[t]he seat of the legal entity is located where its administration is carried out, unless its articles of association provide otherwise'. Swiss jurisprudence provides further interpretation of this provision, establishing that the 'location' is the place in which the company is 'factually' administered and in which the decisions concerning the management of the company are made and the orders given. In Switzerland, company law also stipulates that domestic companies must be able to be represented by one person who is resident in Switzerland. This person must be a member of the board of directors or an executive officer³²⁴.

³¹⁶ Findings from national research. See also EEE News, 2018.

³¹⁷ Gerner-Beuerle et al., 2019, p. 16.

³¹⁸ Study on the law applicable to companies, 2016, p. 112, (citing Merle P. 'Droit commercial: Sociétés commerciales', Dalloz, 18th ed. 2015, par.105): <https://op.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1>.

³¹⁹ The reason is that the shareholders' resolution on relocating the registered seat of a company abroad constitutes grounds for the dissolution of such company (country report for Poland in Gerner-Beuerle et al., 2019, p. 592).

³²⁰ Rodzynekiewicz, M., *Kodeks spółek handlowych – Komentarz* (4th edition), LexisNexis, 2012, pp. 254, 575.

³²¹ Pyziół, W. (Ed), *Kodeks spółek handlowych – Komentarz*, LexisNexis, 2008, p. 331.

³²² Country report for Poland (Gerner-Beuerle et al., 2019, p. 593).

³²³ Study on the law applicable to companies, 2016, p. 114, <https://op.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1>.

³²⁴ Article 718 para. 4 of the Swiss Civil Code.

5.1.1.2 Economic activity related requirements

As per the working definition used for this study, given that letterbox companies have no economic activity (in the country of incorporation or anywhere), it is important to look in more detail at whether there are any requirements **explicitly** relating to the companies' economic activity.

Although hardly any of the jurisdictions analysed have rules explicitly referring to the term 'economic activity', some elements related to company's activities can be found in a few Member States. Below are some examples of Member States which have reference to economic activities. However, as explained above, some Member States such as Spain and Austria have requirements related to principal place of business or permanent establishment or operations which also presume economic activities of the company.

- A reform of Belgian company law in 2019 introduced a requirement for incorporators of limited liability companies to make a self-declaration about the location in which the company will be operating once registered. Such a self-declaration of the intended activity must be included in the financial plan³²⁵, which must now contain more details than before³²⁶. For instance, companies need to take into consideration the future funding needs of their business to be set up and foresee sufficient initial assets to conduct the contemplated activities over a period of at least two years. From the obligation to draw up a financial plan, it could be derived that Belgian company law presupposes that a company will conduct some economic activity somewhere in the world³²⁷.
- Estonian company law leaves it open as to whether or not a link between a company's activity and its registered office is necessary and does not explicitly require economic activity within its territory. In Estonia, the place of business of a legal person is defined as the 'place where the permanent and continuous economic activity of the legal person or other activities specified in the articles of association of the legal person are carried out'³²⁸. There is, however, no statutory requirement for a company to have actual business premises at the registered office/business address³²⁹.
- Polish company law does not explicitly require any link between the registered office and company's activity³³⁰. However, as stated above, the interpretation of the rule is unclear and Polish legal scholars³³¹ tend to take the view that the registered office must be a place somehow associated with the company's activity but not necessarily the seat of the management board. This, however, is not enough to suggest that economic activity on Polish territory is required.

³²⁵ Article 5(4), § 2, 1°, Article 6(5), § 2, 1° and Article 7(3), 2, 1° Code of Companies and Associations.

³²⁶ Article 5(4), § 2 sets out that the financial plan must as a minimum include:

(1) a precise description of the planned activity; (2) an overview of all sources of funding when incorporating the company, including, where appropriate, the guarantees provided in this regard; (3) an opening balance sheet, as well as balance sheets projected after 12 and 24 months; (4) projected profit and loss account after 12 and 24 months; (5) a budget of projected revenue and expenditure for a period of at least two years from incorporation; (6) a description of the assumptions used in estimating the expected turnover and profitability; (7) where applicable, the name of the external expert who provided assistance in drawing up the financial plan.

³²⁷ Findings from the country research in Belgium. Especially: Article 5(4), § 2, 1°, Article 6(5), § 2, 1° and Article 7(3), 2, 1° of the Belgian Code of Companies and Associations (CCA).

³²⁸ §29 (2) GPCCA (Estonian Civil Code Act)

³²⁹ Country report for Estonia in Gerner-Beuerle et al., 2019.

³³⁰ Findings from national research.

³³¹ Country report for Poland in Gerner-Beuerle et al., 2019; Szajkowski, A., in Stanisław Sołtysiński, A., Szajkowski, A., Szumański and Szwaja, J. (Eds), *Kodeks spółek handlowych t. II, Spółka z ograniczoną odpowiedzialnością, Komentarz do artykułów 151–300* (3rd edition), C.H. Beck, 2014, p. 83; Kidyba, H., *Kodeks spółek handlowych t. I, Komentarz do artykułów 1-300* (9th edition), Wolters Kluwer, 2013, p. 648.

- In relation to Ireland, according to section 18(1) of the 2014 Irish Companies Act, 'A company shall not be formed or registered unless it appears to the Registrar that the company, when registered, will carry on an activity in the State'. Activity means in this context 'any activity that a company may be lawfully formed to carry on and includes the holding, acquisition or disposal of property of whatsoever kind'³³². The company's director or secretary must sign a specific declaration form. Once it appears to the Registrar of Companies that the company, when registered, will carry on an activity in the State, it issues an incorporation certificate. The Irish Companies Act also requires that at least one director must be resident in the European Economic Area (EEA). The incorporators need to certify this fact to the Registrar. However, this requirement does not apply if the company holds a bond, in the prescribed form, in force to the value of EUR 25 000³³³ or where the company has a certificate that it has real and continuous link with economic activity in the State. A company is deemed to have such an economic link, for example, if the affairs of the company are managed by one or more persons from a place of business established in the State and that person or those persons is or are authorised by the company to act on its behalf, the company is a subsidiary or a holding company of a company or other body corporate that satisfies the previous condition or the company carries on a trade in the State³³⁴.
- In Romania, companies are required to engage in some economic activity, with both activities within the country of incorporation and activities in other countries considered. Although Romanian companies are not explicitly required to perform some activity on Romanian territory, company law determines that companies must submit regular declarations to fiscal authorities and notify the authorities in cases where they do not conduct any economic activity at all. Where a company notifies the responsible authority about the ceasing of economic activity, the company will be dissolved based on a court decision. Effectively, this means that companies throughout their lifecycle are required to continuously perform some economic activity somewhere, while it is not mandatory that the company operates on Romanian territory.
- Finally, in France, the clerks will check that the address of the company seat and of the establishment are evidenced either by a lease contract, a residence certificate, or an electricity/ telephone bill. While French law does not require companies wishing to incorporate to conduct economic activities in France, the clerk may, in practice, refuse to register a company whose actual/real activities are exclusively performed abroad³³⁵. However, no further declaration is required. Once the company is registered, there is no regular control of the actual pursuit of the activity.

³³² International Business Publications, *Ireland: Starting Business, Incorporating in Ireland Guide - Strategic, Practical Information, Regulations*, p. 99.

³³³ Section 137 of the Irish Companies Act.

³³⁴ Section 140(9) of the 2014 Irish Companies Act provides that a company is deemed to have such a link if one or more of the following conditions are satisfied by it

(a) the affairs of the company are managed by one or more persons from a place of business established in the State and that person or those persons is or are authorised by the company to act on its behalf;

(b) the company carries on a trade in the State;

(c) the company is a subsidiary or a holding company of a company or other body corporate that satisfies either or both of the conditions specified in paragraphs (a) and

(d) the company is a subsidiary of a company, another subsidiary of which satisfies either or both of the conditions specified in paragraphs (a) and (b).

³³⁵ Interview with the clerk of the Commercial Court of Pontoise.

5.1.1.3 Requirements in the EU acquis

The real seat-related requirements in EU law are worth mentioning when discussing national approaches to determine the real seat. One of those is the Regulation for the European public limited liability company, the *Societas Europaea* (SE)³³⁶. One of the main characteristics of an SE is that the company's registered and head office must always be in the same country, creating a real link between the SE and the country of incorporation, which *de facto* is a real seat requirement³³⁷. The SE Regulation regulates the consequences of not having the head office in the Member State of registration and specifies that the Member State of registration 'shall take appropriate measures to oblige the company to regularise its position within a specified period either (i) by re-establishing its head office in the Member State in which its registered office is situated or (ii) by transferring the registered office' under a sanction of liquidation³³⁸. However, the SE Regulation does not provide for a definition of the 'head office', leaving the decision as to when the requirements are fulfilled to Member States' discretion. It is not unlikely that interpretations of the term 'head office' at national level lead to differences between the requirements in respect of the connection that must exist between the SE company and the country of registration, as different Member States will have varying definitions of what constitutes the head office³³⁹.

The SE Regulation (Article 2(5)) provides that a company whose head office is not in the EU may participate in the formation of an SE *if* it is formed under the law of a Member State, has its registered office in that Member State, and demonstrates 'a real and continuous link with a Member State's economy'³⁴⁰. The recital further explains that 'such a link exists in particular if a company has an establishment in that Member State and conducts operations therefrom.'

In other areas of EU law, more requirements could have an impact on letterbox companies. In the area of financial services, for example, the Capital Requirements Directive³⁴¹ requires that credit institution which is a legal person and which, under its national law, has a registered office, has its head office in the same Member State as its registered office. The directive on payment services³⁴² requires that for the purposes of granting an authorisation, a payment institution which, under the national law of its home Member State is required to have a registered office, shall have its head office in the same Member State as its registered office and shall carry out at least part of its payment service business there. The Directive on Alternative Investment Fund Managers (the AIFMD) prohibits delegation of management tasks by the manager of an alternative investment fund which would make them act as a *de facto* letter box company. Also, in the area of road transport

³³⁶ The so-called "SE-Regulation" (Council Regulation (EC) No. 2157/2001 on the Statute for a European Company which has as a legal basis Article 352 TFEU). came into force in 2004 in 31 EEA countries, providing companies that operate across borders the possibility of being established with a European corporate identity and operating with basic requirements that are the same in all the Member States. Alongside the SE-Regulation, the SE is subject to, and governed by, the national laws of the Member State of its domicile who implement the Regulation and transpose the SE Directive. This leads to a system, in which the basic set of rules applicable to SEs is harmonised, whereas the determination of details is left to the discretion of Member States.

³³⁷ Gerner-Beuerle, C., Mucciarelli, F., Schuster, E., & Siems, M. (eds.) (2019). *The Private International Law of Companies in Europe*. C.H. Beck, Munich, p.3.

³³⁸ Article 64 (1) and (2) of the SE-Regulation

³³⁹ In Austria, for instance, the SE needs to have its seat where it has a permanent establishment, or where it has its centre of administration or headquarter.

³⁴⁰ Article 2(5) of the SE-Regulation

³⁴¹ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

³⁴² Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC

and social acquis (see Section 6.3 and Annex 4), there are requirements in relation to companies which have a bearing on letterbox companies.

5.1.1.4 Evolution of the incorporation requirements

It is important to bear in mind that traditional understandings of the incorporation requirements are **currently experiencing substantial transformation**.

While the place of the registered office remains easily determinable, the notion of the real seat was challenged by a more globalised economy and, in the EU, the ambition to create a **borderless European Single Market** allowing companies to be involved and operate in several legal orders at the same time. Shareholders and directors often come from different jurisdictions than the one in which their company is registered. The generic understanding of the 'real seat' no longer seems fit-for-purpose to address this development.

Different indicators could be used to determine the location of a company's head office, central administration or place of effective management, such as the location of the **general meetings of shareholders**, the **seat of the board of directors** or the **meetings of the board of directors**. This is e.g. the case in Luxembourg, where these indicators are used to identify where the most important decisions in the company's life are taken³⁴³. The requirement of the centre of administration is deemed to be fulfilled when meetings of the board of directors and the general meetings take place in Luxembourg, even if the day-to-day management is conducted from abroad³⁴⁴. Due to formal requirements of this type, the location of the centre of administration will not necessarily coincide with the place with the closest connection to the company's operations or, indeed, management.

Countries whose substantive company law requires that the meetings of the board of directors and/or general meetings of shareholders are held in the country of incorporation seem to create a stronger connection with the country of incorporation. However, there appear to be many exemptions. For example, although Romania's substantive company law states that general meetings shall be held at the company's registered office and at the place indicated by the document convening the meeting at least once a year, the constituent act can provide otherwise. In Spain, while companies are required to have their registered offices either at their real seat, which is where the main administration or management is located, or at their principal establishment, Spanish company law provisions do not contain any requirements for the board of directors to meet on Spanish territory. In general, the board is required to meet every three months³⁴⁵, with no location specified. However, in cases where a president of the board has not conducted any meeting, directors representing at least one third of the board have the possibility to initiate it and to meet where the registered office is, within a month³⁴⁶.

It is worth recalling that, historically, legal concepts related to real seat were developed as sorts of proxies for the location of a company's main activities. Today, the management and control centre of the company might not necessarily correspond to what might traditionally have been the company's main or effective place of business (e.g., production plants) anymore.

³⁴³ District Court (*Tribunal d'arrondissement*) Luxembourg, 18 April 2008, case no 105744, in *Jurisnews- Droit des sociétés*, vol. 1, n° 12/2008; Luxembourg Court of Appeals, 7th Chamber, 21 October 2009, n° 33908 and Cass. 9 November 2010, n° 58/10.

³⁴⁴ Country report for Luxembourg in Gerner-Beuerle et al., 2019.

³⁴⁵ Article 245(3) LSC Company Law Act (*Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital*; hereinafter, 'LSC') as amended by Ley 31/2014, de 3 de diciembre) provides that the board of directors must meet at least once a quarter.

³⁴⁶ Article 246(2) LSC Company Law Act mentioned above

A second key development for the understanding of real seat is the transition into the **age of digitalisation**, a process that started several decades ago but which has greatly intensified and accelerated in the last decade. Technological advances have strongly shaped the way of doing business, with an increasing number of companies conducting ever-greater parts of their activity (or even all) online.

Nowadays, modern technology has rendered the link between the place where business decisions were taken (e.g. the location of board meetings) and the place at which companies' activities are far less reliable. Directors can easily and quickly travel to virtually any location in order to hold board meetings but holding board meetings at a common place is cumbersome in the age of globalisation, as directors are regularly scattered across different locations. Video conferencing is a communication method by which many people can gather in different locations, using real-time video. Enabling the board of directors to hold meetings without being physically present has the potential to reduce the inhibiting effects of geographical distance as well as inter-organisational frictions³⁴⁷. On the other hand, technologies such as video conferencing make it hard to determine a single physical location where decisions are reached and reduces the connection to the country of incorporation, which can facilitate the use of letterbox companies.

Some of the jurisdictions analysed have already reacted to the growing technological possibilities and included provisions relating to digital means to hold board of directors' meetings and/or general meetings electronically via video conferencing into their company law regimes³⁴⁸. In France, for example, meetings of the board of directors may be held via telecommunication or video conference³⁴⁹, as long as this possibility is provided for in the company's statutes. Some decisions and deliberations, such as the termination of the company's activities or consolidated financial statements, cannot be taken via video conference³⁵⁰. The Irish Companies Act of 2014 specifies that companies 'may provide for participation in a general meeting by electronic means including (i) a mechanism for casting votes, whether before or during the meeting; (ii) real time transmission of the meeting; (iii) real-time two-way communication enabling members to address the meeting from a remote location'³⁵¹. In Luxembourg, board meetings now frequently take place via video conference³⁵².

The rapid **technological progress** into a digitalised world also affects understandings of a company's economic activity: the value creation chain has increasingly moved online, rendering the physical location of production and sales facilities less relevant³⁵³. Beyond the disruptive effect on the traditional operation of companies, new technologies are likely to create new marketplaces. Examples for this are emerging online platforms, such as Airbnb or Uber, that gather vast amounts of data from users to increase the counterparty connectivity and to reduce the costs of transactions³⁵⁴.

³⁴⁷ Hamdani et al., 'Technological progress and the future of the corporation', *Journal of the British Academy*, Vol. 6, 2018, p.226.

³⁴⁸ A practice also encouraged by the Shareholders Rights Directive (2007/36) for general meetings of certain types of companies. It is also worth noting that due to the Covid-19 pandemic, several Member State introduced temporary measures to allow digital general meetings.

³⁴⁹ Articles L. 225-37, alinéa 3, R. 225-21 et R. 225-48 French Commercial Code.

³⁵⁰ Findings from national research

³⁵¹ Article 1106(1) Companies Act (2014)

³⁵² Article 444-4(3) of the Luxembourg law of 10 August 1915, as added by the law of 10 August 2016 provides that this meeting (and in fact, any other meeting via video conference) is deemed to take place at the place of the registered office of the company. Hence, it indirectly allows for meetings to be held electronically.

³⁵³ See also Kurcz, B. and Paizis, A., Company law, connecting factors, and the digital age - a new outlook, *European Company and Financial Law Review*, Vol 16, 2019, p.444.

³⁵⁴ Hamdani et al., 2018.

5.1.2 Other relevant substantive company law requirements

In terms of other substantive law requirements, those regarding directors, in particular **nominee directors** (appointed to represent the person appointing them vis-à-vis third parties), and the possibility to have legal persons as directors may be relevant factors in the context of letterbox companies, as they help to reduce transparency around ownership and activity. Those regarding minimum capital requirements set in national substantive company law are also relevant, as they can have an impact on where companies incorporate.

Based on the substantive company law regimes analysed, **nominee directors**³⁵⁵ are allowed for limited liability companies in Belgium, Spain, Cyprus, Luxembourg, the Netherlands, Austria, Switzerland, the US and Panama. Depending on the details of the company's articles of association, nominee directors can **have different responsibilities**, varying from registering the company, submitting relevant company information to the competent authorities, signing documents, administering bank accounts, organising general meetings, etc.

Although nominee directors are technically subject to all legal duties and responsibilities for directors in the jurisdiction in question, explicit and implicit arrangements typically mean that they have no discretionary control over the company. In Luxembourg, for both private limited liability companies (SARL) and public limited liability companies (SA), shareholders listed in the shareholders' register of the company can be appointed nominee director(s). In the Netherlands, however, the presence of a nominee director does not – from a civil law perspective – impact the existence of letterbox companies³⁵⁶.

Sometimes, the purpose of having a nominee director could be to protect or hide the identity of the actual ultimate beneficial owner of the company, ensuring anonymity. Achieving a certain level of secrecy seems, for various reasons, to be an important aspect of establishing and using an LBC (see Section 4). As the appointment of nominee directors creates anonymity for the company's owner, national company law provisions that allow this can play an important role in the context of letterbox companies and can, in severe cases, help organised crime organisations to hide and obscure the beneficial ownership of companies to conduct illegal activities. This is even more the case when a chain of interconnected letterbox companies is established, each having nominee directors, which adds to the difficulty of tracing back the ultimate owner(s). However, this practice should be prevented by the implementation of the 5th AML Directive³⁵⁷, to which all national jurisdictions are bound since January 2020, which intends to limit cases where directors can be indicated as beneficial owners to residual cases.

In the US, any company may have a nominee director, although in practice, nominee directors are almost always confined to letterbox companies³⁵⁸. In Switzerland, a company which has its seat in Switzerland and wishes to be registered in the Commercial Register must be represented by a person who is resident in Switzerland. This can be a managing director or a director. Thus, a designated director is a prerequisite for the existence of a letterbox company.

³⁵⁵ Attention must be paid to the context in which the term 'nominee director' is used. In offshore jurisdictions, for instance, the nominee regularly rents their name, which is used during the incorporation process. After that, the nominee is obliged to give all powers to the beneficial owner through a power of attorney. This is the case in Panama, as described in: Obermayer, B. and Obermaier, F., *The Panama Papers: breaking the story of how the rich and powerful hide their money*, 2017.

³⁵⁶ Findings from the research conducted at national level.

³⁵⁷ Directive 2018/843 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0843&from=EN>

³⁵⁸ Findings from the legal research conducted at national level.

Some jurisdictions provide for the right to appoint a **legal person as a director of a limited liability company** (Belgium, Spain, France, Luxembourg, the Netherlands, Romania, UK). In practice, this technique is regularly applied by a parent company which establishes a subsidiary company and then acts as the company's director. Sometimes, this practice is used in the context of tax planning in respect of directors' fees³⁵⁹. It could also potentially be used to reduce or bypass the directors' liability regime. What is possible in practice, however, strongly depends on the particularities of the national company law regime that allows for director-legal-entities.

- Belgian legal entities that are nominated as directors are obliged to immediately appoint a physical person as their permanent representative. Until May 2019, however, the legal entity nominated as the company's director regularly appointed another legal entity as permanent representative, which then again appointed a physical person as their permanent representative³⁶⁰. This facilitated the establishment and prolongation of chain of companies and, in turn, could result in veiling owners. The new Belgian Companies Code³⁶¹ determines that a legal entity appointed as director will only be able to appoint a natural person as its permanent representative and no other legal entity. This development could contribute to increased transparency.
- On the one hand, the recognition of corporate directors (legal persons) as directors in Spain³⁶² has been pointed out by legal doctrine as a factor that may allow for certain abusive behaviours, as it creates an 'in-between corporation', which can minimise transparency³⁶³. On the other hand, Spanish company law holds a provision that requires a natural person to represent the legal person director, which effectively contributes to more transparency.
- As for French limited liability companies, while both the manager and the general manager must be a natural person, directors may be legal entities. In the latter case, a natural person must be appointed as permanent representative and is subject to the same rights and obligations of a director³⁶⁴.
- When a legal person is appointed as a director in Luxembourg, that legal person is obliged to appoint a natural person as the permanent representative who is responsible for the execution of this task for and on behalf of the legal person. The representative is subject to the same conditions and assumes the same civil liability as if they were to carry out this task on their own account, without prejudice to the joint and several liability of the legal person that they represent³⁶⁵.

³⁵⁹ De Maeijer, S., Vastmans, S., Bidoul, V., Wessels, J. and Evers, D., VAT and directors' fees in the Benelux, *International VAT Monitor*, May/June 2017, available at:

https://www.tiberghien.com/images/publications/Stein_De_Maeijer2c_Stijn_Vastmans2c_Valerie_Bidoul2c_Joel_Wessels2c_Dirk_Evers_VAT_and_directors27_fees_in_the_benelux2c_International_VAT_Monitor_2017-3.pdf

³⁶⁰ Laga, Guide to the new Belgian Companies Code, 2019, available at:

https://www.laga.be/content/dam/assets/lg/Documents/Laga_NCC-Did%20you%20know_BE-2019.pdf

³⁶¹ The new Code will apply to new companies or in case of dispute resolution as from 1 May 2019. The rules will apply to existing companies as of the date on which they opt in voluntarily or, at the latest, 1 January 2020.

³⁶² Article 212(1) and Article 212 bis LSC (Spanish Company Law Act).

³⁶³ See, on the debate, Del Val Talens, P., *El administrador persona jurídica*, Madrid, 2017, pp. 61-62. This seems to be the only existing comprehensive study on the corporate directors in Spain.

³⁶⁴ Article L. 225-20 of the French Commercial Code, in conjunction with Article 225-54 which provides an age limit for the permanent representative, as follows: 'the company statutes must provide for an age limit for the exercise of the functions of 'general manager' (L. no. 2001-420 of 15 May 2001) "or deputy general manager" which, in the absence of an express provision, is set at sixty-five years of age.

³⁶⁵ Luxembourg's official information portal, available at: <https://guichet.public.lu/en/entreprises/creation-developpement/projet-creation/definition/responsabilite-dirigeant.html> (accessed on 14 November 2019).

- This is similar to the Dutch system, where legal person directors are allowed under national company law. In order to prevent the use of this construction to circumvent liability, Article 2(11) BW was introduced, which shifts the liability from the legal person as director to the natural persons behind it. However, the natural person behind the legal person cannot be held liable when a director is a foreign legal person and the other State does not have a comparable rule in place.
- In the UK, legal persons can be directors of companies but at least one director must be a natural person³⁶⁶.

Finally, some countries have **minimal capital requirements**. These generally intend to protect creditors and investors if a company experiences financial distress. Jurisdictions that do not have any capital requirement or in which the capital requirement is relatively low will often appear as a more attractive option – provided other requirements are either inexistent or easy to meet – to establish a (letterbox) company to reduce the costs. Countries, in which companies must deposit a high amount of minimum capital before they can begin their business operations, will regularly be considered burdensome and attract fewer entrepreneurs. Countries can broadly be grouped in two:

- **Countries with minimum capital requirements** for private limited liability companies: Denmark, Estonia, Spain³⁶⁷, Luxembourg, Austria, Poland³⁶⁸, Romania and Switzerland.
- **Countries with no or only a symbolic minimum capital requirement** (i.e., those that have minimum capital requirements of EUR 1) for private limited liability companies: Belgium, Bulgaria, Germany³⁶⁹, France³⁷⁰, Ireland, Cyprus, the Netherlands, Finland, the UK, most corporate law jurisdictions in the US, and Panama.

5.1.3 EU measures that may have an impact on letterbox companies

In the aftermath of the *Polbud* judgment, which contributed to opening up additional opportunities for companies in the internal market to foster economic growth, effective competition and productivity, in 2018 the European Commission put forward a proposal for a reform of EU company law, the so-called **company law package**. The latter resulted in the adoption of Directive (EU) 2019/1151 on the use of digital tools and processes in company law³⁷¹ and Directive (EU) 2019/2121 on cross-border conversions, mergers and divisions³⁷², both amending Directive 2017/1132. The package aimed to remove restrictions to the freedom of establishment by facilitating the company restructuring in

³⁶⁶ Section 155 (1) of the UK Companies Act 2006.

³⁶⁷ Spanish law generally requires limited liability companies (LLC) to have a minimum of EUR 3 000 available in order to incorporate in the country. However, a special provision foresees the possibility for LLC to incorporate for EUR 1, and to then fall under a special regime until the EUR 3 000 capital is reached (Article 4 bis LSC and the so-called *sociedades limitadas en regimen de formación sucesiva*). This situation is rather exceptional though.

³⁶⁸ It is noted that a recent company form allows the set-up of simplified joint-stock companies for PLN 1.

³⁶⁹ There is no minimum capital requirement for small GmbH (UG), however, 25% of the benefits have to go to a reserve until the company reaches the usual minimum capital requirement of a GmbH.

³⁷⁰ In France, there is no minimum capital requirement for setting-up a SARL (*Société à Responsabilité Limitée*), the most common form of limited liability company in the country [according to the French national institute for statistical and economic studies (*INSEE*), in 2017, 40% of companies created were SARLs]. There is, however, a minimum capital requirement for setting-up SA (*Société anonyme*), which are public limited liability companies and SE (*Societas Europaea*).

³⁷¹ Directive 2019/1151 on the use of digital tools and processes in company law; <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L1151&from=EN>

³⁷² Directive 2019/2121 on cross-border conversions, mergers and divisions; <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L2121&qid=1576662469712&from=EN>

the Internal Market, while providing adequate protection for stakeholders such as employees, creditors and members and making it easier to use digital tools in company law procedures.

Previously, **digital processes** were - to a limited extent - covered by EU law and significant differences between Member States existed with respect to the availability of online tools for companies. In 2018, 17 Member States³⁷³ provided a procedure for the fully online registration of companies, while the others required physical presence before the competent authority in order to register a company³⁷⁴. To address resulting inefficiencies and create a level playing field for companies, Directive 2019/1151, adopted on 20 June 2019, requires Member States to make it possible to establish a company, register branches and file documents online, without the necessity to appear in person before any competent authority or other person/body responsible for online formation, online registration of branches or online filing. The envisaged enhanced digital interactions between companies and Member State authorities are intended to lower the costs and burden for entrepreneurs and thus foster economic activity within the Internal Market³⁷⁵. In addition, the increased cross-border accessibility of up-to-date information about EU companies is designed to increase transparency³⁷⁶. Taking into account the risks flagged by stakeholders during consultations that such digital procedures could be abused, Directive 2019/1151 was explicitly designed with the aim that 'the use of digital solutions in company law, in particular for the registration of companies, should be done in such a way as to **avoid the possibility of fraud or abuse**'³⁷⁷.

To that end, the Directive defines a set of safeguards against fraud and abuse, such as compulsory identification control and the possibility for Member States to request information on disqualified directors from other Member States. More specifically,

- Member States must ensure secure identification online and use trusted services, which should allow for sound control of the identity and legal capacity of those setting up a company;
- Member States are allowed to require the physical presence of the applicant before any authority or person or body mandated under national law, provided there are reasons to suspect identity falsification or non-compliance with the rules on legal capacity, or when there are doubts as to the applicants' authority to represent a company;
- The Directive envisages the possibility for Member States to request information from other Member States on the disqualification of directors, thus opening the possibility to prevent fraudulent or other abusive behaviour;
- National authorities can request the presence of notaries or lawyers throughout the procedure, insofar as the procedures can be completed online.

Directive 2019/1151 is to be transposed into national laws by August 2021. Assessing the effectiveness of such measures is thus not yet possible. These safeguards are, however, expected to result in an increased ability by authorities to detect fraudulent and illegal activities, preventing potential abuses by letterbox companies established for fraudulent purposes.

³⁷³ BG; DK; EE; IE; FR; IT; LV; LT; MT; PL; PT; RO; SI; SK; FI; SE; UK (based on the Impact Assessment, SWD(2018) 141 final).

³⁷⁴ See Impact Assessment - Proposal for a directive amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions and as regards the use of digital tools and processes in company law, SWD(2018) 141 final.

Available online: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD%3A2018%3A141%3AFIN>

³⁷⁵ Recital 8 of Directive 2019/1151.

³⁷⁶ Recital 29 of Directive 2019/1151.

³⁷⁷ Commission Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law, COM(2018) 239 final, p.4.

Regarding **cross-border operations**, Directive 2019/2121 creates a legal framework for companies to move to another Member State (by carrying out a cross-border conversion) while maintaining their legal personality and to carry out cross-border divisions, and updates the previously existing rules on cross-border mergers. While the right to move to another Member State is inherent to the Treaty, as interpreted by the CJEU, the lack of legal certainty has so far meant that such cross-border conversions or divisions were difficult to achieve in practice. At the same time, many stakeholders and Member States called for an EU legal framework on conversions that would stimulate growth but would not lead to abuse, including a proliferation of "letter-box" companies for abusive purposes³⁷⁸. The Directive therefore contains significant **anti-abuse provisions** for all three cross-border operations, in the form of obligations for the authorities of the Member States³⁷⁹. Considering the previous lack of harmonisation for cross-border conversions and divisions at EU level, and given that some Member States did not have rules applicable to these operations, Directive 2019/2121 is an important tool for limited liability companies and practitioners within the EU who will no longer need to rely exclusively on CJEU case-law.

Among the changes brought by the Directive, the following appear particularly relevant to letterbox companies, in that they may be seen as disincentives to resort to artificial arrangements for abusive uses.

- Directive 2019/2121 requires that Member State authorities check the compliance of a cross-border conversion, division or merger with the law of that Member State. If all procedures and formalities are properly completed in the departure Member State, a so-called 'pre-operation certificate' is issued by the authorities. However, it also provides for an 'anti-abuse' check. Where the authorities see a risk that the cross-border conversion, merger or division could be used for abusive, fraudulent or criminal activities (that can also be conducted by using a letterbox companies, as seen in Section 4) that could breach or evade EU or national law, it will be refused. This pre-operation check provides a safeguard mechanism to prevent and detect abusive or illegal cross-border uses of letterbox companies.
- Legality check by the destination Member State: cross-border operations are also assessed in the Member State of destination, which checks compliance with the national legislation. More specifically, the authorities in the destination Member State will check if the new companies comply with its incorporation and registration requirements, thus ensuring that the mobility does not also increase the ease with which letterbox companies can be set up.
- Directive 2019/2121 provides safeguards for stakeholders involved in cross-border conversions, divisions and mergers, in particular for employees, creditors and minority shareholders. It requires sufficient information to be provided to stakeholders (and authorities) about a cross-border operation, e.g. through draft terms of a cross-border conversion, division or merger, through the reports for members and employees and a report prepared by an independent expert.

The draft terms will need to include information about the likely repercussions of a cross-border conversion, division or merger for employment, any safeguards for creditors and cash compensation for members. Shareholders and employees of converting, dividing or merging companies must be provided with a report (or two separate reports, for shareholders and for employees) indicating the potential impact and consequences of the operation overall and describing the implications for shareholders and employees (including changes to conditions of employment and to companies' places of business). Dissatisfied shareholders will have the option

³⁷⁸ Commission Impact Assessment accompanying the company law package, SWD(2018) 141 final, 2018, p.73, available online: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018SC0141&from=EN>

³⁷⁹ See Articles 86m, 127 and 160m of Directive 2017/1132, as amended by Directive 2019/2121.

to withdraw by selling their shares, while discontented creditors can seek protection from the courts when satisfaction of their claims is at stake.

Based on these measures, it seems unlikely that corporate mobility will exacerbate problems related to the use of letterbox companies. Nevertheless, it remains to be seen how difficult it will be for authorities to detect abusive or fraudulent cross-border operations in practice. Here again, it is too early to draw any conclusion about the effectiveness of such measures. It will be interesting to see how the situation evolves once the Directive is transposed by all Member States (the transposition deadline is in January 2023).

While the enhanced and new measures stemming from the company law package seem promising in setting up a framework that dissuades the use of letterbox companies for fraudulent and abusive purposes, time alone will tell if the anticipated deterrent effect is actually met and observed in practice.

5.1.4 Legal form and letterbox companies

This study examined whether **the use of letterbox companies might be inherent to the specific legal form of the company** or, more precisely, whether LBCs operate solely (or chiefly) under the form of a limited liability company.

It is often stated that limited liability companies seem to be the most common legal form appearing in the context of letterbox companies, although a variety of other legal entities can and are used as letterbox companies throughout the jurisdictions analysed. On the basis of the research, in some countries³⁸⁰, **limited liability companies** indeed appear to be the legal form most often chosen when operating as a letterbox company, with private limited liability companies also seemingly more frequently used than public limited liability companies.

A key reason is that the company's **owners will not be held personally liable** for debts should the company become unable to pay its creditors (*i.e.*, corporate veil), as the limited liability company is considered a separate entity (unlike partnerships or sole proprietorships). This was reported for Finland, where the corporate veil is lifted only very rarely³⁸¹.

Minimum capital requirements set out in national substantive company law not only have a significant impact on where companies incorporate but also on the choice of the company's legal form. The majority of the analysed countries' jurisdictions³⁸² do not require a private limited liability company to deposit any minimum capital before starting their business operations. In most of those countries, however, incorporating other legal forms incurs a minimum capital requirement³⁸³. Considerations of cost saving may thus have an

³⁸⁰ For instance, in Estonia, Spain, the Netherlands, Romania, Finland and Switzerland. These are based on assumptions of the national experts due to the lack of quantitative evidence for LBCs (see Section 3). Experts from Bulgaria, Denmark, Germany, Cyprus, Luxembourg and Austria reported that limited liability companies were not the most often chosen legal forms when operating as an LBC. The national experts of the remaining countries (Belgium, Bulgaria, Ireland, France, Poland, UK, US, Panama) said that there was not enough evidence to answer this question.

³⁸¹ Findings from the country research in Finland. The corporate veil may be lifted in cases of artificial arrangements where the arrangement has been given a legal form that does not correspond to the actual nature or purpose of the matter. See, for example, Enforcement Code (*Ulosottokaari*) Chapter 4, Section 14 – Artificial arrangements, available at: https://www.finlex.fi/fi/laki/kaannokset/2007/en20070705_20070987.pdf

³⁸² BE, BG, DE, FR, IE, CY, NL, FI, UK, US (the majority of the state's corporate law jurisdictions) and Panama. This does not mean that no other requirements exist. For instance, in Belgium, instead of this minimum capital requirement, there is the need to submit a detailed financial plan. In other countries, such as Germany, 25% of the net benefits must be reserved until the "normal" minimum capital requirement is met, while in France, a minimum capital is required for certain types of companies (see footnote 375).

³⁸³ BE, BG, IE, ES, FR, CY, NL, FI, UK, which means that all EU Member States analysed in this study and the UK require a minimum capital for some company legal form.

impact on the choice to opt for a private limited liability company rather than another legal form.

In the Netherlands, most letterbox companies appear to be private limited liability companies (BV)³⁸⁴. It is comparatively advantageous to set up a BV, as the minimum capital has been reduced from EUR 18 000 to EUR 1. In addition, the requirements to establish a BV were simplified in 2012: the mandatory bank statement and accountant's report for contributions in kind were abolished and shareholders agreements no longer have to be published. While the BV is the most prevalent legal form for letterbox companies in the Netherlands, there is some evidence that other legal forms are used as well. For example, SOMO suggests that the legal form 'CV' can be used by companies to create a certain degree of anonymity. A CV is a limited partnership business entity with unlimited (general partners) and limited partners (investors). The limited partners of the CV are often not publicly known, hindering the determination of the residency of owners and the applicable tax rules³⁸⁵.

Although, private limited liability companies seem the most commonly used legal form for letterbox companies in Estonia, **limited partnerships** (*usaldusühing*)³⁸⁶ might also be a convenient legal entity as they entail fewer formalities than private limited liability companies. While unrestricted liability applies to at least one general partner, for the other partners the liability stays within the limitation of their capital contributions.

Similarly, in Germany, the so-called GmbH & Co. KG, which is a limited liability partnership, seems to be an attractive legal form used in the context of letterbox companies. It is often set up to circumvent workers' participation rights³⁸⁷. It regularly has one or several (foreign) limited liability companies as general partner (*Komplementär*). A similar construction and use for letterbox companies can be found in Poland. Limited partnerships (*spółka komandytowa*) operating with a private limited liability company as the unlimited partner (*Komplementariusz*) allows liability for debts incurred by the partnership to be minimised. Such legal structures are mostly used as letterbox companies to avoid double taxation on corporations.

Danish 'limited partnerships' used as letterbox companies in Denmark

In 2016, the Danish Tax Authority published a report on the use and abuse of limited partnerships (*Kommanditselskaber*, K/S) with foreign owners. The report found that in the period between 2010-2014, there were 5 381 K/S in Denmark, of which the vast majority appeared engaged in legal economic activities. Of those 5 381, 384 had foreign owners. Fifteen were selected for further investigation, which led to eight cases being considered a risk of tax evasion or ATP (over half of the sample). On that basis, the authors of the report estimated that 205 of the 384 K/S with foreign owners that existed between 2010 and 2014 had an enhanced risk of abusive tax planning. The increased risk of these K/S being used for abusive purposes may be ascribed to the limited reporting requirements and the fact that there is no minimum capital requirement in such companies. Moreover, Danish limited partnerships are not taxable entities since the partners themselves are taxed.

Also, in Switzerland, common legal forms used for letterbox companies are companies limited by shares (*Aktiengesellschaften*) and partnerships limited by shares (*Gesellschaften mit beschränkter Haftung*).

Next to limited liability companies, Belgian **non-profit organisations** (*Association sans but lucratif* (ASBL)/*vereniging zonder winstoogmerk* (VSW)) are commonly used as

³⁸⁴ Findings from the country research in the Netherlands.

³⁸⁵ Kiezebrink and McGauran, p. 13.

³⁸⁶ § 125 of the Estonian Commercial Code.

³⁸⁷ Findings from the country research in Germany.

letterbox companies³⁸⁸. They are relatively easy to establish, as they do not require much expertise and funding and can be managed and controlled by few persons.

In the US, **common law trusts** are sometimes used as letterbox companies as they provide substantial anonymity to the so-called 'settlor'³⁸⁹. Trusts are legal arrangements in which the legal title and control of an asset are separated from the equitable interests to that asset. A trust is not a legal person and assets held by a trust are legally owned by the trustees. A trust cannot conduct transactions or hold property in its own right but must do so through the trustees. In a typical trust, a settlor transfers the legal title of assets to a trustee, who must hold those assets for the benefit of certain beneficiaries in accordance with the declaration of trust. Transactions are conducted in the name of the trust, which is the holder of the assets³⁹⁰. Sole purpose trusts used as letterbox companies also occur in Panama³⁹¹.

If in many of the countries analysed, limited liability companies seem to be the primary legal form opted to set-up artificial undertakings, the mere fact that letterbox companies are often limited liability companies is not enough to establish a link between the legal form and such companies but, rather, is the result of the fact that some 80% of companies in the EU are limited liability companies³⁹². One company law professor interviewed explained that operating in the form of a company providing limited liability seems much more convenient for any type of company, whatever its use³⁹³.

However, it may be one of the preferred legal forms if the intention is to use the company in an abusive or illegitimate manner, since it avoids attribution of personal liability for such behaviours, with the exception - as pointed out by a European business organisation - of the director, who continues to be fully liable³⁹⁴.

5.1.5 Enforcement of incorporation requirements

While the previous sub-sections have analysed the degrees to which countries require a connection between the company and the country of incorporation, and the extent to which these may impede the use of letterbox companies (or not), these requirements will only be effective if they are properly enforced. Jurisdictions that merely require a registered office only have minimal requirements for a factual connection between company and country of incorporation, while jurisdictions that hold the real-seat requirements require a more substantiated connection. The latter generally provides competent authorities with a more extensive legal basis to verify whether the company complies with incorporation requirements, which could facilitate the detection of abusive behaviours. However, it needs to be remembered that only a few of the jurisdictions analysed have requirements specifically related to *economic* activity (Section 5.1.1.2) and that it is not easy to access the necessary information on companies' economic activity (Section 3 on quantification).

Enforcement of incorporation requirements is inevitably linked to the question of whether authorities sufficiently verify the information provided by founders when incorporating companies.

³⁸⁸ Findings from the country research in Belgium.

³⁸⁹ Findings from the country research in the US.

³⁹⁰ For example, settlor A creates a trust called B with C as the trustee and transfers all its assets to that trust. Trustee C then buys a property. All public documents will show that C is acquiring the property for B and nowhere will be mentioned that A is involved.

³⁹¹ Findings from the country research in Panama.

³⁹² Proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, (COM(2018)0241), p. 1.

³⁹³ Interview No.4.

³⁹⁴ Interview No.2.

Verification of the validity of information

Verification can be generally grouped into **ex-ante checks** and **ex-post checks**. All authorities' verification processes taking place before the company is registered or at the registration stage fall in the *ex-ante* category, while *ex post* checks comprise all checks conducted after completion of registration.

In general, the challenge posed by *ex-ante* checks is that the only information that authorities have access to is mainly (though not only) declarative, provided by the founder, typically aspirational, and subject to change. Ex-post checks undertaken by authorities might be a more effective way to verify whether a company incorporated in one country continues to comply with requirements in the respective territory.

Some Member States have processes in place to verify the registered address by checking certificates of registration, rental contracts or by (automatically) comparing the data against other registers (France, the Netherlands). While manual checks of submitted company information is checked in several Member States (e.g. Germany, Spain, France, Austria³⁹⁵) by notaries, lawyers or court staff who verify whether the submitted data corresponds to the documents provided. In US³⁹⁶ or UK³⁹⁷, the filed and declared information in the register does not undergo any validation or verification of accuracy.

An important development in the EU in this context is the European Business Registers Interconnection System (BRIS)³⁹⁸, which interconnects national central, commercial and companies' registers. BRIS allows business registers to exchange cross-border messages on mergers and branches and makes it possible for the general public to obtain multilingual information on EU limited liability companies from one access point (the e-Justice portal)³⁹⁹. The system has been operational since June 2017 and could contribute to an enhanced and facilitated access to up-to-date information on companies registered in the EU for national authorities, which, in turn, could support them to identify abusive letterbox companies. While BRIS' purpose is to increase transparency and availability of company information, it does not facilitate access to information on companies active outside the EU. In addition, the reliability and correctness of the information accessible through BRIS still depends on whether and how submitted company information is checked by national authorities when registering a company.

Ex-ante checks

Ex-ante checks in France

In principle, the French commercial register is based on declarative information. As outlined during an interview with the French registrar, the *Conseil National des Greffiers des Tribunaux de Commerce* (CNGTC), the clerks verify, in practice, that the address of the company seat and of the establishment are in line with the information submitted upon registration. To do so, they check evidence of either a lease contract, or residence certificate or of an electricity or telephone's bill. As a French clerk indicated, in practice, they would refuse to register a company whose actual/real

³⁹⁵ Based on the country research, submitted information is, for example, at least formally, checked by a notary before registration of the company in Austria and Germany and France.

³⁹⁶ Finding from the research conducted at national level in the USA ('States do not verify the information collected during the formation process', 2016 FATF Mutual Evaluation of the United States, p.157).

³⁹⁷ In the UK, for instance, submitted information is filed without undergoing any verification or validation. See e-justice portal- Business registers in Member States.

³⁹⁸ Directive 2017/1132 and the Commission Implementing Regulation (EU) 2015/884.

³⁹⁹ Directive (EU) 2012/17 of the European Parliament and of the Council of 13 June 2012 amending Council Directive (EEC) 89/666 and Directive (EC) 2005/56 and Directive 2009/101 of the European Parliament and of the Council as regards the interconnection of central, commercial and companies registers. Following Directives (EU) 2019/1151 and 2019/2121, new functionalities of BRIS will go live between 2021 and 2023, including more exchanges between business registers and more information available through BRIS free of charge.

activities are exclusively performed abroad, indicating that the company's registered seat and real seat are completely dissociated⁴⁰⁰. However, no further declaration is required regarding the company's real activity⁴⁰¹.

The CNGTC indicated that in order to determine whether a company might be a letterbox company used in an abusive way, they would verify whether a director was ever banned from managing companies (i.e., registered in the national file of management prohibitions (*Le Fichier National des Interdits de Gérer* (FNIG))). If it turns out that this is the case, the registration will not be possible. They will then check the truthfulness of the documents provided by the manager upon registration and ask the latter to provide a (clear) criminal records (bulletin n°2). If the CNGTC finds that a natural person is managing more than 50 companies within their jurisdiction, that the same company's manager is involved in multiple activities in the areas of building/construction, clothing, fast food, electronic cigarette, self-employed for meal delivery, or owns a transport vehicle with driver, or that the shareholder of a private limited liability company is a legal person, further investigations will be undertaken⁴⁰².

The French commercial register is primarily based on declarative information. As a result, no additional checks will take place, once the company is registered. No further declaration or proof of the company's actual activity is required. This could mean that the requirement, while dissuasive in the early steps of the process, might not be effective in practice on the long-term.

A clerk indicated that clerks within French commercial courts currently have no means to check future activity before or at the time of registration of a company⁴⁰³. The CNGTC suggested that in order to be able to effectively identify letterbox companies, companies should have to submit proof of existence of the registered office, as well as proof of the existence of a bank account in the country of registration, at least once a year.

- Since the 2019 company law reform, Belgian companies are required to submit a more detailed financial plan, including a self-declaration on the intended activity, future funding of the activity in the following two years, as well as the location of the activity⁴⁰⁴. However, whether or not this obligation implies that Belgian company law presupposes that a company will conduct some economic activity somewhere in the world, such a self-declaration regarding the intention to conduct activity could indirectly result in an endorsement that the company will not act as a letterbox company in the future. This might, in theory, have a deterrent effect on those who want to establish an artificial undertaking. However, this will only be true if the information provided is verified. While the recent changes reinforced the obligation to issue and submit an even more detailed financial plan⁴⁰⁵, indicating an increased

⁴⁰⁰ Interview with the clerk of the Commercial Court of Pontoise. According to Article L. 123-11 of the French Commercial Code, 'Any legal entity applying for registration in the Trade and Companies Register must justify the use of the premises where it installs, alone or with others, as well as the head office of the company. The clerk usually requires, in practice, a lease contract, a domiciliation contract, an electricity or telephone subscription contract'.

⁴⁰¹ Findings from the country research in France.

⁴⁰² Interview with the CNGTC.

⁴⁰³ Interview with the clerk of the Commercial Court of Pontoise.

⁴⁰⁴ Findings from the country research in Belgium. Especially: Article 5(4), § 2, 1°, art. 6:5, § 2, 1° and Article 7(3), 2, 1° of the Belgian Code of Companies and Associations (CCA).

⁴⁰⁵ *Doc. parl., Chambre, sess. 2017-2018*, n° 54-3119/001 clarifying that the financial plan, which has proven its usefulness in practice, aims at a double objective. Firstly, it must prevent companies being incorporated in a rash manner. The founders should reflect on the planned activity and put the necessary financial means at the company's disposal. Secondly, it protects the founders because it allows to the judge to rely on the situation and the information existing at the time of incorporation to assess their responsibility in the incorporation of a company with a manifestly

focus, this plan - which does not have to be published - must be submitted to the notary prior to the incorporation of the company, but the latter only retains it and does not examine it⁴⁰⁶. According to Article 5.4 CCA indeed, this 'document is not filed with the incorporation act but is kept by the notary', who may 'transfer it to the court - if so requested by the judge - in case of bankruptcy pronounced within three years of the acquisition'. The content of the financial plan will then be verified by the judge to determine liability (of the founders), especially if this financial plan showed an underfunding of the company for the foreseen activity⁴⁰⁷. Although the company law reform did not entail a reinforcement of checks, the strengthened obligation to issue a detailed financial plan could mean that information on the company and its activities will be increased (compared to information made available in the past). Hence, authorities might not only have more information to check the viability of the company's foreseen activity but could also use the financial plan as a tool to distinguish whether a company is, or will be used as, a letterbox company.

- In Estonia, the Commercial Register performs a formal check of the fulfilment of incorporation requirements. Based on the information provided in the electronic database of the Estonian Commercial Register, it will verify that no EU financial sanctions have been imposed on the undertaking incorporating in the country, or on the group of which it is part or any of the entities it may own, and whether any court judgment exists that prohibits that person from becoming a member of a managerial body of a company (deriving from criminal liability) or engaging in business (deriving from bankruptcy matters). Some basic checks are performed by notaries in respect of whether anti-money laundering rules are followed, through a questionnaire on the background of the funds used for setting up the company. In other words, Estonia has a mixed system, according to which establishment done via notaries is checked (document and data), while incorporation done through the electronic portal is not verified.
- According to the Irish Companies Act 2014⁴⁰⁸, registering a company in Ireland requires a declaration regarding the activity being carried on by a company^{409,410}. The declaration must include the general nature of the activity, information on the place or places in the country where it is proposed to carry out the activity, as well as where the central administration of the company will be placed. A company may

insufficient initial wealth (Article 5(16), 2°). The reinforcement of the obligation to issue a financial plan might be based on the fact that that 80% of the approximately 10 000 annual bankruptcies in Belgium are due to cash-flow problems as a result of overestimates in the companies' initial financial plan (see: <https://www.lecho.be/opinions/carte-blanche/le-nouveau-code-des-societes-va-renforcer-les-obligations-relatives-au-plan-financier-et-c-est-tant-mieux/10073936.html>).

⁴⁰⁶ Findings from the country research in Belgium.

⁴⁰⁷ Laga, Guide on the new Belgian Companies Code, 2019, available at: https://www.laga.be/content/dam/assets/lg/Documents/Laga_NCC-Did%20you%20know_BE-2019.pdf as well as https://www.deloittelegal.be/content/dam/assets/lg/Documents/DeloitteLegal_Did%20you%20know%20that%20series%20brochure_BE-2020.pdf

⁴⁰⁸ Irish Companies Act 2014, ss 18, 966, 1005, 1175, 1232 and 1391.

⁴⁰⁹ <https://www.cro.ie/Registration/Company/Incidental-Obligations/Activity-in-State>

⁴¹⁰ The declaration must include the following particulars:

(i) the general nature of the activity and the appropriate NACE-code Classification (the NACE-code is the common basis for statistical classifications of economic activities within the European Commission set out in the Annex to Council Regulation (EEC) No. 3037/90 of 9 October 1990 on the statistical classification of economic activities in the European Commission);

(ii) if the activity cannot be classified under the NACE-code, a precise description of the activity;

(iii) the place or places in the State where it is proposed to carry on the activity (full postal address(es) to be furnished); and

(iii) the place, whether in the State or not, where the central administration of the company will normally be carried on (full postal address to be furnished).

not be incorporated and registered unless it appears to the Registrar of Companies that the company, when registered, will carry on an activity in the country⁴¹¹. Declarative company information is disclosed in the register by the Irish Companies Registration Office (CRO). There is a legal obligation not to knowingly or recklessly supply false information to the CRO and, for the submission of certain documents, the law stipulates that the person making the submission must sign a statutory declaration that they believe that the required particulars and documents have been properly submitted⁴¹². In theory, persons who knowingly make a false or misleading statutory declaration are liable to prosecution and, on conviction, to a fine or imprisonment, or both⁴¹³. However, prosecutions for supplying false or misleading information in this regard are not common⁴¹⁴.

- In Austria, the companies' register checks the existence of physical premises upon registration of a branch but does not – and cannot – continuously monitor whether or not the premises continue to be available and used by the branch after registration.

Apart from the above examples, **authorities in the countries analysed do not seem to conduct any other ex-ante checks.**

Based on these challenges and limitations of effectiveness, solely *ex ante* checks at the moment of incorporation do not seem adequate to address the monitoring and verification of letterbox companies.

- **Ex-post checks**

As part of ex-post checks, information included in financial statements can be used to verify whether the company complies with requirements. As EU legislation requires limited liability companies doing business in the EU (with the exception of small and micro companies) to prepare, file and disclose annual financial statements to the relevant national business register⁴¹⁵, information is regularly updated.

While EU law provides auditing and disclosure rules⁴¹⁶, **checks beyond the compliance with national rules implementing these requirements differ across Member States.**

- To better identify letterbox companies in France, the CNGTC suggested introducing a provision whereby companies that do not file their annual accounts every year should be mentioned on the extract of registration in the national register. In their view, failure to file accounts regularly can be an indication of fraud, concealment or financial difficulties that will lead to the company being put into judicial liquidation⁴¹⁷.

⁴¹¹ <https://www.cro.ie/Registration/Company/Incidental-Obligations/Activity-in-State>

⁴¹² See e-justice portal: Business registers in Member States - Ireland.

⁴¹³ Based on the amended Statutory Declarations Act 1938.

⁴¹⁴ Finding from research conducted at national level, corroborated by interviews with officials at the Office of the Director of Corporate Enforcement (i.e. the office does not encounter prosecutions for false or misleading information on a regular or significant basis).

⁴¹⁵ Article 14 lit (f) Directive 2017/1132.

⁴¹⁶ Enforcement of disclosure related rules falls within the remit of (private) auditors, specifically appointed by a company.

⁴¹⁷ Suggestion made over a phone interview conducted as part of the research for this study (2019).

- In the Netherlands, the Dutch Chamber of Commerce can dissolve a(n) (empty) legal entity⁴¹⁸ on the grounds of non-compliance with its obligation to publish its financial statements for at least one year⁴¹⁹.
- In Austria, no regular checks exist beyond requirements to have statements audited if and where required due to company size. In practice, there are no checks for small companies, except for face validity.

Some other Member States apply sanctions for failure to disclose financial statements, such as Spain.

The effectiveness of using the information from the financial statements to identify letterbox companies might be limited. Firstly, because of the existing broad reporting exemptions for small and micro companies to file annual reports, which can also be used by letterbox companies⁴²⁰ and affect data availability. Secondly, given that many letterbox companies appear to be used in a structure of groups of companies and operate by using chains of companies with a parent company registered in one country with subsidiaries in other countries authorities would need to have access not only to the information about the parent company filed in the country of its registration, but also to information about letterbox (company) subsidiaries in the other country(ies).

In the light of the current level of company information to which authorities have access, it seems unlikely that they will be able to engage in ongoing effective *ex post* monitoring of the information submitted by companies. Any such attempt would likely create administrative burdens for small companies with legitimate business purposes, while imposing only minimal costs on abusive letterbox companies, which would be likely to avoid this scrutiny with relative ease by choosing a law of incorporation that does not impose such requirements.

5.2 Main findings on substantive company law requirements and letterbox companies

Substantive company law certainly plays a role in the existence of letterbox companies in the EU. Incorporation-theory countries put fewer company law requirements in place with regard to the establishment and existence of companies, offering a more favourable environment compared to countries that follow the real-seat theory or that include real-seat-like requirements. In the latter, regardless of how the real seat is interpreted, domestic companies are obliged to maintain a more factual connection to the country of incorporation, going beyond merely asking for the registered office, which seems to restrict the range of circumstances in which letterbox companies can be used.

It can therefore be stated that it is easier to set up and use any type of company in those countries that follow the incorporation theory, than in countries that go beyond merely asking for the registered office and that require companies to maintain a more substantial link to the country of incorporation. In relation to letterbox companies, a requirement to maintain a 'real-seat like' connection with the country of incorporation thus **restricts the range of circumstances** in which **letterbox companies are set up** and used.

The analysis of 15 Member States and four third countries (including the UK) carried out in this Study shows that three Member States⁴²¹ follow the real seat principle under substantive company law and four Member States⁴²² contain, at least, some elements of

⁴¹⁸ <https://ondernemersplein.kvk.nl/wanneer-en-hoe-wordt-een-lege-rechtspersoon-ontbonden/>

⁴¹⁹ Article 2(19)a BW (Dutch Civil Code). Other grounds for dissolution are, for instance, that no director has been registered in the Trade Register for at least one year or the director has died or has not been available for at least one year at the address in the Dutch Trade Register or the population administration.

⁴²⁰ In particular, see Article 3 and 36 of Directive 2013/34/EU.

⁴²¹ AT; ES; LU.

⁴²² EE; FR; DE; PL.

the real seat principle, whilst twelve⁴²³ jurisdictions only had minimal requirements in place, including eight Member States, the UK, Switzerland, the US and Panama.

Overall, the majority of countries analysed as part of this study have a framework that may facilitate the set-up of companies that do not require any substantial link to the country of incorporation. This could reflect countries' overall effort to attract companies by merely requiring the registration of the company and thus facilitating its incorporation in their country. The choice of incorporation requirements of the national legislators indeed plays a role in the context of regulatory competition, since more companies seem to incorporate in jurisdictions following the incorporation principle than in those that hold at least some elements of the real seat theory.⁴²⁴

However, while the extent to which the company law regime of a country is favourable to letterbox companies may be an initial important factor determining the choice of establishment, this will greatly depend on the purpose for which the letterbox company is set up.

Letterbox can be used for legal purposes (such as tax planning, risk sharing, financing, raising capital, securitisation of loans and other receivables, intellectual property and trademark purposes, corporate mergers and joint ventures, etc.), as well as for illegal and abusive ones (such as in the context of criminal activities, illegal fiscal practices such as tax evasion and abusive practices such as tax avoidance, as well as fraudulent activities in the context of labour and social security law) (see Section 4). The choice of country will be chiefly led by considerations as to which jurisdiction provides the most beneficial environment given its purpose, be that because of the applicable tax, social security or other regime, or a combination thereof.

This means that company law measures alone are insufficient to address the phenomenon of letterbox companies. However, some measures could be considered to create a more equal level playing field, focusing on making the establishment of letterbox companies less easy and attractive and facilitating their identification (see below). The current lack of harmonisation leads to significant variety in incorporation requirements and enforcement in Member States and contributes to the existence of corporate arbitrage. Harmonisation of incorporation requirements in the EU could be considered as a means of addressing the phenomenon from the perspective of company law.

The bar for deterring the set-up and use of letterbox companies through harmonisation of substantive company law incorporation requirements appears high. Given that incorporation requirements are an important part of national company laws and given the diversity of approaches across Member States, reaching an agreement on an EU measure could be politically very difficult. Even if every Member State required some factual connection between a company and its country of incorporation, including some economic activity in that country, it would likely be difficult to define the factual connection required in a way that would allow consistent application across the Member States.

In addition, any such harmonisation would likely be difficult to enforce, as it is unlikely that checks conducted during the formation stage of a company, or ongoing monitoring, would be able to reliably identify (abusive) letterbox companies. There could be also a risk that some European companies might move to third countries to escape such harmonised requirements in the EU.

Even if a harmonisation attempt could (theoretically) contribute to reducing the number of letterbox companies, harmonising incorporation requirements as a means to deter abusive

⁴²³ BE; BG; CY; DK; FI; IE; NL; RO; UK; CH; USA; PA.

⁴²⁴ See Carsten Gerner-Beurle/Federico Mucciarelli/Edmund-Philipp Schuster/Mathias Siems, "Why do businesses incorporate in other EU Member States? An empirical analysis of the role of conflict of laws rules", *International Review of Law and Economics* 2018, showing a statistically significant relationship between the costs of incorporation and the intensity of real seat requirements and foreign incorporations.

and illegal letterbox companies might not be seen as proportionate as it would also affect letterbox companies that are used legally and all limited liability companies in general.

To increase the amount of information available to company law authorities to properly enforce the incorporation requirements to help them identify letterbox companies and their uses, it may be worth considering obliging EU companies to adhere to more detailed disclosure requirements, as well as removing some of the existing exemptions. This would need to be done in a way that does not counteract efforts at both national and EU level to reduce the burden for micro companies and SMEs, not to have an adverse impact on the Single Market. In addition, the most problematic types of letterbox companies are unlikely to voluntarily comply with more detailed disclosure rules, which suggests that more resources might be needed to enforce such rules.

6 Mapping of existing measures that have an impact on letterbox companies

This section provides an overview of measures taken at international, EU and Member States' level, and which are specifically aimed at addressing the phenomenon of letterbox companies, together with measures that are not expressly targeting letterbox companies, but which nevertheless affect the phenomenon by their nature. The identification and analysis of the main characteristics of the measures is based on information collected from an extensive literature review, information obtained through consultation with stakeholders at international and EU level, and findings emerging from the 19 country analyses carried out for the purposes of this study.

Measures are classified and described using a typology that allows comparability and elaboration of their specific aspects. To the extent possible, the section identifies commonalities and differences across the measures, investigates possible reasons and considers the evident rationale.

Where information was available, the effectiveness of the measures adopted at EU, international and national level was analysed. However, concrete evidence of effectiveness - **existing assessments, studies or evaluations - is very scarce**, indicating a significant information gap that impacts understandings of the effects of the measures overall and on letterbox companies specifically. Most of the assessments of effectiveness provided here stem from the views of the sector experts and country researchers involved in this study.

This section maps and analyses measures in the areas of taxation, anti-money laundering, employment and social security. Each sub-section starts with an overview table of measures in each individual area.

6.1 Measures in the area of taxation

Table 14. Summary of (existing) binding and non-binding international and European measures in tax law

Type	Organisation	Measure
Binding		
International	OECD	▪ BEPS Action 5 (Substantial Activity Requirements)
		▪ BEPS Action 6 (Avoiding Treaty Abuse)
		▪ BEPS Action 13 (Country-by-Country Reporting)
European	EU	▪ Modified Parent-Subsidiary Directive (including General Anti-Abuse Rules (GAAR) and anti-hybrid rules)
		▪ Anti-Tax Avoidance Directive (including CFC rules, anti-hybrid rules, exit taxation, interest limitation, GAAR)
		▪ Automatic Exchange of Information (Directive on Administrative Cooperation (DAC))
		▪ Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation

Type	Organisation	Measure
		and combating fraud in the field of value added tax
Non-binding		
International	OECD	▪ BEPS Action 15 (Multilateral Instrument (MLI)) ▪ Global Forum on Tax Transparency
European	EU	▪ Code of Conduct on Business Taxation ▪ Transaction Network Analysis (TNA) tool

At **international level**, the Organisation for Economic Co-operation and Development (OECD) launched the **Base Erosion and Profit Shifting (BEPS) initiative in 2013**. This initiative proposed solutions to reduce tax planning opportunities created by the lack of coordination between domestic tax systems and chiefly aimed to prevent multinational enterprises from exploiting existing gaps, including through the use of letterbox companies. Launched in 2013, the BEPS initiative consisted of a set of specific actions⁴²⁵, several of which are relevant to the letterbox company phenomenon.

Of particular importance, Actions 5 and 6 set **minimum standards** that apply to all parties to the BEPS project. Constituting binding measures, these Actions are enforceable, and subject to peer review to ensure timely and accurate implementation.

- **Action 5** aims to provide a **better definition of the substance (substantial activity) requirements** linked to the entitlement to benefit from certain tax regimes. This is intended to ensure that the benefit of obtaining the tax incentives is more in line with where the respective economic activities are carried out. The action is primarily based on the idea that taxation should be aligned with economic substance, and that tax benefits should only be available where there is a certain minimum level of economic substance.

OECD reports on progress in the implementation of Action 5⁴²⁶ indicate that during 2018-2019, legislation was enacted to abolish or make amendments to more than 80 regimes in order to comply with the Action 5 minimum standard. The adopted minimum standard (based on an agreed methodology to assess whether there is substantial activity in a preferential regime) has significantly changed preferential tax regimes all over the world, many of which have now been abolished, while others are in the process of being aligned with Action 5, or remain under review⁴²⁷. While France has applied this framework already through Articles L.114 and L.114A of its Book of Tax Procedures⁴²⁸, neither in Finland nor in the US any preferential tax regimes were identified in either country⁴²⁹.

All 16 intellectual property regimes listed in the 2015 BEPS Action 5 report that were deemed inconsistent with the agreed standard are now aligned or have been abolished⁴³⁰. Luxembourg, for example, introduced an intellectual property box

⁴²⁵ OECD/G20 Inclusive Framework on BEPS Progress report July 2018 – May 2019.

⁴²⁶ *ibid.*

⁴²⁷ *ibid.*, p. 9.

⁴²⁸ Report from the French National Assembly on the Draft bill authorising the ratification of the Multilateral Convention for the Implementation of Tax Treaty Measures to Prevent the Erosion of the Tax Base and the Transfer of Profits, June 2018.

⁴²⁹ See OECD/G20 Base Erosion and Profit Shifting Project, Harmful Tax Practices - 2018 Progress Report on Preferential Regimes

⁴³⁰ OECD/G20 Inclusive Framework on BEPS Progress report July 2018 – May 2019, p. 10.

regime from 1 January 2018 to align itself with BEPS Action 5⁴³¹. The revised regime follows the 'nexus approach', according to which i) substantial economic activities must be performed in the benefiting country and ii) a direct link is required between the income benefiting from preferential treatment and the research and development expenditure that contributes to that income. The old regime can be maintained until 30 June 2021 because of transitional rules, but cannot apply simultaneously with the new regime. Similarly, in 2018 the Swiss Parliament adopted a Federal Act on Tax Reform and AHV Financing (TRAF), which abolished tax statuses that were no longer accepted internationally. As a result, a patent box was introduced in line with the OECD standard. Canton Nidwalden's patent box has been amended in line with the asset requirements of the final report on BEPS Action 5. *Germany* had no intellectual property box in place, nor any research and development-related tax incentives, until 2019⁴³², which only gives a mark-up related to expenses and not a profit-related tax break.

Information on tax rulings is now routinely exchanged by national tax administrations. This is the case in Finland, which was reported as meeting the minimum standard in that respect⁴³³, but also in Germany, which passed the law on exchange of information on financial accounts in 2015⁴³⁴. In Switzerland, the spontaneous exchange of information on advance tax rulings entered into force on 1 January 2018 (TRAF, see above). Since then, Switzerland is deemed compliant with Action 5 BEPS⁴³⁵, as is Spain. Other than unilateral Advanced Pricing Agreements, the US generally does not issue rulings of the kind that must be spontaneously exchanged under Action 5.

The two years of operation of the Action 5 standard have seen almost 21 000 exchanges of information on tax rulings (to 2018). The work not only increases transparency but means that tax administrations have more data on the international tax arrangements of their multinational groups, allowing them to detect ATP/non-compliance earlier. The exchange of information on these rulings might also act as a deterrent to governments and taxpayers considering attractive ('sweetheart') deals.

- **Action 6 addresses a number of issues related to the abuse of tax treaties, including treaty shopping.** Treaty shopping refers to strategies through which a person who is not a resident of a State attempts to obtain benefits granted to residents of that State by a tax treaty concluded by that State. Letterbox companies can also be used to facilitate treaty shopping, for instance where they act as a conduit company between its controlling shareholder(s) and an income stream in order to claim the benefits of a tax treaty (see Section 4). The establishment of letterbox companies in countries with attractive tax treaties might, in some cases, result in double or even multiple non-taxation.

Action 6 sets a minimum standard, meaning that all jurisdictions participating in the BEPS project are required to adopt it. In their BEPS Action Plan, the OECD and G20 countries recommend the inclusion of anti-abuse measures in tax treaties in order

⁴³¹ Implemented by new Article 50ter of the Luxembourg income tax law.

⁴³² German Ministry of Justice, available at: <http://www.gesetze-im-internet.de/fzulg/>

⁴³³ OECD/G20 Base Erosion and Profit Shifting Project, Harmful Tax Practices – 2018 Peer Review Reports on the Exchange of Information on Tax Rulings.

⁴³⁴ German Ministry of Justice, see <http://www.gesetze-im-internet.de/fkaustg/index.html>

⁴³⁵ Swiss Federal Council, State Secretariat for International Finance, available at: <https://www.sif.admin.ch/sif/en/home/multilateral/unternehmensbesteuerung/mindeststandards.html>

to prevent treaty shopping⁴³⁶. In their published final report from 2015⁴³⁷, they recommend countries to include a limitation-on-benefits (LOB) rule in their treaties to limit the availability of treaty benefits to entities that meet certain conditions. Those conditions are based on an entity's legal nature, ownership and general activity, and they seek to ensure that there is a sufficient link between the entity and its State of residence. In addition, the Action Plan recommends the inclusion of a more general anti-abuse rule based on the principal purpose of transactions or arrangements. That rule - generally referred to as the principal purposes test (PPT) - denies treaty benefits if one of the principal purposes of a transaction or arrangement is to obtain those benefits, unless it is established that granting the benefits would be in accordance with the object and purpose of the provisions of the treaty.

The recent assessment of the implementation of Action 6⁴³⁸ shows that a large majority of countries have made substantial progress towards implementing the minimum standard. Compliance with the Action 6 minimum standard requires participating countries to include anti-abuse provisions in their tax treaties, such as a PPT or LOB. To date, 87 participating countries have some agreements that were already compliant with the minimum standard or were subject to a complying instrument and would therefore comply shortly⁴³⁹. This substantial level of progress in implementing the minimum standard can also be expected to have a deterrent effect on the establishment of letterbox companies for the purpose of treaty shopping.

- **Action 13 on Transfer Pricing Documentation aims to improve the coordinated exchange of local files**, increase the quality of the information provided to tax administrations and limit the compliance burden on businesses. In this context, the Action establishes a three-layered approach to transfer pricing documentation: a master file with a summary of an MNE's business and transfer pricing policies, local files with information on specific transactions, and a country-by-country (CbC) report containing information on the global spread of an MNE's activities, results, and where it pays tax⁴⁴⁰.

Transparency of business reporting information constitutes an important tool to detect and identify letterbox companies, as well as to potentially deter their use. The BEPS package includes two transparency measures that may assist tax authorities in identifying letterbox companies and the absence of operating activities, assets, employees, etc. These two mandatory requirements are the CbC reporting under Action 13, which applies to MNEs with total consolidated group revenues above EUR 750 million, and the exchange of information on certain tax rulings.

The latest monitoring of Action 13 implementation⁴⁴¹ shows significant progress in CbC reporting, which can be expected to increase the transparency of MNE reporting and thus deter the abusive use of letterbox companies. In 2019, 59 countries required or permitted CbC reports to be filed by the ultimate parent entity of MNEs with consolidated group revenue of at least EUR 750 million (or near equivalent in domestic currency as of January 2015) in the previous year. Almost 80 countries

⁴³⁶ OECD, Preventing the granting of treaty benefits in inappropriate circumstances, Action 6 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, 2015, available at: <https://doi.org/10.1787/9789264241695-en>

⁴³⁷ *ibid.*

⁴³⁸ OECD, Prevention of treaty abuse - peer review report on treaty shopping, 2019.

⁴³⁹ OECD policy note provided to this study, 2019.

⁴⁴⁰ OECD/G20 Inclusive Framework on BEPS Progress report July 2018 – May 2019.

⁴⁴¹ *ibid.*

have introduced a CbC reporting filing obligation into law, while some 25 others have drafted laws to introduce an obligation in the near future. In total, over three-quarters of countries have introduced or are in the process of introducing a CbC reporting obligation, including all G20 countries. As a result of this progress, almost every MNE above the consolidated group revenue threshold is already within the scope of CbC reporting, and the remaining gaps are rapidly being closed.

There are more than 2 000 bilateral relationships for the exchange of CbC reports currently. These relationships are put in place under the Convention for Mutual Administrative Assistance in Tax Matters, bilateral double-tax conventions and tax information exchange agreements, and between EU Member States. However, the third annual progress report of the OECD/G20 Inclusive Framework on BEPS notes that 'further work is needed to support jurisdictions in putting exchange relationships in place and in meeting the conditions for obtaining CbC reports'⁴⁴².

- **Action 15** of the BEPS Action Plan provides an analysis of the possible development of a multilateral instrument to implement tax treaty-related BEPS measures 'to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties'. In line with this objective, the **Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Multilateral Instrument, MLI)** was developed. The MLI offers concrete solutions for governments to close the gaps in existing international tax rules by transposing and implementing the measures resulting from the OECD/G20 BEPS Action Plan.

All of the assessed EU Member States, as well as Switzerland and Panama, are parties to the MLI. The US is not, however. The MLI modifies the application of many bilateral tax treaties concluded to eliminate double taxation, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. It also implements agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms. LBCs are sometimes used to avoid double taxation, making use of tax exemptions to the parent company (see Section 4). However, depending on how the LBC operates, it can also be abused to obtain undue tax advantages, such as achieving double non-taxation through treaty shopping. Such a practice would fall within the scope of the MLI instrument.

The MLI had to retain flexibility to achieve the consensus of the participating jurisdictions. Signing countries can choose from certain opt-in provisions or entirely opt out of provisions that are not considered necessary. The MLI also contains the option to exclude specific tax treaties from the scope of the MLI, while ensuring that some minimum standards will be implemented by the signatories. This flexibility risks a confusing network of tax treaties whereby opt-ins and opt-outs will have to be observed. The PPT introduced by Action 6 of BEPS as one of the minimum standards to be implemented by the participating countries has also been introduced in the MLI. Countries were given the choice of introducing the PPT (with or without detailed or simplified LOB) or a detailed LOB with anti-conduit financing arrangements. The 2019 Peer Review Report on Treaty Shopping⁴⁴³, however, shows that the majority of countries are choosing to implement the former. One of the main criticisms against the PPT of the MLI is that it concentrates on the purpose of the transaction or arrangement (and even more so 'one of the principal purposes') while ignoring the lack of a genuine arrangement or transaction as

⁴⁴² *ibid.*, p. 14.

⁴⁴³ <https://www.oecd.org/tax/beps/prevention-of-treaty-abuse-peer-review-report-on-treaty-shopping-9789264312388-en.htm>

provided in the Anti-Tax Avoidance Directive, or the 'wholly artificial arrangement' provided in the case-law of the CJEU⁴⁴⁴.

Worth highlighting in the context of tax treaties is Luxembourg's reaction to the 'LuxLeaks' revelations in November 2014. The then-newly elected government was urged to respond to international transparency demands and materialised its commitments with the insertion of a new provision⁴⁴⁵ into the General Tax Act in 2014 (*Abgabenordnung*)⁴⁴⁶. It provided a definition of what constitutes a tax ruling: rulings are neither contracts nor mutual agreements. They are unilateral decisions by the tax authority. Any taxpayer, individual or a company, may contact its tax office and seek such a binding decision in order to get legal certainty as to the tax treatment of a specific operation at the tax assessment procedure at a later stage. The newly introduced rule aimed to formalise and partly amend the earlier practice of tax rulings⁴⁴⁷. The position paper on tax transparency and substance also referred to conditions of access for tax rulings by referring to the necessary economic substance of corporations applying for tax rulings: 'In order to be able to be granted a ruling, it is mandatory for companies to demonstrate to the Luxembourg tax authorities that they have appropriate economic substance and are genuinely active in Luxembourg (offices, active management and shareholders meeting to be held in Luxembourg), which is a minimum requirement, in addition to other company requirements in relation to the place of effective management and compliance with the general rule according to which the internal organisation of any company needs to be adapted to its corporate purpose.'

Another relevant international level initiative is the **OECD Global Forum on Tax Transparency**. The Forum seeks to ensure the implementation of international standards of transparency and information exchange in the area of tax, through a peer-review process which monitors the implementation of these standards by its members⁴⁴⁸.

The EU also plays an active role in the global debate on tax avoidance and tax evasion-related matters. Acting in concert with the OECD, the EU initiated several actions to tackle abusive or aggressive tax behaviours, primarily by encouraging the exchange of tax-related information and promoting cross-border transparency. Starting with its 2015 Action Plan for a fair and efficient corporate tax system in the EU, the European Commission initiated a reform of the existing framework in place, with a view to tackling tax abuse and ensuring a safer business environment on the other. Aimed at ensuring fair taxation in those jurisdictions where profits are generated, the Action Plan focused on increasing

⁴⁴⁴ Cuoco, C., 'The Principal Purpose Test as Introduced by the OECD MLI: is it time for a compromise with EU tax law?', *Intertax*, Vol. 47, No. 10, 2019, pp. 869-884.

⁴⁴⁵ §29 General Tax Act (*Abgabenordnung*)

⁴⁴⁶ Art. 5, Loi du 1er décembre 1978 réglant la procédure administrative non contentieuse, (*Mémorial A* N°87, 27 décembre 1978, p. 2486).

⁴⁴⁷ The practice of tax rulings previously in place in Luxembourg was described by the European Commission as allowing for the reduction of MNEs' tax burden. Cases have been observed in which a holding company was a limited partnership with no employees, no offices and no business activities acting as an intermediary in Luxembourg between the operating company (in Luxembourg) and one company in the US. The holding company, holding certain intellectual property rights, was simply passing them on to the operating company for its exclusive use. Despite not performing any activities, it received large amounts of royalties. The Commission concluded that the tax ruling issued by Luxembourg endorsed payments between two companies in the same group which, because of the inflated level of the royalty payments, did not reflect economic reality, thus violating state aid rules (see European Commission Press Release in the Amazon case from 4 October 2017, IP/17/3701). In the Fiat Chrysler Finance Europe (FFT) case, the European Commission similarly argued that the tax ruling by the Luxembourg tax authority on 'the calculation of the taxable basis in Luxembourg for the financing activities of Fiat Finance and Trade' allowed Fiat Finance and Trade to use an 'artificial and highly complex method' of computing taxable profits that 'did not reflect economic reality'. The CJEU confirmed the Commission's decision on 24 September 2019 (Judgments in Cases T-755/15 Luxembourg v Commission and T-759/15 Fiat Chrysler Finance Europe v Commission).

⁴⁴⁸ OECD, Global Forum on Transparency and Exchange of Information for Tax Purposes, 2018, available at: <https://www.oecd.org/tax/transparency/>

transparency and promoting EU coordination⁴⁴⁹. In line with the BEPS project, in January 2016 the Commission proposed an anti-tax avoidance package that called for a stronger and more coordinated stance against companies that seek to avoid paying their fair share of tax and the implementation of international standards against base erosion and profit-shifting. It targeted internal measures and common actions against external threats⁴⁵⁰. Several legal instruments are being used or were newly introduced, in line with its agenda to counter tax avoidance and ATP.

Particular reference can be made to the **recent Anti-Tax Avoidance Directives of 2016 and 2017**⁴⁵¹, which include CFC provisions targeting hybrid mismatches (in line with the BEPS initiative) and a general anti-abuse provision for corporate income tax purposes. In particular, Chapter II of the Anti-Tax Avoidance Directive expressly foresees anti-avoidance measures, including: CFC rule that seeks to discourage profit-shifting to a low/no tax country; exit taxation, intended to avoid companies from evading tax when re-locating assets; interest limitation, aimed at dissuading artificial debt arrangements; general anti-abuse rule, with the purpose of tackling ATP. These practices are sometimes associated with the use of letterbox companies seeking to avoid paying the taxes normally expected in the country of incorporation and to engage in treaty shopping, which often lead to tax avoidance through ATP, profit-shifting and transfer pricing abuses (see Section 4).

Once transposed by Member States, these EU measures translate to national measures on **CFCs**. These national taxation rules on CFCs aim to diminish the attractiveness of establishing a CFC for the purposes of avoiding or reducing tax payments. The box below presents two different examples.

In **Finland**, the law was modified to transpose the Anti-Tax Avoidance Directives and became effective as of 1 January 2019. It imposes a tax on CFCs based on objective factors without the tax authorities having to establish a tax avoidance motive. The share in the CFC's income is considered taxable income in the hands of a taxpayer. A CFC is defined as a corporate body, in its foreign country of residence placed under the ownership and control of a Finnish taxpayer, and liable there to less than three-fifths of the corresponding Finnish level of income taxation than if it were a Finnish company. The advantage of this approach is that the legislation is based on objective factors, i.e., the tax administration does not have to prove any tax avoidance motive.

The experience in **Poland** provides some interesting lessons: one year after the implementation of the CFC regulations, the Polish Ministry of Finance issued over 100 interpretations in which they addressed the taxpayers' doubts regarding the application of these provisions. Administrative courts also ruled on the interpretation of CFC provisions. The main lesson was that the first regulation on CFC included only corporations, yet many tax evasion transactions involved other forms, such as foundations established in Liechtenstein. This led to amendments to the regulation in 2019. Overall, the measure led to a decrease in the motivation to establish companies in tax havens. The measure seems to be regarded positively at national level, as it focuses on tax evasion matters without imposing a significant administrative burden on businesses.

⁴⁴⁹ European Commission, Taxation and customs union (Taxud), Action Plan on Corporate taxation, June 2015, available at: ec.europa.eu/taxation_customs/business/company-tax/action-plan-corporate-taxation_en

⁴⁵⁰ European Commission, Communication from the Commission to the European Parliament and the Council: Anti-tax avoidance package: next steps towards delivering effective taxation and greater tax transparency in the EU, COM (2016)23, 2016, available at:

<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2016%3A23%3AFIN>

⁴⁵¹ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market; Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

The **amendments introduced in 2014 and 2015 to the Parent-Subsidiary Directive**⁴⁵² include an anti-abuse provision and an anti-hybrid rule, in order to prevent instances of directive shopping and double non-taxation. The Parent-Subsidiary Directive was designed to eliminate tax obstacles for profit distributions between parent companies and subsidiaries based in different Member States⁴⁵³. The objective of this Directive is to exempt dividends and other profit distributions paid by subsidiary companies to their parent company from withholding taxes, and to eliminate double taxation of such income at the level of the parent company. Anti-abuse rules are aimed at tackling behaviour that may be in line with the letter of the tax law but defies its spirit and purpose in order to achieve undue tax advantages. Essentially, anti-abuse rules invalidate or block-off tax avoidance strategies. Anti-abuse rules may be shaped to tackle specific types of abuse or may be designed to act more widely against any other abusive behaviour (i.e. GAARs). The anti-abuse rule included in the proposal follows the lines of the Recommendation on aggressive tax planning and is then adapted to the specifics of the Parent-Subsidiary Directive.

The measure is also relevant in the context of letterbox companies. The European Commission's memo on the Parent-Subsidiary Directive describes a situation in which a parent company sets up one (or several) intermediate companies (which could be LBCs) in a Member State other than that in which the parent company is incorporated, with the objective of reducing the payment of taxes. Such behaviour would be considered an artificial arrangement in the context of the Directive and the benefits of the Directive would be denied⁴⁵⁴.

Annex 5 of this report presents a case study on taxation, demonstrating the application of the Parent-Subsidiary Directive in the context of conduit companies.

The extension of the scope of **automatic exchange of information and administrative cooperation in the field of taxation** is of particular importance in identifying and countering letterbox companies used to avoid or evade taxes. Reference can be made in this respect to the **Common Reporting Standard (CRS)** at OECD level⁴⁵⁵ and to the various directives on administrative cooperation in taxation at the European level, notably:

- Directive 2011/16/EU on administrative cooperation in the field of taxation and repealing Directive 77/779/EEC (DAC1).
- Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation (DAC2).
- Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation (DAC3).
- Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation with regard to Country-by-Country Reporting (DAC4).
- Council Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities (DAC5).

⁴⁵² Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

⁴⁵³ https://ec.europa.eu/commission/presscorner/detail/en/MEMO_13_1040

⁴⁵⁴ European Commission, Questions and Answers on the Parent-Subsidiary Directive, Memo, 2013, available at: https://europa.eu/rapid/press-release_MEMO-13-1040_en.htm?locale=en

⁴⁵⁵ <https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/>

- Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (DAC6)⁴⁵⁶.

DAC2 amended DAC1 with respect to mandatory automatic exchange of information in the field of taxation and extended the cooperation between EU tax authorities. As such, DAC2 and its provisions are an essential EU measure to counter potential abuses by letterbox companies, in particular regarding tax evasion by individuals.

One of the aims of DAC2 is to counteract tax evasion through the use of interposed legal entities and arrangements in a cross-border context that are intended to conceal the identity of the beneficial owner. However, neither DAC2, nor the OECD Common Reporting Standard on automatic exchange of financial account information upon which DAC2 is based, provide a definition of what is a letterbox company. Therefore being subject to DAC2/CRS reporting does not mean per se that such a structure is used for abusive purposes. Rather these transparency agreements assess the activities of such interposed structures to determine whether they should be subject to DAC2/CRS, in particular whether such a structure has significant passive financial income and assets. In terms of DAC2 and the CRS, in terms of income and assets, the following defines an active Non-Financial Entity (NFE):

- (i) Less than 50 % of the NFE's gross income for the preceding calendar year or other appropriate reporting period is passive income, and
- (ii) Less than 50 % of the assets held by the NFE during the preceding calendar year or other appropriate reporting period are assets that produce or are held for the production of passive income.

The definition of passive NFE's provides for a number of exemptions, for example for investment entities which would fall under the category of a reporting financial entity.

In order to determine whether a letterbox company would be subject to DAC2/CRS, the following elements are undertaken by a reporting financial entity in the customer due diligence process:

- the type of account or product (i)
- the location of the financial account (ii)
- the place of (tax) residence of the relevant taxpayer (iii)

Concerning the type of account, the first step would consist in determining whether it is a reportable financial account or not. If classified as such and should the account holder be a legal person like company or an arrangement like a trust, then attention would be given to determining whether that legal person/arrangement can be defined as a passive Non-

⁴⁵⁶ In order to accommodate new initiatives in the field of tax transparency at the level of the Union, Council Directive 2011/16/EU (3) has been the subject of a series of amendments in recent years. Council Directive 2014/107/EU (4) introduced the CRS developed by the OECD for financial account information within the Union. The CRS provides for the automatic exchange of information on financial accounts held by non-tax residents and establishes a framework for that exchange worldwide. Directive 2011/16/EU was amended by Council Directive (EU) 2015/2376 (5), which provided for the automatic exchange of information on advance cross-border tax rulings, and by Council Directive (EU) 2016/881 (6), which provided for the mandatory automatic exchange of information on CbC reporting of MNEs between tax authorities. In light of the usefulness of anti-money-laundering information for tax authorities, Council Directive (EU) 2016/2258 (7) placed an obligation on Member States to give tax authorities access to customer due diligence procedures applied by financial institutions under Directive (EU) 2015/849 of the European Parliament and of the Council (8). Finally, Directive 2018/822, which became effective from July 2020, established mandatory disclosure rules for intermediaries and the automatic exchange of information on tax planning cross-border arrangements. Failure to comply with DAC6 may lead to sanctions and reputational risks for businesses, individuals and intermediaries

(<https://www.pwc.com/lv/en/news/dac6.html#:~:text=The%20aim%20of%20DAC6%20is,for%20businesses%2C%20individuals%20and%20intermediaries>).

Financial Entity ('passive NFE') and thus be reportable or not if it does not fall under the definition.

For relevant taxpayer, this is where the place of residence (iii) becomes an important element. Scrutiny would be given to the legal person/arrangement which is a passive NFE to identify the natural person(s) who are the controlling person of the passive NFE to determine whether they are residents of a reportable jurisdiction.

If that is the case, information would then be exchanged between the jurisdiction in which the reportable financial account is located, and the tax authorities where the controlling person is resident. In the EU, the relevant framework is provided by the 4th Anti-Money Laundering Directive (as amended by the 5th), which is also largely based on the FATF standards but goes beyond them in areas of relevance for this study such as beneficial ownership transparency.

DAC2 provides a definition of a 'Passive Non-Financial entity' as opposed to an 'Active' entity which depends on the activities of the entity which is defined under DAC2. That is to say, a passive NFE holds financial assets and the income derived therefrom and **is not an active trading company**. Therefore, a letterbox company may indeed fall under the passive NFE classification definition, but some letterbox companies would not, for example, letterbox companies with no income/assets or letter box companies which are trading companies.

Overall, available evaluations⁴⁵⁷ show limited evidence of the effectiveness of DAC1. Due to their relatively recent implementation, and to the unaligned definitions between passive NFE in DAC2 and that of letterbox company, it is too early and not easy to assess the effect of DAC2 and its effect on the ability of Member States to tackle harmful tax competition and avoidance.

There is partial **evidence that certain administrative cooperation elements of the Directives have contributed to safeguarding some Member States' tax revenues** and to high amounts of additional tax revenue, on the basis of simultaneous controls, but only from a limited number of Member States. The exchange of information has seen the Directives improve Member States' ability to fight cross-border tax fraud and tax evasion by complementing the otherwise partial, missing or incorrect reporting of income from or assets held abroad (which could be partially undertaken through the letterbox companies). DAC1, by introducing core elements of administrative cooperation, and later DAC1/DAC2 envisaging automatic exchanges of information, have enabled Member States to perform audits and assess taxes due more efficiently, and to identify taxpayers with a risk of non-compliance because of their activities abroad (including through the letterbox companies but not always since passive NFEs would not necessarily be classified as abusive letterbox companies even when these operate fraudulently). Finally, DAC6 brought a specific abuse provision (Hallmark D), aimed at obliging intermediaries to report on schemes which may lead to the circumvention of tax transparency agreements like DAC2/CRS and beneficial ownership, for example through the use of interposed structures. Recently adopted, time will show how effective this measure is.

Non-binding but nevertheless relevant, the **European Code of Conduct Group on Business Taxation** assesses tax measures in EU Member States that may constitute harmful tax competition. The latter is sometimes observed in the context of abusive letterbox companies. The Group also drafts guidance on anti-abuse measures, assesses the compliance of third countries' regimes with the OECD BEPS minimum standards

⁴⁵⁷ SWD/2017/0462 final.

(Actions 5 and 6) and seeks dialogue with these countries. In the context of this dialogue, an EU-list of non-cooperative jurisdictions for tax purposes was published⁴⁵⁸.

As part of relaunching the 2011 Common Consolidated Corporate Tax Base proposal⁴⁵⁹, in 2016 the European Commission's published proposals for Council Directives on a **Common Corporate Tax Base** (CCTB)⁴⁶⁰, and on a **Common Consolidated Corporate Tax Base** (CCCTB)⁴⁶¹, aimed at improving the functioning of the Single Market by proposing a harmonised tax regime for companies. In the C(C)CTB impact assessment, the Commission highlighted the need for harmonised corporate taxation across the EU internal market, in view of the complications for companies arising from the obligation to comply with 28 different corporate tax systems and national rules and which, as a result, might allow ATP. The CCTB proposal provides for the determination of a single set of rules for the calculation of the corporate tax base. It would be mandatory for groups of companies with consolidated turnover exceeding EUR 750 million during the financial year for companies established under the laws of a Member State, including its permanent establishment (PE) in other Member States, and for PEs of a company established under the laws of a third country that are located in EU Member States. Companies that remain below the threshold would have the possibility to opt into the system.

Unlike the 2011 project, the 2016 proposal was divided into two separate frameworks. The CCTB proposal lays down common rules for computing the tax base of multinational companies within the EU, while the CCCTB proposal provides the consolidation element. Discussions on the consolidated proposal (CCCTB) will only begin after the adoption of the CCTB. The CCTB proposal is under the consultation procedure. The Parliament's Committee on Economic and Monetary Affairs (ECON) adopted its report on 21 February 2018, amending the proposal. The Parliament, which is only consulted, adopted its report in plenary on 15 March 2018. The Council's latest Presidency compromise on the file (at the time when this research was finalised) was published on 27 November 2019⁴⁶².

The CCCTB proposal builds on the CCTB proposal and proposes that the European profit of a group of companies is calculated on a consolidated basis and is subsequently allocated (using a formula) to the individual group companies and PEs. Subsequently, each Member State can tax resident companies and PEs against its own rates, meaning that the proposals do not affect the competence of Member States to set their own tax rates⁴⁶³.

The Commission claims that the CCCTB is an effective tool for attributing income to where the value is created, and the proposed formula apportionment is a fair and efficient answer to profit-shifting and base erosion⁴⁶⁴. This measure could thus contribute to combat ATP, a practice also occurring in the context of letterbox companies, by determining where real

⁴⁵⁸ See Council conclusions on the EU list of non-cooperative jurisdictions for tax purposes, 2017, available at: <https://data.consilium.europa.eu/doc/document/ST-15429-2017-INIT/en/pdf>, as well as link to the list: <https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/>

⁴⁵⁹ European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) (COM (2011) 121/4), available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/company_tax/common_tax_base/com_2011_121_en.pdf

⁴⁶⁰ European Commission, Proposal for a Council Directive on a Common Corporate Tax Base, (COM (2016) 685 final), available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_685_en.pdf

⁴⁶¹ *ibid.*

⁴⁶² Interinstitutional File: 2016/0337(CNS); Doc. 14291/19, available at:

<https://data.consilium.europa.eu/doc/document/ST-14291-2019-INIT/en/pdf>

⁴⁶³ van de Streek, J.L., Some Introductory Remarks on the Relunched CCTB/CCCTB Proposals from a Policy Perspective, p.1

<https://www.uva.nl/binaries/content/documents/personalpages/s/t/j.l.vandestreek/nl/downloads/downloads/assets/%5B4%5D/asset>

⁴⁶⁴ See paragraph 1 of the explanatory memorandum accompanying the CCTB/CCCTB proposals (COM (2016) 685 and 683 final)

economic activity takes place. In addition, the CCCTB is supposed to eliminate mismatches between national tax systems, preferential regimes and hidden tax rulings - which tax avoiders exploit, including through the use of abusive letterbox companies. It will remove the need for transfer pricing, which is a primary route for profit-shifting and which puts a high administrative burden on companies and gives rise to double taxation⁴⁶⁵.

Reference can also be made to the recent **EU level proposals for curbing VAT fraud**, targeting for example the use of letterbox companies in the context of MTIC fraud⁴⁶⁶ (where such companies are mostly used in the role of a 'missing trader', usually registered in the name of socially disadvantaged people and who usually do not have staff, assets or any economic activity (see Section 4). Adopted in a first reading by the Parliament on 19 February 2019, the proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States is, at the time of finalisation of the research for this study⁴⁶⁷, awaiting feedback from the Council⁴⁶⁸. Regulation 904/2010 was amended by Regulation (EU) 2018/1541 of 2 October 2018 as regards measures to strengthen administrative cooperation in the field of value added tax, which has introduced the status of 'certified taxable person'.

In May 2019, in the context of VAT fraud, the Commission announced that a new mechanism, called **Transaction Network Analysis** (TNA), will be deployed on an EU-wide basis by the end of 2019. Not yet implemented when this research was finalised, the system, already in use in some Member States, will rely on data-mining to quickly identify suspicious activity and flag likely cases of VAT fraud⁴⁶⁹. One of the key issues with respect to tackling cross-border VAT fraud is that by the time the relevant VAT audits have been performed, the perpetrators have moved on and can no longer be located. Abusive undertakings can be set up and quickly dissolved for this purpose. The mechanism could thus contribute to identifying abusive letterbox companies at an early stage and help enforcement authorities to take action before the company is dismantled.

The Commission has consistently sought to put in place a more modern and fraud-proof cross-border VAT system⁴⁷⁰. The TNA, developed in close collaboration with Member States, allows national tax authorities quick and easy access to cross-border transactional information. It is expected to boost cooperation and information exchange between national tax officials, as well as allowing the EU's network of anti-fraud experts (Eurofisc) to cross-check information with criminal records, databases and information held by Europol and OLAF (the EU anti-fraud agency) and to coordinate cross-border investigations. In the longer term, the TNA should enable tax authorities to detect and

⁴⁶⁵ van de Streek, J.L., Some introductory remarks on the relaunched CCTB/CCCTB proposals from a policy perspective, p.3
<https://www.uva.nl/binaries/content/documents/personalpages/s/t/j.l.vandestreek/nl/downloads/downloads/assets/%5B4%5D/asset>

⁴⁶⁶ Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax; European Commission, Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329 final.

⁴⁶⁷ December 2019.

⁴⁶⁸ Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329 final, available at:
https://ec.europa.eu/taxation_customs/sites/taxation/files/25_05_2018_proposal_on_detailed_technical_measures_for_the_operation_of_the_definitive_vat_system_en.pdf.

⁴⁶⁹ European Commission, press release IP/19/2468. See also Lamensch, M., VAT fraud - Economic impact, challenges and policy issues, available at

[http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU\(2018\)626076](http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU(2018)626076)

⁴⁷⁰ Wilson, E., EC launches Transaction Network Analysis to recoup billions in VAT fraud, 2019.

intercept VAT fraud, including through the use of abusive letterbox companies, more quickly and effectively.

Some national taxation measures specifically aimed at **combating VAT fraud, including VAT fraud committed by using abusive letterbox companies**, have also been identified. Worth highlighting in this context are, for example, the measures in Germany and Poland.

In **Germany**, the possibility of un-announced *ex post* VAT investigations (*Umsatzsteuer-Nachschau*) is established in the Sales Tax Act (*Umsatzsteuergesetz*) to fight VAT fraud, as well as the requirements for new companies to report monthly in the year of their establishment and the following year. Tax inspectors also have comprehensive knowledge of domestic and foreign letterbox companies, according to the Ministry of Finance.

In **Poland**, the registration of VAT payers has become much stricter and now includes checking of company address (seat) by tax officers in person. Applicable to all company types, the latter occurs after formally registering the company and before undertaking any business activity. Evidence of its effectiveness shows a mixed picture: while the main effect of the measure has been the reduction of fictitious letterbox companies, it has also increased the duration of the registration process from less than a week to around one month or more. It also improved the public enforcement of tax provisions and mechanisms of gathering information about companies. However, there is a risk that the new rules are too difficult for businesses to comply with (unclear how they should be interpreted) and that they could result in a significant administrative burden. Although the measure is considered good practice in the national context, it has been criticised by entrepreneurs for complicating the process of establishing a business in Poland.

In the context of rules that intend to counter tax evasion while guaranteeing the correct application of the Treaties, it is important to take into account relevant **CJEU jurisprudence**.

While not constituting measures *per se*, precedents from the Court nevertheless contribute to the set of established rules to be considered by national authorities in their fight against tax evasion. It may be challenging to distinguish between legal and illegal uses that may be made of letterbox companies, in particular in the fiscal domain (see Section 4.2.1). Although perfectly legal for an undertaking to enjoy tax advantages granted by EU legislation, it is also possible for national authorities to intervene and decide otherwise by, for example, depriving undertakings of a tax benefit deriving from EU law where a presumption of abuse is established (i.e., ‘abuse of rights principle’, see Section 4.1, in particular the recent CJEU judgment of 29 February 2019).

In the well-known *Cadbury*⁴⁷¹ and *Egiom*⁴⁷² cases, the Court held that the initial presumptions of abuse claimed by the national authorities constituted unjustified restrictions to the freedom of establishment. In doing so, the Court did not question the right for a national jurisdiction to withdraw tax benefits offered by EU laws, but, rather, disproved the soundness of the argument brought forward by the national authorities (see Section 4.1). The Court then emphasised the need for national decisions to be based on **objective factors ascertainable by third parties**.

In *Cadbury*, the CJEU underlined that a restriction on the freedom of establishment **can only be justified on the ground of prevention of abusive practices**, if the specific

⁴⁷¹ CJEU, 12 September 2006, *Cadbury Schweppes*, C-196/04

⁴⁷² CJEU, 7 September 2017, *Egiom* (formerly *Holcim France SAS*), C-6/16

objective of such a restriction is to prevent conduct involving the creation of 'wholly artificial arrangements' that do not reflect economic reality, with a view to evading the tax normally due on the profits generated by activities carried out on national territory⁴⁷³. 'The incorporation must correspond with an actual establishment intended to carry on genuine economic activities in the host Member State'⁴⁷⁴. If one concludes that the foreign controlled company 'is a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State [...] [it] must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a "letterbox" or "front" subsidiary'⁴⁷⁵.

If the mere fact that a company uses no (or limited) office space and has no (or limited) staff was not sufficient for the Court to conclude that there was tax avoidance, more recent verdicts have reaffirmed the responsibilities for Member States to withdraw tax benefits deriving from EU legislation where there is suspicion of fraud.

In the **C-116/16** (*T Denmark*) case, the Court emphasised that national authorities must refuse benefit if financial arrangements are set up with the sole aim of obtaining such benefits, and confirmed in C-115/16 (**N Luxembourg 1**)⁴⁷⁶ that Member States are obliged to refuse entitlements to rights contained in EU law – even in the absence of domestic provisions supporting such a position – where an undertaking acts as a conduit company.

Some taxation measures also include **economic substance requirements that are to be met in order to be regarded as a resident for tax purposes** (and, consequently, to obtain the benefits of a tax treaty or a Directive, or of a beneficial tax regime in the country in question). In the Netherlands, for instance, a number of measures were introduced from 2014 specifically to prevent letterbox companies from abusing the tax treaty network of the Netherlands⁴⁷⁷. In particular, substance requirements were imposed on taxpayers that benefited from tax treaties or the EU Interest and Royalty Directive and the tax administration was given the possibility of spontaneously providing information on the lack of substance to the source country⁴⁷⁸.

Similarly, the German Tax Code (*Abgabenordnung*) was amended in 2016 (further to the transposition of the 4th AML Directive) to introduce new measures to combat the use of letterbox companies. Most notably, an obligation was introduced for financial institutions to notify the tax authorities of business relationships they have set up or facilitated between German taxpayers and non-EU companies (Section 138b AO), a banking secrecy provision was repealed (Section 30a) and the tax authorities' access to bank account information was extended in order to determine the existence of relationships with letterbox companies (Section 93(7)).

Some Member States have established specific measures referring to **the principle of 'substance over form'** in their taxation regulations.

In Estonia, the tax authorities can apply the conditions that correspond to the actual economic content of the transaction where they have discovered a fictitious transaction performed for the purposes of tax evasion⁴⁷⁹. The measure aims to discourage companies from performing fictitious transactions to avoid taxes, as it

⁴⁷³ CJEU, 12 September 2006, *Cadbury Schweppes*, C-196/04 para 55.

⁴⁷⁴ *ibid.*, para 66.

⁴⁷⁵ Case C-341/04 *Eurofood IFSC* [2006] ECR I-0000, paragraphs 34 and 35.

⁴⁷⁶ C-115/16.

⁴⁷⁷ *Besluit van 18 december 2013 tot wijziging van enige uitvoeringsbesluiten op het gebied van belastingen en toeslagen*, *Stb.* 2013, 569.

⁴⁷⁸ See also Schrievers, P. and Vogel, J., 'The Netherlands has not turned a blind eye towards the international debate regarding tax planning', *European Taxation*, Vol. 54, No. 5, 2014.

⁴⁷⁹ Dismissal of fictitious transactions and subsequent application of tax: Article 84, Taxation Act.

adheres to the principle of 'substance over form'. The effect of this measure depends on the initiative of the tax authority: if the tax authority discovers a fictitious transaction performed for the purposes of tax evasion, it can apply the conditions that correspond to the actual economic content of the transaction. Therefore, the measure has both a deterrent and practical effect if applied diligently. This is a general rule to prevent the agreement between parties for a transaction avoiding or reducing the taxation. Specific tax laws (e.g., the Income Tax Act § 50(4)) state the same principle, and this gives wider applicability than previously provided for in more specialised tax laws. Although not directly addressing letterbox companies, these measures might have a deterrent effect on letterbox companies that usually do not perform economic activity in the place of incorporation and that can be used for abusive purposes such as tax evasion.

A similar principle is applied in Finland, where taxation legislation establishes that taxation takes place to reflect the correct circumstances if transactions have a legal form not commensurate with its actual character or meaning⁴⁸⁰. The general anti-abuse rule aims to prevent tax avoidance in income taxation. The provision tackles arrangements that have a tax avoidance motive and whose legal form is not in accordance with the economic substance of the arrangement.

A similar method is also provided in **the national taxation laws of Luxembourg** and allows possible requalification of such transactions in a way that fully reflects the real intention of the parties⁴⁸¹. For instance, assets transferred for the purpose of security are attributed to the sellers. According to the substance over form approach, the economic concept has primacy over the literal application of the law or the observance of the formal qualification of the transaction. The added value of this approach is that it empowers the revenue authorities and administrative judges to requalify facts and acts to better correspond to their economic reality.

While information about the effectiveness of such measures at national level is scarce, they enable the tax authorities to identify potentially fraudulent transactions and tax evasion behaviours and to reclassify them reflecting their real economic purpose. In Luxembourg, for instance, the rule is considered good practice as it allows judges and the tax administration to look beyond legal formalism. In practice, the principle of substance over form is used by administrative judges as a complementary rule to define notions that the legislator did not specifically delineate (such as the notion of 'holding' on the exemption applied to income arising from certain qualifying participations). Such supplementary rules must not be followed when specific rules of allocation exist. However, the effective application of such measures requires significant capacity of tax authorities to act proactively and identify such behaviours.

Several offshore centres have introduced new substance requirements for companies, as a direct result of the monitoring exercise carried out by the EU Code of Conduct Group on Business Taxation. In this respect, reference can be made to the guidance in relation to economic substance requirements jointly published by the British Crown Dependencies (Jersey, Guernsey and the Isle of Man)⁴⁸².

Other measures address **residence mismatches**, following from a difference between two jurisdictions or under the rules of a tax treaty in the criteria used to establish tax residence. Several countries, such as Belgium and Ireland, modified their domestic tax rules in order

⁴⁸⁰ General anti-avoidance rule, Tax Assessment Procedure Act 18.12.1995/1558 28 §. It is noted that taxation legislation does not, in general, establish that taxation follows the economic situation. That is only applicable when the GAAR applies. An arrangement can be taxed according to its 'real nature'. This must be established by analysing all the facts and circumstances. The taxpayer must have an apparent tax avoidance purpose.

⁴⁸¹ 11 StAnpG (*Loi d'adaptation fiscale du 16 octobre 1934*) encapsulating the 'substance over form' principle.

⁴⁸² <https://www.gov.gg/CHttpHandler.ashx?id=118851&p=0>

to prevent dual non-residence mismatches resulting from the application of a tax treaty and/or differences in domestic rules to established tax residence⁴⁸³.

A number of national measures relate to the **definition of the substance or actual business activity** for the purposes of taxing the company. These are particularly widespread in Luxembourg and Spain. In Luxembourg, a number of recent taxation legal changes (from 2018 and 2019) have established a range of principles to establish the substance of the business activity. In particular, the amended Income Tax Law⁴⁸⁴ now defines the companies considered resident in Luxembourg for tax purposes when they have either their registered office or their central administration in Luxembourg. However, since the measure allows for subjection to the Luxembourg corporate tax on the basis of the registered office, without requiring the central administration to also be in Luxembourg, it could still facilitate the establishment and the use of letterbox companies. In cases where the central administration (or effective management) is in another State, it is very likely that the company is considered as tax resident in that other State. The main success factor identified in the implementation of the rules in Luxembourg is that specific substance criteria can, by analogy, be transposed to other corporations besides those engaging in intra-group financing activities. On the other hand, companies have difficulties in keeping track with these valuation methods and in developing their documentation accordingly. A review of the previously filed advanced pricing agreements, as well as past defensive transfer pricing documentation will need to be carried out in light of this revised legal framework.

In Spain, the principle established in the tax laws is that the registered office is also considered the domicile for tax law purposes. In the tax laws defining the substance requirements of the company (Article 48 LGT; Articles 7 and 8 Act 27/2014 on companies' tax (*Impuesto de Sociedades*, LIS), the registered office is also considered the domicile for tax law purposes (Article 48 LGT). But the criteria of the tax law suggest that Spain is a 'real seat country' that tries to impede –indirectly– the use of letterbox companies. Similarly, companies with residence in Spain are taxed according to Spanish tax rules. Companies are considered as Spanish tax resident when (a) incorporated in Spain or (b) having their headquarters in the Spanish territory or (c) when the effective management operates from Spain (Article 8(1)(a)-(c) LIS).

In Poland, the **national tax registration requirements** allow the Ministry of Finance and the local tax authorities to identify entrepreneurs involved in taxable transactions. However, the court concluded that the authority is not entitled to examine whether the building (premises) meets the conditions for performing management activities and/or business activities, when conferring the Taxpayer Identification Number (NIP)⁴⁸⁵.

⁴⁸³ Article 2, § 1, 5°, a) of the Belgian Income Tax Code; Section 23A of the Irish Tax Consolidation Act 1997.

⁴⁸⁴ Article 159 Income Tax Law (Law of 4 December 1967 on income tax) (in original language '*Loi du 4 décembre 1967 concernant l'impôt sur le revenu*').

⁴⁸⁵ NSA judgment, 5.8.2014 r., II FSK 3549/13, extract 'In the course of the procedure for granting a tax identification number (NIP), the authorities are not authorised to examine whether the company's management activities are performed at the address indicated in the application for tax registration. Also, the fact that other companies are also based at the address indicated cannot affect the issue of assigning the applicant's tax identification number (NIP). On the other hand, no legal provision gives the tax authorities, in the framework of the procedure for granting NIP, the competence to control the suitability of the premises (real estate) provided as the taxpayer's seat to conduct business activity there. Neither does any provision define the criteria that would determine the suitability of a building (premises) for recognition as the company's seat. There is also no provision imposing an obligation on the entity obliged to submit an application to demonstrate that management activities or that business activities may be carried out in the premises located at the indicated address (apart from the obligation to prove the legal title to the premises in the proceedings for entry in the National Court Register). What is more, in the current realities of economic trading, taking into account modern technologies, management activities and business activities are and can be carried out anywhere, also using the so-called virtual offices or coworking offices (shared)'.

Finally, some national taxation measures have been identified in relation to the establishment of **taxation benefits for micro-entrepreneurs** (Romania, Bulgaria) and the taxation rules allowing a range of **tax advantages for companies without business operations** (Switzerland). Although the Swiss provisions cover all types of companies, the characteristics of domicile companies generally fall within the scope of this standard and can benefit from tax advantages.

In **Germany**, the 2017 **Act to fight tax dodging** had a particular focus on third country companies. Tax fraud involving a non-EU/EFTA company is treated as a particularly severe case, incurring higher minimum and maximum penalties. Taxpayers have to indicate to the tax authorities a number of links to non-EU/EFTA companies, including establishment or acquisition of foreign businesses or permanent establishments and the nature of the activity of the businesses. Tax authorities can access the centralised bank account register (which exists since 2005) to investigate whether a taxpayer is entitled to hold a letterbox company.

In the Netherlands, a **conditional withholding tax on interest and royalties** (*Conditionele bronbelasting op rente - en royaltybetalingen*) will be included in the legislative proposal of the Withholding Tax Act 2021 (*Wetsvoorstel Wet Bronbelasting*). The entire legislative proposal is geared towards this measure, which aims to counteract tax avoidance and tax base erosion.

6.2 Measures in the area of anti-money laundering⁴⁸⁶

As described in Section 4, letterbox companies can be used as a 'conduit' for sending dividends to tax havens outside the EU (a mechanism also used by money launderers). More frequently referred to as shell or front companies in this context, the exploitation of corporate structures has become a key feature of many money laundering schemes. Some organised crime groups and terrorist financiers construct their money laundering schemes around shell companies or use them in the scheme to anonymise the ultimate beneficial owner. Front companies are used to integrate physical cash into a business and then exploit its banking relationships to move cash across jurisdictions.

This mechanism has been under scrutiny at many levels since the beginning of the 21st century. Both the EU and international legal frameworks contribute to the prevention of the abuse of shell or letterbox companies for money laundering purposes, through three main types of standards and measures, which:

- Ensure that companies do not serve as fronts to money-launderers, and therefore ensure transparency of the **beneficial owners**.
- Control various categories of **intermediaries** and service providers that may enable or prevent the abusive use of shell or letterbox companies.
- Limit the provision of services by banks or other professionals to shell/ letterbox companies.

Table 15 outlines key international and EU legal instruments that provide anti-money laundering measures, alongside some others from third countries.

⁴⁸⁶ Money laundering as a consequence of tax crimes (relating to direct and indirect taxes, as laid down in national law) will have to be criminalised in all EU Member States once Directive 2018/1673 is transposed on 3 December 2020.

Table 15. Overview of measures in the money laundering area

Type	Organisation/ Country	Measure
International	Financial Action Task Force (FATF)	- International standards on beneficial ownership and due diligence, including for designated non-financial businesses and professions⁴⁸⁷ - Guidance for Risk based approach to Trust and Company Service Providers (TCSPs)⁴⁸⁸, accountants⁴⁸⁹, legal professionals⁴⁹⁰
European	EU	- Anti-money laundering Directives (AMLD)⁴⁹¹: 4th AML Directive (EU) 2015/849, which repealed the 3rd AML Directive 2005/60/EC and was amended by 5th AML Directive (EU) 2018/843: the 3rd AML Directive introduced requirements for trust and company service providers, the 4th AML Directive⁴⁹² required Member States to set up national registers of beneficial owners for companies, while the 5th AML Directive expanded their transparency regime and mandated for semi-public registers of beneficial ownership for trusts and similar legal arrangements - EU list of high-risk third countries
Examples of relevant national measures in third countries		
National	Switzerland	- Agreement between the Swiss Financial Market Supervisory Authority and the Swiss Bankers Association on the code of conduct for the exercise of due diligence by banks - Code of Conduct of the Self-regulatory organisations (SRO) <i>Treuhand Suisse</i> - Article 15 Ordinance of the Swiss Financial Market Supervisory Authority on the

⁴⁸⁷ FATF, International standards on combating money laundering and the financing of terrorism & proliferation, FATF Recommendations, 2019, available at: <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

⁴⁸⁸ FATF, Trust and company service providers, 2019, available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/RBA-Trust-Company-Service-Providers.pdf>

⁴⁸⁹ In some countries, accountants are involved in the formation of companies or may provide advice to individuals seeking to register a company. Accountants may be involved in the management of companies or may act as nominees. (See FATF, Guidance for a risk-based approach – Accounting Profession, 2019, p.12, available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/RBA-Accounting-Profession.pdf>).

⁴⁹⁰ In many countries, legal professionals are involved in the formation of companies, may provide advice to individuals seeking to register a company, represent or participate in the management of companies, or act as nominees (see FATF, Guidance for a risk-based approach – Legal Profession, 2019, p.14, available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Legal-Professionals.pdf>).

⁴⁹¹ Directive (EU) 2018/843 of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU.

⁴⁹² Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU.

Type	Organisation/ Country	Measure
		obligation for financial intermediaries to make additional enquiries in the case of business relationships or transactions involving increased risks
National	US	Customer due diligence requirements for banks, other financial institutions, professional money managers

▪ Effective identification of beneficial owners

At both **international and EU level**, the need to ensure **effective beneficial owner identification** has become central in debates and several measures have been taken in response. The importance of the identification of beneficial owners is linked to the vulnerability of all sectors to infiltration, integration or ownership by organised crime organisations and terrorist groups⁴⁹³. Studies also confirmed that one of the most common ways in which criminals bypass the ownership regulations is by creating letterbox companies, trusts or complex corporate structures to hide their identities⁴⁹⁴.

Since 2003, **the FATF**, which was the first international body to set international standards, developed a set of 40 recommendations, which have been endorsed by all EU Member States. The following are relevant to beneficial ownership:

- **Recommendation 10:** Standards for financial institutions to carry out **due diligence** to identify customer's identity, beneficial ownership, or control structure of legal entities, understanding the purpose and nature of business relations.
- **Recommendation 19:** Enhanced due diligence in business relations and transactions with legal persons from high-risk countries.
- **Recommendations 24 and 25:** Standards to **establish transparency of beneficial ownership** to prevent the misuse of legal persons and legal arrangements for money laundering, calling for countries to ensure that their authorities could have access to accurate and updated information about the persons behind foundations, companies and other legal entities.

While FATF recommendations are not binding, EU law has integrated their principles in the **AML Directive**. Some of provisions of the AML Directive actually go beyond the requirements set forth by the recommendations.

The **4th AML Directive** in May 2015⁴⁹⁵ included a requirement to set up national registers of beneficial owners of companies and some trusts and defined the beneficial owner as a person(s) who ultimately owns or controls a legal entity through direct or indirect ownership of a sufficient percentage of the shares or voting rights or ownership interest in

⁴⁹³ European Commission, Report from the Commission to the European Parliament and the Council on the assessment of the risk of money laundering and terrorist financing affecting the internal market and relating to cross-border activities, 2019.

⁴⁹⁴ Findley, F., Nielson, D. and Sharman, U., *Global Shell Games: Experiments in Transnational Relations, Crime, and Terrorism*, Cambridge: Cambridge University Press, 2014; Gordon, R.K., 'Laundering the Proceeds of Public Sector Corruption', SSRN Scholarly Paper, Social Science Research Network, Rochester, NY, 2009, available at: <https://papers.ssrn.com/abstract=1371711>

⁴⁹⁵ Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU.

that entity. This can be helpful to trace back the beneficial owner and impede the establishment of anonymous letterbox companies to hide criminal activities. It may also contribute to drawing links between the companies that share the same ultimate controlling party. Some risks remain, however.

While initial due diligence may establish beneficial ownership, in cases when the beneficial owner of a letterbox company is a third-country-based trust and company service provider (TCSPs), EU-based TCSPs may not always have access to the beneficial ownership changes (see case study in Annex 6). The 4th AML Directive foresees that ongoing customer due diligence should be applied 'at appropriate times to existing customers on a risk-sensitive basis' (Article 14(5)). However, the abusive use of a letterbox company may take place only within a period of a few months or only in a single criminal scheme, which makes it difficult for obliged entities to determine the 'appropriate times' or have the resources to effectively apply customer due diligence with such frequency. Outsourcing of due diligence to third parties means that, in practice, financial institutions or designated non-financial businesses and professions (DNFBPs) may never meet or truly know their customers.

The national registers on beneficial ownership might have weak spots in their technical implementation or management. Criminals might move their business to Member States with a less effective framework.

To improve identification of the ultimate beneficial owner, **the 5th AML Directive of 2018**⁴⁹⁶, amending the 4th AML Directive, provides for public access to the national registers of beneficial owners for legal entities and links these registries across the EU. The Directive also allowed Member States to require obliged entities to apply additional measures in cases of higher risk. These measures include enhanced monitoring of business relationships and transactions. A requirement was also foreseen for special mitigation measures supporting or going beyond enhanced due diligence regarding entities and transactions linked to high-risk third countries.

Access to the information about legal arrangements, including trusts, is subject to the demonstration of a legitimate interest.

The 5th AML Directive also improves access to the national registers of beneficial owners for competent authorities of the Member States and strengthens mechanisms to improve the quality of information filed in the register. Since Member States had until January 2020 to set up such registers, it is too early to draw conclusions on their effectiveness and impact. The Tax Justice Network (TJN)⁴⁹⁷ has argued that in addition to establishing a public register, other measures are also important to ensure accuracy and quality of information⁴⁹⁸.

The Directive therefore adopts a multi-pronged approach and requires obliged entities to report any discrepancy identified between the information contained in the register and the information obtained through their customer due diligence process. The TJN argues,

⁴⁹⁶ Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU.

⁴⁹⁷ Knobel, A., 'Beneficial ownership verification: ensuring the truthfulness and accuracy of registered ownership information', *Tax Justice Network*, 2019, p.16, available at: https://www.taxjustice.net/wp-content/uploads/2019/01/Beneficial-ownership-verification_Tax-Justice-Network_Jan-2019.pdf

⁴⁹⁸ In Spain, for instance, where a beneficial owners' database was established in 2012, obliged entities are required **not** to rely solely on the beneficial owners' database but to request additional documents, such as a sworn declaration and other documents otherwise demonstrating the beneficial ownership. Notaries, in particular, typically relied also on customer declarations and requested additional documents in 20% of cases. Source: FATF, Anti-money laundering and counter-terrorist financing measures - Spain, 2018, p.17, available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/fur/Follow-Up-Assessment-Spain-2019.pdf>

however, that another step in this verification process may be to oblige the beneficial owners themselves to report any inaccuracies or change to the register.

Another issue raised by the TJN is the **scope of the entities** that are registered in the beneficial registers. While the 5th AML requires companies incorporated in an EU country to be registered in the EU, the TJN argues that the **registers fail to capture the beneficial ownership of foreign companies that operate in the EU** (e.g., have bank accounts, own assets) or that have parties in the EU (e.g., owners, shareholders, directors, beneficiaries)⁴⁹⁹.

- **Measures to control service providers**

The FATF has also set standards for “**designated non-financial businesses and professions**” (**DNFBPs (Recommendations 22 and 23)**), such as TCSPs⁵⁰⁰, accountants⁵⁰¹, legal professionals⁵⁰², to implement Recommendations 10 (customer due diligence) and 19 (related to due diligence where they are: acting as formation agent for legal persons, providing a ‘registered office, providing a director/secretary, acting as nominee shareholder’); or for lawyers/notaries, when creating, operating, or managing a legal person or arrangement. Recommendation 10 stipulates that these professionals should verify the identity of customers and their beneficial owners when establishing a business relationship or providing services for occasional customers. Part of the due diligence is also the identification of the registered address of the customer and their principal place of business⁵⁰³.

- **Measures to limit the provision of services to shell companies**

While the 5th AML Directive allowed for Member States to introduce limitations on business relations and transactions with legal entities in high-risk third countries, some Member States have introduced even broader measures, regardless of the country of establishment⁵⁰⁴.

- Cyprus’ Central Bank (CBC) explicitly prohibits the provisions of services to shell companies by TCSPs or banks⁵⁰⁵. The CBC provided a definition of what constitutes a shell company, and the two key criteria that should be considered to identify a legal entity as a shell company: (1) the lack of physical presence and (2) lack of established economic activity, little or no economic value, and no documentary proof to the contrary in the country of incorporation or registration⁵⁰⁶. Further detailed criteria were then provided to assess physical presence and established economic activity. The checklist approach was considered inadequate and the CBC revised its guidance in 2018 to allow for a risk-based approach.

⁴⁹⁹ *ibid.*, p.18.

⁵⁰⁰ FATF, Trust and company service providers, 2019, available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/RBA-Trust-Company-Service-Providers.pdf>

⁵⁰¹ In some countries, accountants are involved in the formation of companies or may provide advice to individuals seeking to register a company. Accountants may be involved in the management of companies or may act as nominees (see FATF, 2019).

⁵⁰² In many countries, legal professionals are involved in the formation of companies, may provide advice to individuals seeking to register a company, represent or participate in the management of companies, or act as nominees (see FATF, 2019).

⁵⁰³ FATF, *International Standards On Combating Money Laundering And The Financing Of Terrorism & Proliferation* Interpretive Note to Recommendation 10, 2012-2019, p.59, available at: <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

⁵⁰⁴ Except in Estonia where the limitation applies to companies established in the country solely

⁵⁰⁵ <https://www.uniwide.biz/latest-news/central-bank-of-cyprus-has-prohibited-service-of-shell-companies/>

⁵⁰⁶ <https://www.mondaq.com/cyprus/offshore-financial-centres/788070/revised-definition-of-shell-companies-by-the-central-bank-of-cyprus-and-practical-solutions-to-effective-banking>

- Latvian anti-money laundering legislation prohibits financial and other services to be provided to shell companies. The definition of a shell company again takes into account the place of economic activity and criteria for establishment in Latvia⁵⁰⁷.
- Finally, and while limited to companies established in Estonia, the amendment⁵⁰⁸ to the Estonian Money Laundering and Terrorism Financing Prevention Act adopted in January 2020 requires a company established in the country and offering virtual wallet/exchange services to have not only its seat in Estonia but also its management and actual place of business on the national territory.
- In addition, both the FATF and the EU have set-up lists of high-risk jurisdictions.
 - **The existence of money-laundering blacklists**

In its role as 'global money laundering and terrorist financing watchdog'⁵⁰⁹, the FATF established the first money-laundering blacklist in 2000, which contained about 20 countries one year after its creation. Following a series of revisions, two distinct lists exist at present: non-cooperative and non-compliant countries. The former list contained, as of 2020, two countries: North Korea and Iran⁵¹⁰. Since then, the FATF has revised its strategy and now opts for a more preventive approach, listing (and monitoring) jurisdictions that are actively working to address money laundering issues. As of early 2020, the list comprises 19 countries, with one in Europe (Albania)⁵¹¹. As provided by Directive (EU) 2015/849, the EU adopts Delegated Regulations designating 'high-risk countries with strategic deficiencies' and vulnerable to money-laundering and terrorist finance, which pose a threat to the EU financial system. This list largely coincides with the list of non-cooperative and non-compliant countries identified by the FATF, but not fully⁵¹².

6.3 Measures in the employment and social security area

Letterbox companies are also used in the area of employment and social policy, generally to benefit from more advantageous social schemes or to gain advantage over competitors by abusing the existing rules (see Section 4). At EU level, there are several measures in place to tackle abusive and illegal behaviours in this context.

Table 16. Overview of measures in the area of employment and social security

Level	Organisation / country	Measure
International		None
European	EU	▪ Directive 96/71/EC (Posting of Workers Directive) ▪ Directive 2014/67/EU (Enforcement Directive)

⁵⁰⁷ <https://eng.lsm.lv/article/economy/banks/government-upholds-bill-banning-shell-companies.a274483/>

⁵⁰⁸ [https://www.riigikogu.ee/tegevus/eelnoud/eelnou/24832445-95e0-4ffc-adbe-ec44d87d5eb1/Rahapesu%20ja%20terrorismi%20rahastamise%20t%C3%B5kestamise%20seaduse%20ning%20riigil%C3%B5vuseaduse%20muutmise%20seaduse%20eeln%C3%B5u%20\(8%20SE%20I\)](https://www.riigikogu.ee/tegevus/eelnoud/eelnou/24832445-95e0-4ffc-adbe-ec44d87d5eb1/Rahapesu%20ja%20terrorismi%20rahastamise%20t%C3%B5kestamise%20seaduse%20ning%20riigil%C3%B5vuseaduse%20muutmise%20seaduse%20eeln%C3%B5u%20(8%20SE%20I))

⁵⁰⁹ FATF website, available at: <https://www.fatf-gafi.org/about/>

⁵¹⁰ <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/call-for-action-february-2020.html>

⁵¹¹ European Parliament, Improving Anti-Money Laundering Policy, April 2020, available at: [https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648789/IPOL_STU\(2020\)648789_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648789/IPOL_STU(2020)648789_EN.pdf)

⁵¹² https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counter-terrorist-financing/eu-policy-high-risk-third-countries_en

Level	Organisation / country	Measure
		▪ Directive 2018/957 amending Directive 96/71/EC ▪ Regulation 883/2004 on the coordination of social security systems ▪ Regulation 987/2009 laying down procedures for implementing Regulation 883/2004 ▪ Proposal for a Regulation amending Regulation (EC) 883/2004 on the coordination of social security systems and Regulation 987/2009 laying down the procedure for implementing the former ▪ Regulation 1071/2009 establishing common rules concerning the conditions to be complied with to pursue the occupation of road transport operator ▪ Proposal for a Regulation amending Regulation (EC) No 1071/2009 establishing common rules concerning [...] the occupation of road transport operator

Measures taken at EU level to tackle such practices have focused on companies and workers providing cross-border services. More specifically, they consist of **two sets of distinct yet interrelated rules**, which indirectly affect the possible abusive use of letterbox companies:

- In the field of **posting of workers**, the EU acquis includes Directives 96/71/EC, 2014/67/EU and 2018/957, and to some extent, Regulation 1071/2009.
- In the area of the **coordination of social security systems in the EU**, Regulations 883/2004, 987/2009 (and the proposal to amend the latter) are of relevance.

6.3.1 Posting of workers acquis

Directive 96/71/EC (PWD)⁵¹³ aims to facilitate the provision of cross-border services, while ensuring the rights of posted workers. Article 1(1) of the Directive defines a posted worker as 'a worker who, for a limited period, carries out their work in the territory of a Member State other than the State in which they normally work'. It also sets criteria for posting and formulates core terms and conditions of employment which must be met according to the host Member State law. For instance, undertakings may post workers to the territory of a Member State as long as there is an employment relationship.

Article 4 of the PWD requires each EU Member State to designate a **liaison office** or a competent body in charge of monitoring appropriate application of the provisions. Such administrative cooperation consists of replying to requests for information from other Member State authorities concerning cross-border involvement of workers, including manifest abuses or possible cases of unlawful transnational activities. This initiative is seen as particularly relevant for identifying letterbox companies used for illegal purposes.

In May 2014, the EU adopted an Enforcement Directive to further define the rules for the application of the PWD. Developed with a view to prevent risks of fraud in a context marked

⁵¹³ Directive 96/71/EC concerning the posting of workers in the framework of the provision of services, OJ L 1997/18.

by an increasing use of posting, **Directive 2014/67/EU (Enforcement Directive)** aims to improve the implementation of the PWD by providing a more transparent legal framework for service providers and presenting strengthened instruments to fight and sanction circumventions, fraud and abuse.

Article 4 contains a list of elements that can help to assess whether a specific situation can be considered a **genuine posting**. The 'requirement of genuine performance of substantial activities' means that undertakings must carry out activities in the sending State, a prerequisite that may discourage those who intend to set up letterbox companies for fraudulent purposes (see Section 2, the lack of genuine/economic activity is a key feature of such companies). In this sense, some tools exist and may be used to address abuses and circumvention of rules that may derive from letterbox companies.

Specifically, Article 4(2) provides a (non-exhaustive) list of elements that Member States may use to assess and determine whether a company genuinely performs substantial activities in the country of origin. This provision foresees tools that can help in identifying artificial undertakings, including also letterbox companies, notably through the assessment of elements such as: the place where the undertaking has its registered office and administration or [...] pays taxes and social security contributions, or the place where posted workers are recruited and from which they are posted. Other elements are also cited as relevant, such as the law applicable to the contracts concluded by the undertaking with its workers [...] or the place where the undertaking performs its substantial business activity and where it employs administrative staff, as well as the number of contracts performed and/or the size of the turnover realised in the Member State of establishment, taking into account the specific situation of, inter alia, newly established undertakings and SMEs. These elements are particularly interesting when exploring the phenomenon of letterbox companies, as some of the same aspects are required from a company law perspective for an undertaking to validly incorporate in a Member State (see Section 5). Through this list of elements, it is possible to assess the authenticity of corporate structures, a crucial element in detecting artificial arrangements, such as letterbox companies.

Article 6 sets the framework for enhanced administrative cooperation between national authorities in charge of monitoring compliance. This form of mutual assistance includes sharing documents and carrying out checks, inspections and investigations concerning situations of posting, including the investigation of any non-compliance or abuse of applicable rules. Member States must ensure that the service providers established in their jurisdiction provide the competent authorities with all of the information necessary for supervising their activities. The Internal Market Information (IMI) system (see text box below) is used for information exchanges.

The IMI system: potential for tackling fraudulent activities

Developed by the Commission with a view to ensure **administrative transnational cooperation**, the IMI system is governed by Regulation (EU) No 1024/2012.

It is used in eight different domains, including professional qualifications, services, posted workers and cross-border road transport of euro cash. The IMI is used across the EU-27 as well as in Norway, Liechtenstein and Iceland.

Although its main purpose is not to detect fraudulent activities, the IMI system nevertheless has the potential to identify possible artificial and/or fraudulent entities. Different administrative cooperation procedures exist within IMI. They can be activated independently for each policy area and may involve two or more Member State competent authorities. While not purposely designed for this, its use could nevertheless be further expanded to detect abuses emanating from artificial corporate situations. Taking the form of a communication mechanism aimed at facilitating transnational exchange of information and mutual assistance, labour inspectorates from EU Member

States (and other enforcement authorities) could transfer and analyse data suggesting potential offences, frauds and/or abuses.

The latest figures, however, indicate that the use of the IMI system varies between domains, with the majority of requests that circulate through the system relating to the recognition of professional qualifications (72.6%), with a remarkably high share of requests being sent by Norway. Based on the data collected for 2017, the share of requests concerning service provision with posted workers represented 21.5% of all requests, of which one-third were sent by Austria. It seems that even though Member States are given the possibility to issue urgent request about an undertaking that posts workers, only 1.4% of all posting requests fell within this category (from three Member States only)⁵¹⁴. Therefore, while the increase in the number of information exchanges shows that relevant authorities and labour inspectors are aware of this system, its broader use in the area of posted workers would probably contribute to detecting more cases of fraud.

Article 7 gives competent authorities of the host Member State the possibility to refer to relevant authorities of the country of establishment in order to obtain information on the legality of the service provider's establishment, conduct, and the absence of any infringement to the applicable rules. On the basis of joint reading of Article 7 and Article 10, authorities of the host Member State are responsible for ensuring effective and adequate inspection of the terms and conditions of employment. In doing so, they ensure compliance with the provisions and rules laid down in Directive 96/71/EC and, if done properly, may contribute to halting the existence and development of abusive letterbox companies. Article 7(1) nevertheless specifies that such controls are not mandatory, but the 2018 revision encourages a reinforcement of cross-border inspections (see below).

Article 9 provides the possibility for Member States to impose national control measures and administrative requirements for monitoring compliance with both the PWD and the Enforcement Directive, provided these are justified and proportionate and in accordance with Union law. Finally, Article 12 covers liability aspects and gives Member States the possibility to set-up (on a non-discriminatory and proportionate basis) a liability regime to ensure that in subcontracting chains, the direct contractor may be held responsible (in place of the employer) by the posted worker for any unpaid remuneration. This liability regime is mandatory for the construction sector and optional in other economic sectors. While the decision to opt-in in those other economic sectors is at the discretion of the Member State, this legal choice should have a deterrent effect on those intending to set up a letterbox companies for abusive purposes.

In 2016, the European Commission proposed a revision of the rules on posting of workers, which resulted in the adoption of **Directive 2018/957** (the Revision Directive). The new Directive amends Directive 96/71/EC, and Member States had to transpose it into their national laws by 30 July 2020. Reaffirming the freedom for undertakings to provide services in another Member State of the EU, the Revision Directive aims at striking a better balance between the provision of cross-border services within a fair and level playing field, and the protection of workers' rights⁵¹⁵.

Among the changes brought by the new Directive, four appear particularly relevant to the abusive use of letterbox companies. As letterbox companies may consist of undertakings operating abroad and/or relying on mobile workers to enjoy softer regimes and rules (see Section 2), the increase of workers' protection by the amending Directive in respect of remuneration and working conditions is expected to reduce the use of such practices. In

⁵¹⁴ Figures taken from ETUC, 'EU Company law, artificial corporate entities and social policy', Discussion paper, Tilburg University, January 2020, pp.18, available at: https://pure.uvt.nl/ws/portalfiles/portal/32397188/Brochure_EU_Lax_company_EN.pdf

⁵¹⁵ *ibid.*

addition, the Directive calls for improved cooperation between Member States' authorities, which should also help in tackling abusive uses of letterbox companies:

- **Remuneration of posted workers:** one of the key aspects of the revision lies in the application of the remuneration, based on the principle of **equal treatment between posted workers and workers in the host Member State**. The Directive states that the remuneration is to be determined by the law and/or common practice of the Member State where the worker is posted but includes all the constituent elements of the remuneration rendered mandatory by the national rules in place, or by collective bargaining agreements/arbitration awards that have been declared universally applicable or are otherwise applicable in that Member State (Article 1(2) a), par.3). On that basis, employers are obliged to pay posted workers the remuneration and all its elements that are applicable to the workers in the host Member State. This may make it less attractive to set up letterbox companies in order to post workers to low(er)-cost Member States.
- Rules on **temporary work agencies**: the Revision Directive reaffirms the principle of equal treatment between temporary agency workers posted by an employment agency and workers recruited directly by the user undertaking located in the territory of a host Member State⁵¹⁶. As such, temporary employment agencies and placement agencies are obliged to comply with the applicable legislation in cases of workers posted to other Member States⁵¹⁷. By imposing this equal treatment obligation on temporary work agencies, regardless of whether they are posted or subject to a local contract, Directive 2018/957 should have a deterrent effect on employers wishing to resort to employment agencies to hire more affordable staff, as well as on letterbox companies set up to fulfil the role of employment agency.
- **Long-term posting**: when the effective duration of a posting exceeds 12 months (18 months by way of the submission of a motivated notification by the employer), Member States shall ensure that all the applicable terms and condition of employment applicable in the country where the work is carried out are guaranteed to posted workers (new inserted Article 3(1)a). In other words, the new Directive imposes on employers the obligation to ensure that the working and employment conditions applicable in the host Member State are guaranteed to posted workers after a certain period of time⁵¹⁸.
- **Reinforced compliance control and enforcement mechanisms**: Directive 2018/957 reiterates indeed the importance of good coordination between Member States' competent authorities and the need for cooperation at Union level when it comes to combating fraud relating to posting of workers⁵¹⁹.

Already recommended by Article 6 of the Enforcement Directive, the Revision Directive encourages enhanced inspections, inquiries and exchange of information between the competent authorities/bodies of the Member States concerned. In particular, amended Article 4(2) prescribes for i) national authorities to reply to reasoned requests concerning transnational hiring-out of workers coming from

⁵¹⁶ Principle already enshrined in Article 5 of Directive of Directive 2008/104/EC of the European Parliament and of the Council on temporary agency work.

⁵¹⁷ Deloitte Tax and Legal, 'The posting of workers in the framework of the provision of services: Main amendments brought to Directive 96/71/EC', Weekly alert, 19 July 2018, available at: https://www2.deloitte.com/content/dam/Deloitte/ro/Documents/tax/english/Tax%20Legal%20Alert_EN_16-20%20July.pdf

⁵¹⁸ Except for the provisions concerning (i) the procedures, formalities and conditions for the conclusion and termination of employment agreements, including non-compete clauses, respectively (ii) supplementary occupational retirement pension schemes.

⁵¹⁹ ETUC, 2020.

other national authorities, and ii) for competent authorities in the host Member State that are not in a position to provide the relevant information requested by the posting Member State to seek to obtain it from other relevant bodies. For its part, the European Commission shall, once informed, take appropriate measures in the event of persistent delays in transnational cooperation (Article 4(2) amended). These reinforced rules on co-operation between competent authorities and bodies will help tackling more efficiently abusive letter box companies set up for the purpose of posting workers.

- Furthermore, Article 5 of the PWD, as amended by Directive 2018/957, establishes the rule according to which **Member States** (both posting and hosting) **are responsible** for the **monitoring, control and enforcement** of the obligations contained in both the Enforcement and the Revision Directives, and specifically invites Member States to take appropriate measures in the event of failures to comply with the Directives. Finally, Article 5 also encourages any Member State suspecting that 'an undertaking is improperly or fraudulently creating the impression that a worker is covered by the provisions of Directive 96/71/CE, to take all necessary measures to ensure that the worker will benefit from the relevant law and practices.'

While the recent revisions made to the posting acquis offer promising perspectives in the battle against artificial corporate entities set up for abusive purposes, such as letterbox companies, only time will tell how effective these measures will be. The new Directive was to be transposed into national laws by 30 July 2020, and until its evaluation is undertaken it is not possible to measure its success. Meanwhile, another relevant aspect of posting rules are of interest when examining letterbox companies - the social security of mobile workers.

6.3.2 The coordination of social security systems

Among the reasons for letterbox companies and other artificial corporate arrangements to exist is the intention to benefit from more advantageous social schemes, such as the social security regime applicable to a working situation (see Section 4). While this rationale may sound legitimate for some, the impact that such practices may have on mobile workers and the economy have been at the heart of political debates for several decades.

The Regulations on the coordination of social security systems (Regulation 883/2004 and its implementing Regulation 987/2009) aim to facilitate the freedom of movement for workers. The Regulations also provide employers with the possibility to post workers for a temporary period, during which – to avoid administrative burden – the latter shall continue to be subject to the legislation of the Member State of origin (posting Member State).

Framework in place at the time of development of this report

Currently, and according to the well settled *lex loci laboris* principle⁵²⁰, **Regulation (EC) No 883/2004 on the coordination of social security systems**⁵²¹ provides that for postings of 24 months or less, the posted worker remains affiliated to the social security system of their sending country. As such, they or their employer continues to pay contributions into that system. This provision has nevertheless been exploited by letterbox companies seeking to pay a lower social contribution for their employees (e.g. by sending staff from low-wage Member States to work in Member States subject to higher labour costs). To limit future exploitation, Decision No A2 from the Administrative Commission⁵²²,

⁵²⁰ As per the *lex loci laboris* principle, a person employed (as an employee or as a self-employed) in the territory of a Member State is subject to the legislation of that State.

⁵²¹ Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems <https://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX:32004R0883>

⁵²² The Administrative Commission for the coordination of social security systems was set up by the European Commission as the main body in charge of coordinating social security schemes within the EU. It comprises a representative of government of each EU Member State and is supported by the Commission. It is responsible for

further defined by Article 14(2) of Regulation (EC) No 987/2009⁵²³ implementing Regulation 883/2004, introduced a set of conditions, several of which have to be cumulatively fulfilled⁵²⁴ for there to be a right to **make use of the posting provision**.

The following requirements are of relevance here:

- **i) the worker should be posted on behalf of the sending employer.** In response to concerns that letterbox companies could abuse the posting provisions, the need for a direct relationship between the sending company and the person posted during the whole period of posting was confirmed by the CJEU in several rulings (*FTS*, *Plum*⁵²⁵).
- **ii) the employer should normally carry out activities in the Member State of establishment.** Article 14(2) of the Regulation specifies that for the posting provision to apply, employers must perform substantial activities - other than purely management activities - in the territory of the Member State in which they are established. This second criterion is particularly relevant for addressing abusive uses of letterbox companies, which are often characterised by a lack of economic activity (either in the Member State of registration or anywhere, see Section 2). As such, the Regulation requires an employer who is posting workers to another country to perform **substantial economic activities**⁵²⁶ in the normal business circumstances in the country from which it is sending workers. *De facto*, such criteria shall be suited to the specific characteristics of each employer and the real nature of the activities carried out. Thus, the decisive element is not that the worker habitually carries out their work in the sending State, but that they are attached to an employer which normally carries out its activities in the sending State⁵²⁷. On that basis, artificial undertakings such as letterbox companies that do not perform any activity should not be able to benefit from the provisions contained in the Regulation.

However, these provisions appear to have a limited effect in impeding abuses. Indeed, in its Decision No A2, the Administrative Commission lists a number of elements that may be taken into consideration to establish whether a direct relationship exists and continues to exist (e.g., type of employment contract, remuneration, authority to determine the nature of the work). In case of doubt, the same Decision refers to the relevant national authority in the country where the undertaking is supposedly established to further check and examine whether the undertaking performs substantial activities, on the basis of other criteria (place of registration, number of administrative staff working in the Member State of establishment and in the Member State of posting, place where majority of contracts are concluded, law applicable to contracts concluded, turnover, number of contracts performed in the sending State, etc.). Therefore, national authorities are provided with certain powers, but these are limited as described below.

dealing with administrative matters, questions of interpretation arising from the provisions of regulations on social security coordination, and for promoting collaboration between Member States. Its composition, operation and tasks are laid down in Articles 71 and 72 of Regulation 883/2004 (<https://ec.europa.eu/social/main.jsp?catId=857&langId=en&intPageId=983>).

⁵²³ Regulation (EC) No 987/2009 of the European Parliament and of the Council of 16 September 2009 laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems, available at: <https://eur-lex.europa.eu/legal-content/EN/LSU/?uri=CELEX:32009R0987>.

⁵²⁴ ETUC, 2016, p. 57.

⁵²⁵ Case 404/98 (2000), *Josef Plum v. Allgemeine Ortskrankenkasse Rheinland, Regionaldirektion Köln*, available at: <http://curia.europa.eu/juris/showPdf.jsf?jsessionid=9ea7d2dc30db3f0ad287f91c411b8190d45839e4e516.e34KaxiLc3qMb40Rch0SaxuNax50?text=&docid=101864&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=54774>

⁵²⁶ In the case C-404/98 (*Plum*), the CJEU confirmed the need for a direct relationship between the sending company and the person posted during the whole period of posting. This case-law is now codified in the Implementing Regulation (ETUC, 2016, p. 59).

⁵²⁷ ETUC, 2016.

Limited checks and controls on substantial activities:

While national competent authorities are responsible for monitoring and ensuring that undertakings making use of the posting provisions carry out genuine activities, their competences remain limited in reality. Indeed, through the years, national authorities have mainly been acting as administrative entities in charge of issuing the so-called **A1 forms**, the **posting certificate** certifying that the undertaking in the sending Member State is compliant with social security contributions.

In case of suspicious behaviours from an undertaking, national authorities have not been in a position to disregard these documents unilaterally. Once issued, an A1 form has a binding effect and can only be withdrawn by the issuing Member State (possibly after a dialogue and reconciliation procedure involving the Administrative Commission). The CJEU has established a rigid principle whereby an **A1 form remains binding** as long as not retracted or declared invalid by the issuing State⁵²⁸, **even if there are clear indications of fraudulent practices**⁵²⁹. This precedent has implicitly limited national authorities' competences to administrative responsibilities, a fact that has been reinforced by the position of the CJEU, which subsequently confirmed the binding nature of an A1 form (even when issued retroactively) for both the competent authorities and the courts of the host Member State to which an employee is posted. Despite the recent *Altun* case-law⁵³⁰, in which priority seems to have been given to the fight against cross-border social security fraud, too few examples of the kind exist, highlighting the limited nature of the powers given to national authorities in cases of suspected fraud.

Recent changes and upcoming revision of the legal landscape

With a view to adapt this existing framework to the actual needs and to ensure the continuity of social security rights for mobile workers, in 2016 the European Commission proposed a **revision of both Regulation (EC) No 883/2004**, on the coordination of social security systems, and **Regulation (EC) No 987/2009**. On 23 November 2018, the European Parliament finalised its report and subsequently adopted the negotiation mandate. The proposal concentrates on changes related to a broad spectrum of benefits, including long-term care benefits, unemployment benefits, social benefits for inactive mobile citizens and family benefits⁵³¹. A provisional agreement was reached on 19 March 2019⁵³² between the European Parliament and the Council. However, the agreement was rejected at the Committee of the Permanent Representatives of the Governments of the Member States to the European Union (Coreper) meeting on 29 March 2019, after which the Parliament refrained from voting. The legislative process on this file is thus still ongoing. While it is difficult to anticipate the final outcome yet, the fight against fraud is an important consideration in the negotiations.

Although not envisaged in the proposal for a revision of the social security coordination rules itself, the possibility for national authorities to resort to the new European Labour Authority (ELA) is also worth mentioning. The ELA Regulation, while constituting a general initiative in the area of employment, foresees this eventuality for cases of non-compliance with deadlines, and could help improve the situation of posted workers in general.

⁵²⁸ See C-2/05 *Herbosch Kiere*, C-620/15 *A-Rosa*, C-474/16 *Belu*, C-527/16 *Alpenrind*.

⁵²⁹ ETUC, 2020, pp.21-22.

⁵³⁰ CJEU, 6 February 2018, C-359/16 *Altun*.

⁵³¹ Resolution of 14 September 2016 on social dumping in Europe in the European Union.

⁵³² Council of the European Union, Analysis of the final compromise text with a view to agreement, 25 March 2019, Council document 7698/19 ADD1 REV1, available at: <https://data.consilium.europa.eu/doc/document/ST-7698-2019-ADD-1-REV-1/en/pdf>

The European Labour Authority (ELA): a further step towards enhanced cross-national cooperation

The ELA was announced in September 2017 and established in 2019 to ensure that EU rules on labour mobility are enforced in a fair, simple and effective way.

Aimed at supporting cooperation between Member States in the cross-border enforcement of Union law and facilitating mediation and solution in cases of cross-border disputes between national authorities, the ELA should provide Member State authorities with the necessary operational and technical support to exchange information, carry out inspections and settle disputes⁵³³.

The mission of this new body should help to overcome, at both national and European level, the difficulties and inequalities caused by abusive uses of letterbox companies.

If these changes and initiatives should soon contribute to reducing the use of letterbox companies to circumvent the rules in place, the technological developments that are slowly emerging in the area should also play a meaningful role.

Based on the strategy of the European Commission for the transformation of public administrations, the '**Electronic Exchange of Social Security Information**' (EESSI) system was set-up and made available to Member States in the second half of 2017. Expected to act as a substitute for most paper-based administrative procedures, the EESSI will act as the main tool for information exchange between Member States. All communications between national authorities concerning cross-border social security files will be done through the EESSI, in a harmonised way. This new platform should not only ensure faster and more secure exchange of information between Member States' institutions, but also more transparency and accuracy on the information exchanged about mobile citizens, which should help in tackling errors and fraud.

Finally, among the expected changes and improvements to the actual framework, the recent case of the CJEU, may impact the way the actual employer is defined in the future. The social security regime applicable to an employee depends on the location of their employer, indeed; to avoid abuse by letterbox companies using webs of sub-contracting chains to establish themselves in low(er)-contributions Member States to benefit from more advantageous social contributions, the Court has recently developed and used criteria to be taken into account to define the real employer.

The genuine employer: a new concept in the determination of the applicable social security regime

CJEU case-law - AFMB case (C-610/18) of 16 July 2020

At the heart of this dispute was the issue of the social security regime applicable to the drivers of a Cyprus-based company that had contracted several transport companies in the Netherlands for the circulation of heavy goods, in addition to hiring a number of long-distance drivers residing in the Netherlands.

The question centred on whether to follow the rules of the drivers' country of residence or that of the country where their employer has its registered office, i.e. identification of the real employer.

According to the Court, the most important aspect was that of the **hierarchical relationship** between the employer and the employees. The Court decided that the employer was the one who has actual authority over the drivers, which is not easy to identify in a context of international long-distance drives.

⁵³³ European Commission, DG Employment and Social Affairs and Inclusion, The European Labour Agency, available at: <https://ec.europa.eu/social/main.jsp?catId=1414&langId=en>

In its assessment, the Court investigated the following criteria: Who bears the employee costs? Who has real power over their situation (hiring and dismissal)?

By opting for the employer that has real power over the employee rather than that mentioned in the work contract, the Court highlighted the importance of **worker protection** when determining the social security legislation applicable to a cross-border worker.

At national level, several measures focus on tackling the abuse of **posted workers rules**, including via the use of letterbox companies. The description of some of the national measures below aims to provide a sense of how the EU legislation was applied in practice and to demonstrate how national authorities may play an active role in going further than the requirements at EU level.

Some measures have been identified in Belgium, Germany and Finland (countries which often receive posted workers) as well as in Poland, Romania and Estonia (countries which often send posted workers).

The nature of the measures varies greatly, but the **first group** generally aims to ensure **better controls on the posting of workers**, including:

- **Enhanced verification of documents:** Belgian authorities conduct particularly thorough verifications of the documentation used by posted workers to identify cases of fraudulent documentation (also used by abusive letterbox companies), before issuing the Portable Document A1 (PD A1) form. The PD A1 establishes the presumption that the holder is properly affiliated with the social security system of the Member State which has issued the certificate and consequently confirms that the posted person has no obligations to pay contributions in another Member State.

Member States have an important margin of discretion for designing the PD A1 granting procedure. In the fight against letterbox companies, it is considered important that the conditions determined by Article 12 (posting) or Article 13 (active in two or more countries) are thoroughly checked. Through the use of databases (employers registers, DIMONA, etc.), these conditions are verified by the competent Belgian authority (the National Social Security Office, NSSO). In order to issue a PD A1 on the basis of Article 13, it is also important that the competent authority checks that there are substantial activities by the posting company concerned in the Member State of residence and if not, to determine the real registered office or place of business. The principle of sincere cooperation obliges the competent institution to carry out a proper assessment of the facts relevant to the application of the rules for determining the applicable social security legislation and to guarantee the correctness of the information contained in the PD A1. The measure has been qualified as good practice, as all the PDs A1 issued by Belgium were accepted by the receiving Member States. The main success factors identified are access to relevant (cross-national) data and having a dedicated team in charge of checking the required conditions.

- **In Germany**, the Act on the obligatory working conditions for cross-border posted workers and regular domestic workers⁵³⁴ establishes **adequate minimum working conditions** for cross-border posted workers and regular domestic workers, and ensures fair and functioning conditions of competition by extending the legal norms of sectoral collective agreement. By requiring the same conditions for all companies, it is less attractive to use or set up a letterbox company seated in a country that has a lower level of social security and tax contributions. The liability of the 'general entrepreneur' is, theoretically, a prudent solution, but implementation issues exist

⁵³⁴ The law is based on the PWD but implements rules that go beyond the version in force until recently. Act on the obligatory working conditions for cross-border posted workers and regular domestic workers, (§ 2 AEntG): https://www.gesetze-im-internet.de/aentg_2009.

in practice. According to media reports, the customs unit fighting undeclared work (*Finanzkontrolle Schwarzarbeit, FKS*) has high fluctuation of qualified personnel in addition to organisation issues. It is also difficult to prosecute companies due to the difficulty in bringing the burden of proof (companies just declare in contracts that unlawful activity shall not take place, which may be complex to verify). For this and other reasons (e.g., language barrier), lodging a complaint and investigating a case may be demanding, resulting in the authorities focusing on more complex cases. The cross-border cooperation needed to prosecute abusive letterbox companies does not systematically take place and explains the low numbers of such requests by Germany.

- In Austria, the Act on Fighting Benefit Fraud mainly addresses sham undertakings that **fraudulently register employees** with Austria's social security system. Such registrations are usually aimed at receiving benefits despite not working as employees or, where the employees are registered, with the intent of not making the necessary social security contributions. Since 2016, a total of 164 companies have been formally declared fictitious undertakings, along with several limited partnerships and sole proprietorships.

A **second group** of measures concern **cooperation mechanisms between the national labour authorities of sending and receiving countries**. One such example is found between Estonia and Finland. The agreement on Cooperation between the Labour Inspectorate of Estonia and the Division of Occupational Health and Safety of the Regional State Administrative Agency of Southern Finland was concluded to ensure a greater degree of harmonisation between Estonian and Finnish working conditions for posted workers. The overall aim is to make Estonian companies comply with their statutory obligations in both Finland and in Estonia. This could also reduce the attractiveness of establishing abusive letterbox companies in the context of posting workers between the two countries.

As part of the Agreement on Cooperation, the parties have agreed information transfer, biannual meetings to implement and evaluate the agreement, exchange of labour inspectors, and raising awareness among Estonian posted workers concerning their rights and obligations while working in Finland. In the construction sector, in particular, letterbox companies are known to be used to avoid Finnish statutory obligations (minimum wages, working hours, etc.) by posting a foreign work force. High numbers of posted workers in Finland are from Estonia. The cooperation and information exchanges between the two countries have proven to be important tools to detect the abusive use of letterbox companies.

Another example concerns a cooperation between Polish and French authorities in a specific case.

France-Poland Cooperation: Letterbox companies in the food processing sector

A good example of effective cross-border cooperation to tackle letterbox companies can be found in the joint investigation of such a fraud scheme in the food processing sector, conducted by the French and Polish labour inspectorates and social security institutions. Polish workers were being hired by Cypriot and UK letterbox companies to work mostly in France but also in Belgium. The workers believed that their employer was based in Poland. The scheme sought to avoid the submission of social and fiscal prior declarations in the host country and used undeclared work while also misusing the posting of workers (according to Directive 96/71/EC and deviating from Regulation EC No 883/2004). It set up fictitious employer companies in the UK and Cyprus and wrongfully claimed that the posted workers had more than one employer so they would be entitled to complete the PD A1 form in Poland and to pay social security there, avoiding the higher rates of the host country, France. The checks

effected through joint cooperation between the inspectors proved that the letterbox companies were false places of business⁵³⁵.

Cooperation was suggested and later coordinated by France, with the support of the Centre of European and International Liaisons for Social Security (CLEISS), which provided access to information from the labour inspectorates of Poland and the UK. Cooperation was based on Directives 96/71, 2014/6711 and Regulation No 1024/2012 of 25 October 2012, on administrative cooperation through the Internal Market Information System (IMI). France, Poland and the UK performed simultaneous data gathering and exchange of information on their territories through the prior posting declarations (SIPSI) application, which allows foreign businesses to inform the labour inspectorate of workers posted to France. The French Labour Inspectorate also cooperated closely with the judicial investigation service (OCLTI), the prosecutor's office, tax services, and French social security institutions (URSSAF, CCMSA, ACOSS). The next step were the judicial proceedings which took place between October 2016 and October 2017, with the principal manager of the French host company and four others pleading guilty⁵³⁶.

The legal basis for the case was Article 13 of Regulation (EC) 883/2004 and Article 21 of Regulation (EC) No 987/2009. The result was that the Polish Social Insurance Institution withdrew the incorrect PD A1 forms, the Polish employer was convicted and the company closed, although the owner established a new company soon afterwards. It is estimated that the social costs of the violation were EUR 1 800 000 per host company⁵³⁷. Key challenges were the geographical scope, the speed of adaptation of the main actors to the fraud schemes, and difficulty in tracing the organisations when they organised for the disappearance of their legal entities through corporate name or registered address changes⁵³⁸.

Wider cross-border cooperation arrangements form an important part of the national measures identified so far. Such cooperation frameworks have been identified between the Benelux countries and amongst the Baltic and Nordic countries. They aim to tackle social dumping, undeclared work and other types of social fraud, including through the use of abusive letterbox companies. Joint activities undertaken include information exchanges, joint meetings, joint inspections and other detection of cross-border fraud. Such measures could be instrumental in supporting enforcement authorities' actions in identifying and tackling the abusive behaviour of artificial undertakings.

In 2015, a Recommendation of the committee of the ministers from the BENELUX was signed to enhance collaboration to fight social fraud and social dumping. The Recommendation saw Belgium, the Netherlands and Luxembourg work together against social dumping, undeclared work and other types of social fraud. Furthermore, the Belgian government concluded Memoranda of Understanding with Bulgaria, Slovakia, Portugal and Poland. One of the objectives is to fight abusive letterbox companies used in the context of social fraud and dumping. Key results to date have been joint inspections and the detection of cross-border fraud. As the aim is to exchange information (via meetings or via the IMI system) between Member State authorities in charge of monitoring and protection of labour relations, the measure should contribute to detecting the abuses of letterbox companies engaging a temporary workforce, for example.

⁵³⁵ Mineva, D. and Horodnic, I.A., Case studies on cross-border cooperation, European Platform Undeclared Work, 2018, p. 14, available at:

<https://webcache.googleusercontent.com/search?q=cache:2j4K8HVB4nEJ:https://ec.europa.eu/social/BlobServlet%3FdocId%3D19080%26langId%3Den+&cd=1&hl=en&ct=clnk&gl=be>

⁵³⁶ *ibid.*, pp. 14-16.

⁵³⁷ *ibid.*, pp. 16-17.

⁵³⁸ *ibid.*, p. 16.

6.3.3 The existence of sectoral measures

One of the key elements characterising letterbox companies is their use in cross-border situations (see Section 2). In addition, some activities are inherently more exposed to the abusive use of LBCs (see Sections 4 and 6.3). This is the case in the construction sector, the meat industry, and the road transport sector. In view of the nature of the tasks performed by transport operators (cross-border mobility), this sector is particularly impacted by the presence of letterbox companies.

This sub-section provides an overview of the transport sector. The Revision Directive on posted workers does not apply to the transport sector; it is regulated by a separate set of EU rules which is going through its own reform.

The transport sector and the Mobility package I

On 31 May 2017, the European Commission presented a proposal for a **regulation amending Regulation (EC) No 1071/2009** on the conditions to be met to pursue the occupation of the road transport operator. This proposal was part of the first package constituting the so-called **Mobility package**, comprising three sets of mobility measures aimed at transforming and modernising the sector. The Commission presented the initiatives in three waves: the first in May 2017, the second in November 2017, and the third in May 2018. The Mobility package was specifically designed to improve drivers' working conditions and safety, and to ensure market fairness and efficiency. These proposals cover several aspects, such as the fight against illicit employment, the need to ensure proper employment and social conditions for workers, and the promotion of smart road charging and the reduction of CO₂ emissions.

The Mobility package was eventually adopted in July 2020 after lengthy negotiations. The amended regulation 1071/2009 will become enforceable from February 2022. The discussion below reflects the spirit of the revised instrument, the effectiveness of which may be assessed in the coming years.

One of the main priorities of the Mobility package was the **fight against illicit employment practices and letterbox companies**. To that end, new rules were set forth, obliging transport companies to demonstrate that their **main activity is taking place in the establishment Member State**. Transport undertakings are to be established in the Member State where they have genuine and substantial activity, rather than where they benefit from the most lenient rules. This means that companies must:

- effectively and continuously conduct their transport business and perform substantial activities in that Member State. These measures overall are closely aligned with those suggested in the proposal for a revision of the social security Coordination Regulations (see Section 6.3.2);
- have appropriate financial standing;
- demonstrate the relevant professional competences.

By requiring transport companies to have sufficient activities in the Member State where they are registered, and by obliging trucks to return to the company's operational centre every eight weeks, the new regulatory measures should impede the establishment of artificial companies in one Member State for the sole purpose of circumventing rules and labour costs in another (e.g. hiring staff in a low-wage Member States to be sent to work in higher wage ones). If properly enforced, these rules should ultimately contribute to reducing distortion of competition.

The revised rules contained in the social provisions of Mobility Package I⁵³⁹ intend to improve **drivers' working conditions** and tackle social dumping. To meet this objective, several measures were adopted, such as:

⁵³⁹ Regulation 2020/1054 and Directive 2020/1057

- the application of **the remuneration of the host Member State** where the driver is posted, obliging any employer that posts its drivers;
- the obligation for transport companies to ensure that drivers take their weekly rest period (more than 45 hours) in **suitable accommodation** and at the expense of the company;
- obligation for the transport undertaking to organise the work of drivers in such a way that they are able to return 'home' within each period of three or four consecutive weeks. The driver may choose to return either to his/her place of residence or to an employer's operational centre where the driver is normally based in the Member State of the employer's establishment operational centre.

Access to the profession is further defined and specific requirements are necessary to do business as a road transport operator carrying either goods or passengers in the EU.

The revised measures provide more rigorous **monitoring and enforcement** activities. The need to foster effective cooperation and to enhance joint controls between Member States is also underlined, an important aspect for this study, as cooperation is vital for the control of letterbox companies (especially as the Member State of establishment is not automatically directly affected by the activities of the abusive company). The need for clear information about transport operators in the national electronic registers is also prioritised. If properly implemented, national enforcement authorities should then have a better picture of the ownership of a company.

In order to create fairer competition conditions in the road transport market, the European Commission has set out rules to create an effective link between national electronic registers of road transport undertakings via the so-called **European Registers of Road Transport Undertakings (ERRU)**. ERRU allows efficient exchange of information between the Member States, while allowing the competent authorities to monitor compliance with existing rules on road transport undertakings. In cases of non-compliance, the undertakings will face consequences in the Member State in which they are established.

The rules on posting of drivers (providing for remuneration according to the rules of the Member States where they perform transport operations) will apply to cabotage and international transport operations, with certain exceptions, notably for transit and bilateral operations.

Annex 4 presents a case study focusing on LBCs in the transport sector.

6.4 Main findings on the existence of measures tackling letterbox companies

This section shows that a variety of measures exist in the different policy fields concerned by the phenomenon, reflecting the Section 2 conclusion that a multitude of understandings of letterbox companies exist globally and that the exact characteristics of such undertakings usually depend on the regulations they intend to avoid or circumvent.

In some areas, the first measures were taken quite a while ago, while others stem from very recent policy initiatives that are yet to be implemented. This is because abusive behaviours have not emerged simultaneously in all domains.

The use of letterbox-type companies to avoid corporate **income tax** is a well-known practice at global level and is one which has led policymakers to intervene on several fronts. Notably, the OECD initiated a set of binding and soft measures proposing solutions to reduce tax planning opportunities, which are also reflected in the various instruments adopted at EU level. Comprising no less than eight Directives (see Section 6.1)⁵⁴⁰ and

⁵⁴⁰ Anti-Tax Avoidance Directive (amended in 2016 and 2017), Parent-Subsidiary Directive (amended in 2014 and 2015), and the six Directives on administrative cooperation in taxation (DACs)

accompanying tools (Code of Conduct, TNA mechanism), the legal landscape framing the fiscal area is quite solid.

Once transposed, these measures translate to national rules aimed at better discouraging profit-shifting to low/no tax countries, while also preventing double non-taxation. In parallel, they call for further cooperation between Member States. All measures are expected to impede, or at least discourage, the use of letterbox companies for regime shopping. If the effects of certain of them are slowly becoming evident, others remain too new to assess their effectiveness. Most were either amended or passed in the last four to five years and first need to be evaluated for implementation and effectiveness at both Member States' and EU level.

The partial evidence available to date nevertheless shows that enhanced cooperative administration, as encouraged by the DACs, seems to have contributed to safeguarding Member States' tax revenues. National authorities also appear better equipped to fight cross-border tax fraud and tax evasion. As promising as this outcome may sound, close monitoring of the effects of the more recent measures put in place should allow solid conclusions to be drawn in the coming years, as well as identification of remaining gaps and challenges.

The use of artificial corporate structures for illegal practices has been at the heart of the political agenda at both international and EU level also in relation to **money laundering**. Initially developed at the end of the eighties at international level, through the establishment of the FATF, measures aimed at targeting money laundering were revised and further developed in the past decade. EU law in this area has developed integrating the requirements developed by FATF in subsequent the Anti-Money Laundering Directives. The most recent revision, brought about in 2018 by the 5th Anti-Money Laundering Directive, went beyond FATF standards as regards beneficial ownership transparency for both legal entities and arrangements. The area continues to attract attention, and the European Commission adopted, an action plan on 7 May 2020, paving the way to an overhaul of the EU framework in 2021.

With a view to tackling money laundering activities facilitated by artificial arrangements, international and EU measures set standards designed to ensure transparency of the beneficial owner of said companies, while increasing the controls applied by banks and other institutions and professionals to these corporate structures. In particular, the AML Directive provides a good basis for effective identification of beneficial owners, primarily through the set-up of beneficial ownership registers.

It is too early to assess the implementation of the 5th AML Directive, which was to be transposed by January 2020. Here again, time will allow an evaluation of the impact of the set of anti-money laundering laws on abusive uses of letterbox companies.

Given the difficulty in identifying letterbox companies, the harmonisation of beneficial ownership information contained in the registers appears crucial, as it would ensure smoother and better exchanges of cross-border information, and would, *in fine*, allow national authorities to more effectively trace beneficial owners, and potential illegal practices. Following the 5th AML Directive, better access to beneficial ownership information should be achieved in the coming years.

To tackle the use of letterbox companies to circumvent **labour law and social security** rules, measures and initiatives aimed at tackling abuses in this area abound. Section 6.3 provides an overview of the rules currently in place at EU level, based on Directives on posting of workers and Regulations on social security coordination. Some of these rules were recently revised to adapt to this evolution in the market, and some proposals are still being discussed by the European Parliament and the Council.

There are several Directives and Regulations aiming to protect the main victims of abusive uses of letterbox companies. Unlike the areas of taxation and money laundering, where

the impacts of abuses may seem intangible, the effects of artificial undertakings on labour and social rules impact human beings directly.

To overcome this, measures were taken in the main areas affected by letterbox companies, i.e. the posting of workers and the regulation of social security schemes applicable to these mobile workers.

Measures deemed relevant in addressing the issue of letterbox companies primarily consist of revisions to the Posting of Workers Directive (PWD). In adapting provisions about remuneration, as well as the conditions to be fulfilled for long-term posting and for hiring of posted temporary workers, Directive 2018/957 increases the protection of posted workers. These new rules were to be transposed by Member States by 30 July 2020. While it is too early to assess their effectiveness, the fact that working conditions have been strengthened should discourage employers from abusive practices in posting of workers to circumvent applicable terms and conditions of employment. Furthermore, the new Directive calls on Member States to act responsively, by monitoring and controlling proper enforcement of the provisions, which empowers national authorities to counter the phenomenon.

Revisions to the social security regime applicable to posted workers and those performing activities in two or more Member States, simultaneously or in alternation, are being discussed at EU level. With a view to restricting possible abuses in this area the Commission's proposal to review Regulation (EC) No 883/2004 and Regulation (EC) No 987/2009, would prevent mere registration of an office in a Member State being sufficient to bring mobile workers within the remit of the legislation of that Member State.

However, the recent revisions to the legislation framing the posting of workers and social security coordination, combined with two new mechanisms to support cross-border cooperation, offer an environment conducive to fairer working rules. One is the establishment of the ELA in 2019 which means that national authorities should get technical support to exchange information and carry out inspections in case of suspected fraud relating to labour mobility. The other is the set-up of EESSI and making it available to all Member States; it should act as the main tool for information exchange between national authorities, which will be able to exchange cross-border social security files through this platform in a harmonised way. The success of the revisions to the labour and social security framework will depend on their implementation and enforcement in the coming years.

Overall, the research undertaken for this study shows that the EU is well-equipped to address the issue of letterbox companies and their negative impacts in various policy areas. While none of the existing or upcoming measures has been designed to combat abusive letterbox companies *per se*, they nonetheless address specific issues stemming directly from the use of letterbox companies.

Despite the existence of a solid and freshly revised legal arsenal, half of the promising measures describe above are **too recent to be assessed**.

Regardless of the sector concerned, all measures point to the **need for a greater cross-border cooperation**. Exchange of information and synergies between Member State are crucial in an area where abuses are primarily facilitated by mobility and crossing of borders.

Finally, and as often the case when defining and assessing legal instruments, **enforcement is key**. As part of the new measures identified, more power seems to be given to national authorities, in all areas concerned. If the latter are given the means to effectively endorse their roles of enforcement and monitoring bodies, abuses and their related consequences should be reduced significantly.

Annex 1 Methodological approach to the study

This study was commissioned by the Directorate-General for Justice and Consumers of the European Commission (DG JUST) to get a comprehensive overview of the phenomenon of letterbox companies in the EU and in three third countries, Switzerland, the US and Panama. The presentation and analysis of the phenomenon was carried out on the basis of findings emerging from research over a 11-month period and which mainly consisted of desk research, literature review, analysis of legal and policy findings at EU and Member State level, consultation with stakeholders, triangulation and reporting.

The following sub-sections provide a description of the main methodological tools used to achieve the results.

A1.1 Development of the report

A1.1.1 Inception

The purpose of the Inception stage was to lay down solid foundations for the subsequent stages of the study. The key tasks under this stage included:

- Mobilisation of the Project Team, Senior Experts, and a network of national experts based in the respective Member States.
- Meeting with the European Commission (DG JUST) and with involved experts to outline the exact scope of the study and to ensure a common and agreed understanding of the objectives, approach, method and timing.
- Initial desk research and consultation with key stakeholders at EU and international level.
- Enhancing, refining and finalising the methodological approach, including the stakeholder engagement plan and analytical framework.
- Selection of 16 EU Member States and three third countries for in-depth analysis, in view of obtaining a balance coverage of
 - Both EU-15 (Member States before 2004) and EU-13 (Member States joined after 2004);
 - Member States with real seat theory and incorporation theory;
 - Member States with requirement for companies to conduct economic activity in their territory and without this requirement (if applicable)
- Development of research methods and tools, including country report templates, survey design and interview questionnaires.
- Organisation of a briefing session of national experts.
- Launch of the research at all levels.

A1.1.2 Desk research and literature review

The extensive desk research initiated at the beginning of the Inception phase resulted in a broad literature review process (review, mapping and categorising of information) covering 207 different sources at EU, international and national level (see list of sources at the end of this report). They were carefully examined and the most relevant information was extracted and analysed by the project team.

The range of sources reviewed included legislative and policy documents (e.g. Communications from the European Commission; legislative proposals; impact assessments) case-law, official reports, and studies. Academic and grey literature⁵⁴¹ was consulted for relevant articles and reports.

⁵⁴¹ Grey literature refers to research that is either unpublished, not peer reviewed, or published in non-commercial form. It can include government reports, policy statements, issue papers, conference proceedings, theses and dissertations, newsletters and other research reports (source: <http://www.opengrey.eu>).

At national level, relevant sources were examined as part of the research by the assigned national researchers for each country. The review of the national level literature fed directly into the national research.

Reviewed information covered the main areas of this study, linked to the letterbox company's phenomenon, including company law, labour law and social policy, tax law and criminal justice-related topics. As such, the various dimensions of the phenomenon of letterbox companies were covered and analysed. The information selected and analysed was used to inform the different tasks and was reflected in the different versions of this report.

A1.1.3 Completion and analysis of the country reports

In order to complement the information obtained through desk research in the 19 countries selected for in-depth national research, the team of national experts (covering 16 Member States⁵⁴², Switzerland, the US and Panama) undertook the preparation of country reports. Aimed at gathering information on the phenomenon in general, as well as on horizontal, sectoral and specific measures in a given country, the templates provided to the experts to develop their country reports were designed such that all research questions driving the study were addressed and the outputs could easily be compared across the different countries.

All national experts mobilised to conduct in-depth research in their respective countries covered the key themes of the study (definition and description of the phenomenon, quantification, use made of letterbox companies, extent to which such use may be abusive/illegitimate, incorporation and existence requirements, other horizontal, sectoral and specific legal or other measures aimed at tackling the phenomenon).

They were encouraged to first complete the template based on their own knowledge and desk research, and to then access any missing information through interviews with key stakeholders, which may include:

- Relevant ministries (justice, economy and taxation, labour and social affairs);
- Tax/social security inspectorates;
- Main cross-sectoral trade unions and employers' associations;
- Corporate lawyers;
- Chambers of commerce;
- Key academic experts and/or company lawyers;
- Business registers/notaries;
- Enforcement authorities and bodies.

A first round of quality review was conducted by the project team, after which most experts addressed comments and requests for clarification. A second round of quality control took place a few weeks later to validate all findings and allow for a comparative analysis across Member States. For each country scrutinised as part of this study, findings and data were double-checked, updated and finalised for some of the topics presented in this Second Interim Report.

Table 17. Overview of country reports collected

Country	Report received	Country	Report received	Country	Report received
Austria	✓	Estonia	✓	Poland	✓
Belgium	✓	Finland	✓	Romania	✓

⁵⁴² BE, BG, DK, DE, EE, IE, ES, FR, CY, LU, NL, AT, PL, RO, FI, UK.

Country	Report received	Country	Report received	Country	Report received
Bulgaria	✓	France	✓	Spain	✓
Cyprus	✓	Ireland	✓	UK	✓
Germany	✓	Luxembourg	✓	US	✓
Denmark	✓	Netherlands	✓	Panama	✓
		Switzerland	✓		

A1.2 Stakeholder consultations

A1.2.1 Online survey

The online survey was developed to collect the necessary information from the 12 Member States not covered by the in-depth research and for which a country report would thus not be completed⁵⁴³.

The survey was launched in June 2019 and was open until December 2019 (seven months). The survey was available in English, but stakeholders were given the option to respond in their own language.

The survey consultation was carried out in 12 EU Member States⁵⁴⁴ in parallel to the in-depth national research conducted in the 16 Member States and third countries to ensure comprehensive collection of the following information:

- Existing definitions of letterbox companies;
- Use of alternative terms;
- Characteristics of;
- Quantification of the phenomenon of;
- Existing methods to quantify;
- Legitimate and abusive use of;
- Areas affected by abusive use of;
- Estimation of financial consequences of;
- Relationship between the abusive use of letterbox companies and national laws.

The survey questionnaire was disseminated among the following groups of stakeholders:

- Policymakers and public authorities (labour inspectorates, relevant ministries);
- Sectoral trade unions/employees' representatives;
- Sectoral employers' and business associations;
- Legal practitioners involved in company operations (e.g. lawyers, notaries);
- NGOs;
- Academic experts.

A total of 54 responses were received. The answers were analysed in a comparative way and were used to feed the overall analysis of this report. Where analysis of the findings

⁵⁴³ CZ, EL, HR, IT, LV, LT, HU, MT, PL, PT, SI, SE.

⁵⁴⁴ Contributions to the survey were also received from 'in-depth' Member States, meaning that the survey may have been shared or disseminated by participants.

provided examples (e.g., for countries with a specific method to measure the level of LBCs), the respondents were contacted to conduct further investigation.

Table 18 provides an overview of the contributions to the online survey:

Table 18. Overview of contributions to online survey

Member States	Numbers of targeted recipients	Respondents	Type
Belgium	None	2	Trade unions
Czechia	14	4	Trade unions, think tank, professional association
Denmark	None	3	Trade unions, umbrella organisation
Estonia	None	1	Trade union
Greece	4	1	Ministry
Croatia	11	6	Ministries, auditor, public administration, professional association
Italy	10	5	Employer organisation, professional, trade unions, public administration
Cyprus	none	2	Trade unions
Latvia	7	5	Ministries, professional association
Lithuania	12	6	Trade unions, ministries, professional association
Hungary	11	0	-
Malta	4	2	Trade union, professional association
Netherlands	None	3	Trade unions, ministry
Austria	None	6	Think tank, trade union, public administration, professional association, employer association
Portugal	8	2	Ministry, professional association
Romania	None	1	NGO
Slovenia	4	0	-
Slovakia	4	2	Ministries

Member States	Numbers of targeted recipients	Respondents	Type
Sweden	9	2	Ministry, professional association
UK	0	1	Federation of small businesses
Total	98	54	

A1.2.2 Stakeholder interviews at international and EU level

To complement the extensive literature review carried out and the ongoing collection of national information and data through both the online survey and the country reports, the study team conducted interviews with EU-level and - to a lesser extent - international stakeholders in order to better understand the phenomenon of letterbox companies. Any gaps or points for clarification that may emerge during the development of this report were discussed during these interviews.

During the Inception phase of the study, several scoping interviews were carried out in order to refine the overall methodological approach and understanding of the phenomenon.

Interviews were conducted in all working phases of the study. The choice of interviewees was carried out so as to ensure a balanced and representative overview of the relevant stakeholders' views. In addition, the objective was to obtain specific and practical examples regarding the phenomenon of letterbox companies to feed the overall analysis. To ensure a high response rate, interviews were conducted in the form of face-to-face consultations, telephone interviews as well as through written communication.

A total of 14 stakeholders were consulted, at international and EU level:

- European Commission, DG Employment, Social Affairs and Inclusion (DG EMPL);
- Business Europe;
- OECD, International Cooperation and Tax Administration Division;
- European Trade Union Institute (ETUI);
- European Trade Union Confederation (ETUC);
- French National Council of Clerks of the Courts of Commerce ((*Conseil National des Greffiers des Tribunaux de Commerce* - CNGTC);
- International Road Transport Union (IRU) - Brussels delegation;
- Global network of independent researchers on international taxation (BEPS monitoring)
- European Banking Federation (Fiscal & Anti-money laundering);
- Company Law Professor, University of Oxford;
- European Confederation of Independent Trade Unions (CESI);
- European Transport workers' Federation (ETF);
- Notaries of Europe, Company Law Working Group;
- Accountant/auditor;
- *SME United (Interview scheduled)*

Many stakeholders were contacted and asked for an interview. Several declined or did not respond, including some business associations, umbrella organisations, trade unions and some NGOs.

Seen as a crucial tool to obtain solid, relevant and updated data on all tasks envisaged during this research process, stakeholder consultations were arranged all the way through the finalisation of the study, whenever necessary.

A1.3 Study timeline

Month-Year	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19
Task 0 Inception												
Kick-off meeting and team mobilisation												
Initial desk research and knowledge harvesting interviews												
Development of stakeholder engagement strategy												
Inception report												
Task 1 - Description of letterbox companies phenomenon												
EU-level research (Desk research and interviews)												
National research (Online survey and desk research)												
Survey (management, running, analysis)												
Quantification of LBC												
Task 2 - Description of abusive and non-abusive use of letterbox companies												
Analysis and building a preliminary typology of LBC												
Interim Report I and revisions							10 Jul.	26 Aug.				
Task 3 - Mapping of measures												
Mapping of existing measures in 16 MS and 3 third countries												
Analysis of the measures												
Interviews with key stakeholders												
Interim report II										27 Oct.		
Task 4 - Assessment of the effectiveness of the measures												
Case studies												
Triangulation and analysis												
Final report												14 Dec.

Annex 2 Overview of existing concepts and understandings of letterbox companies

A2.1 Overview of concepts and understandings of letterbox companies used at EU and international level

Concept/understanding	Source
A [letterbox company,] paper company, shell company or money box company, i.e. a company which has complied with only the bare essentials for organisation and registration in a particular country. The actual commercial activities are carried out in another country ⁵⁴⁵ . The term is derived for the purpose of the OECD glossary and does not represent the official position of the OECD.	OECD Glossary of Tax Terms
'Letterbox companies are those that do not have economic substance and are merely interposed to benefit from an advantageous tax regime (no or nominal tax jurisdiction) or to circumvent tax legislation that would normally apply to benefit from a more favourable tax treaty (treaty shopping) or both⁵⁴⁶. The OECD BEPS initiative has adopted a number of actions and suggests international tax law standards to ensure that profits are taxed where economic activities take place and value is created. Among them several issues refer to the requirements of substance. Within Action 5 – Counter harmful tax practices more effectively, taking into account transparency and substance, a consensus between over 60 countries participating in the BEPS process was reached on the nexus approach in determining the application of preferential regimes. The standard was established that for the taxpayer to profit from the preferential tax regime, the taxpayer itself should be generating the core income activities to which the preferential rules would apply.	OECD in the context of its BEPS initiative
'SPEs have the sole purpose of serving as financial intermediaries and the [...] SPE are defined by either their structure (e.g., financing subsidiary, holding company, base company, regional headquarters), or their purpose (e.g., sale and regional administration, management of foreign exchange risk, facilitation of financing of investment) ⁵⁴⁷ . The term is derived for the purpose of the OECD glossary and does not represent the official position of the OECD.	OECD Glossary of Statistical Terms
A 'conduit company' is a 'company set up in connection with a tax avoidance scheme, whereby income is paid by a company to the conduit and then redistributed by that company to its shareholders as dividends, interest, royalties, etc.' ⁵⁴⁸ .	OECD Glossary of Tax Terms

⁵⁴⁵ OECD, Glossary of Tax Terms, available at: <http://www.oecd.org/ctp/glossaryoftaxterms.htm> (accessed 15 August 2018).

⁵⁴⁶ OECD, Centre for Tax Policy and Administration, brief prepared for ICF for the purpose of this study, and providing an overview of the OECD's work directly or indirectly preventing the use of letterbox companies (from the angle of the G20/OECD Base Erosion and Profit Shifting (BEPS) initiative), May 2019.

⁵⁴⁷ <https://stats.oecd.org/glossary/detail.asp?ID=2515>

⁵⁴⁸ OECD, Glossary of Tax Terms, available at: <http://www.oecd.org/ctp/glossaryoftaxterms.htm> (accessed 15 August 2018).

Concept/understanding	Source
A 'base company' is described as a 'company situated in a low-tax or non-tax country (i.e. tax haven), which is used to shelter income and reduce taxes in the taxpayer's home country. Base companies carry on certain activities on behalf of related companies in high-tax countries (e.g. management services) or are used to channel certain income, such as dividends, interest, royalties and fees' ⁵⁴⁹ .	OECD Glossary of Tax Terms
'For the purpose of the paper, shell companies are considered to be companies that are incorporated that have no significant operations or related assets' ⁵⁵⁰ . Shell companies [(which) can be established with various forms of ownership structure[]], especially in cases where there is foreign ownership which is spread across jurisdictions, misused for illicit purposes, including money laundering (ML), bribery and corruption, insider dealings, tax fraud, terrorist financing (TF), and other purposes.	Financial Action Task Force (FATF) under the OECD, Guidance paper on transparency and beneficial ownership
'Companies which have been set up with the purpose of benefiting from legislative loopholes while not themselves providing any service to clients, but rather provide a front for service provided by their owners. Such companies are normally very small and often only operate a letterbox, hence the name' ⁵⁵¹ .	Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and Committee of the Regions
Article 4(5) specifies that an establishment is 'the actual pursuit of an economic activity [...] for an indefinite period and through a stable infrastructure from where the business of providing services is actually carried out'. Recital 37 clarifies that 'according to this definition, which requires the actual pursuit of an economic activity at the place of establishment of the provider, a mere letterbox does not constitute an establishment.'	Service Directive 2006/123/EC
In the Eurofood decisions, the CJEU ruled that a 'letterbox company' '[does] not [carry] out any business in the territory of the Member State in which its registered office is situated' ⁵⁵² .	CJEU Eurofood ruling
Special purpose entity: 'mainly financial holding companies, foreign-owned, and principally engaged in cross-border financial transactions, with little or no activity in the Member State of residence' ⁵⁵³ . The term is derived for the purposes of statistical data collection and analysis by Eurostat.	Eurostat pocketbook on trade and investment

⁵⁴⁹ *ibid.*

⁵⁵⁰ FATF, Guidance on transparency and beneficial ownership, 2014, available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>

⁵⁵¹ European Commission, Smart regulation – Responding to the needs of small and medium-sized enterprises, COM(2013) 122 final.

⁵⁵² CJEU, 2 May 2006, Eurofood, C-341/04, § 35.

⁵⁵³ Eurostat, *International trade and foreign direct investment*, 2013, available at: <https://ec.europa.eu/eurostat/documents/3930297/5969114/KS-FO-12-001-EN.PDF>

Concept/understanding	Source
Letterbox company (Money box company; paper company; shell company): 'Popular term referring to a company incorporated and registered under the laws of a particular jurisdiction but that lacks any further business substance. Such companies are typically based in low or non-tax countries and used to accumulate profits diverted from high tax countries' ⁵⁵⁴ . This description is derived for the purposes of guidance, research and analysis activities of the international organisation.	International Bureau of Fiscal Documentation (IBFD) International Tax Glossary
In the <i>Cadbury Schweppes</i> judgment, the Court made reference to letterbox companies and specified that 'if checking those factors leads to the finding that the CFC is a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a "letterbox" or "front" subsidiary (see Case C-341/04 Eurofood IFSC [2006] ECR I-3813, paragraphs 34 and 35) ⁵⁵⁵ .	CJEU <i>Cadbury Schweppes</i> ruling
Legal entities established in an EU country where they have no (or minor) economic activities in order to 'regime shop' for lower taxes, wages etc. A letterbox company can be defined as a business that establishes its domicile in one Member State merely with a mailing address, while conducting its activities in other Member States, usually with the aim of evading legal and social obligations such as taxation, collective agreements and social security ⁵⁵⁶ . The understanding is derived for the purposes of the study.	ETUC report on letterbox practices
An 'undertaking that is set up with the intention of circumventing legal and conventional obligations. Examples of these are taxation, social security, VAT and wages. These companies do not actually perform any real economic activities although claiming to do so' ⁵⁵⁷ .	Study for the European Parliament's JURI Committee
Letterbox company is 'a company which has no or very little activity at the place where it is registered' ⁵⁵⁸ .	Academic paper

⁵⁵⁴ IBFD, International Tax Glossary, available at: <https://research.ibfd.org/#/>

⁵⁵⁵ CJEU, 12 September 2006, *Cadbury Schweppes*, C-196/04, § 68.

⁵⁵⁶ <https://www.etuc.org/en/pressrelease/letterbox-type-practices-avoiding-taxes-and-exploiting-workers-across-eu#.V8alfEQbIX> [Accessed 29 August 2018]

⁵⁵⁷ Heinen, A., Muller, A. and Kessler, B., Liability in subcontracting chains: national rules and the need for a European framework, European Parliament: Legal and Parliamentary Affairs, 2017, available at: [http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596798/IPOL_STU\(2017\)596798_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596798/IPOL_STU(2017)596798_EN.pdf)

⁵⁵⁸ Sørensen K. E., 'The fight against letterbox companies in the internal market', *Common Market Law Review*, 2015, pp. 85-118, available at: https://pure.au.dk/portal/files/110317295/The_fight_against_letterbox_companies_in_the_internal_market_postprint_2015.pdf

Concept/understanding	Source
The paper follows the understanding of a letterbox company as a company that is incorporated in one country but performs economic activity in another one ⁵⁵⁹ .	Academic paper
Letterbox companies are understood as companies that perform economic activity in another country other than the country of incorporation ⁵⁶⁰ .	Academic paper
Evaluation of Regulation (EC) No 1071/2009: 'A company that is formally registered in a Member State, but none of the administrative or commercial activity of the company takes place in that Member State' ⁵⁶¹ . The term used in the study is derived from the interpretation of Article 5 of Regulation (EC) No 1071/2009, which defines the conditions relating to the requirement of establishment of a genuine transport company.	Study carried out for the European Commission
Companies which have no or very little activity in the place where they are registered ⁵⁶² .	Policy literature
Letterbox companies in the context of the Posting of Workers Directive are 'Companies that are formally established in a particular Member State not linked to their operations as a means to avoid the regulation of another Member State' ⁵⁶³ .	Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and Committee of the Regions

⁵⁵⁹ Ringe, W.E., 'Corporate mobility in the European Union - a flash in the pan? An empirical study on the success of lawmaking and regulatory competition', *European Company and Financial Law Review* 10, 2013, p. 230.

⁵⁶⁰ Teichmann, C. and Knaier, R., 'Experiences with the competition of regulators – a German perspective', in A.J. Viera González and C. Teichmann (Eds.), *Private company law reform in Europe: the race for flexibility*, 2015, p. 209.

⁵⁶¹ Gibson, G., Windish, E., Lohr, E., Luckhurst, S., Moya, S., Troncoso Ferrer, M., Ruixo, C., Sitran, A., Rosa, C. and Pastori, E., Ex-post evaluation of Regulation (EC) No 1071/2009 and Regulation (EC) No 1072/2009, Report for the European Commission, 2015.

⁵⁶² Grzeszczak, R. and Gniadzik, M., 'New vision of "Social Europe": renationalising the integration process in the Internal Market of the European Union', *WASET International Journal of Law and Political Sciences*, Vol. 11, No. 3, 2017, pp. 675–682. Available at: <https://waset.org/publications/10006818/new-vision-of-social-europe-renationalising-the-integration-process-in-the-internal-market-of-the-european-union>

⁵⁶³ European Commission, Smart regulation – Responding to the needs of small and medium-sized enterprises, COM(2013) 122 final.

Concept/understanding	Source
After making reference to the understanding of letterbox companies that the OECD published in its Glossary of Terms, the authors write: 'In lay terms, letterbox companies are businesses which exist via a mailing address only, with actual activities taking place elsewhere (i.e. in another Member State). Other names for letterbox companies include mailbox companies, paper companies, money-box companies, brass-plate companies, shell companies and pro forma-companies' ⁵⁶⁴ .	Policy literature
A 'letterbox' or 'mailbox' company [...] are generally companies registered in one Member State while the substantive economic activity takes place in another Member State. Such companies are sometimes used to circumvent labour laws and social contributions in the Member State in which the substantive economic activity takes place. Such 'letterbox' or 'mailbox' companies are generally mentioned in the context of circumvention of the Posting of Workers Directive ⁵⁶⁵ .	Study of the European Parliamentary Research Service
A 'shell' company has anonymity as a key element – such a company provides anonymity for the actual owner while simultaneously guaranteeing control over the shell company and its resources. The ultimate beneficial owner remains hidden behind such a company, or behind a chain of interconnecting shell companies, often in several jurisdictions. Such companies appear in the context of tax evasion, corruption, money laundering and terrorist financing ⁵⁶⁶ .	Study of the European Parliamentary Research Service
The Special Purpose Entity (SPE) refers to entities whose core business consists of group financing or holding activities. These are entities with no or few employees, with 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 (ATP) ⁵⁶⁷ .	Study of the European Parliamentary Research Service
'Fake letterbox companies have no real economic activity and are only used to dodge collective agreements. These companies increasingly serve as a means of committing social dumping and fraud, primarily large-scale social fraud' ⁵⁶⁸ . This description is derived for the purposes of a campaign.	Campaign of the European Federation of Building and Woodworkers (EFBW)

⁵⁶⁴ Hastings and Cremers, 2017.

⁵⁶⁵ EPRS, An overview of shell companies in the European Union, 2018, available at: http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf

⁵⁶⁶ *ibid.*

⁵⁶⁷ *ibid.*

⁵⁶⁸ <http://www.efbww.org/default.asp?Index=952&Language=EN>

Concept/understanding	Source
Companies (whether real or 'fake', letterbox or otherwise) formed quickly and at low cost, providing labour solutions to companies, or else company owners themselves may register their own letterbox subsidiaries in other Member States ⁵⁶⁹ .	Policy paper - outcome of a platform seminar on letterbox companies and undeclared work
This is a strategy aimed at avoiding taxes and lowering the social security costs by opening a company in another Member State with no (or very few) employees in the country of registration. The company has therefore very little or no economic activity in the country of establishment, its main objective being to send workers abroad, occasionally calling this 'posting'. The abuse goes even further, as even when falsely called 'posted', the workers in question only get the pay levels and conditions of their country of origin ⁵⁷⁰ .	Policy paper regarding the Posting of Workers Directive
'Letterbox companies, or special purpose entities (SPEs), are legal entities constructed to fulfil a narrow and specific purpose. They usually have few or no employees and little economic substance, but they are often able to handle large amounts of funds due to the favourable tax treatment granted them in many countries ⁵⁷¹ . The term is derived for the purpose of the report.	Report coordinated by Eurodad with contributions from national civil society organisations
For the purpose of the report a 'shell company' is described 'as a non-operational company - that is, a legal entity that has no independent operations, significant assets, ongoing business activities, or employees' ⁵⁷² .	Report of the International Bank for Reconstruction and Development/ World Bank

A2.2 Overview of concepts and understandings of letterbox companies at national level

⁵⁶⁹ Cremers, J. and Hastings, T., Developing an approach for tackling letterbox companies: A learning resource, 2018, available at: https://www.researchgate.net/publication/322855817_Developing_an_Approach_for_Tackling_Letterbox_Companies_-_a_learning_resource

⁵⁷⁰ Voss, E. et al., Posting of Workers Directive: current situation and challenges, Ssrn, 2016, doi: 10.2139/ssrn.2817462.

⁵⁷¹ Eurodad, Fifty shades of tax dodging: the EU's role in supporting an unjust global tax system, Eurodad, Brussels, 2015; Eurodad, Europe's role in upholding an unjust tax system, Eurodad, Brussels, 2016.

⁵⁷² van der Does de Willebois et al., 2011.

Concept / understanding	Country	Source	Set in law
A 'letterbox company' is a company that does not conduct substantial economic activities in its Member State of incorporation. The delimitation of the concept of 'substantial economic activities' depends on the specific field: In the context of social dumping: the company does not conduct any substantial activities in the country of establishment; In the fiscal context: the company does not conduct substantial activities in the country of establishment nor in any other country.	Belgium	Studies and case-law	No
'A "letterbox company", that does not have any undertakings in the home country but is only registered there for the purpose of carrying out work in Denmark...'	Denmark	Report from the Danish Parliament's Finance Committee	No
A 'shell company' is described as a company that since its establishment has not had any business activities and whose equity has remained in a banking account in a financial institution since its establishment.	Denmark	Report from the Committee on social dumping prevention (<i>Rapport fra Udvalget om modvirkning af social dumping</i>)⁵⁷³ This Committee was established by the Danish Parliament as part of the agreement on the Finance Bill for 2012)	No
Abusive letterbox companies have been defined by Courts as: Companies that do not have qualified and branch-experienced staff; Companies that do not conduct activities in the country of their incorporation; Companies that aim at circumventing domestic taxes; Companies that do not have materially and personnel-wise adequate operational business; Companies that do not carry out economic activities.	Germany	Court rulings	No

⁵⁷³ Available at:
<https://www.ft.dk/samling/20121/almdel/fiu/spm/14/svar/921241/1181555.pdf> (accessed on 27 May 2020).

Concept / understanding	Country	Source	Set in law
The term 'shelf company' is commonly used to refer to letterbox companies in legal articles, studies, and a few judgments from the Supreme Court.	Estonia	<i>E.g.</i> PhD dissertation by Kaido Künnapas 'Preventive measures securing the payment of taxes before determining the tax liability: principle of precaution in tax procedural law', defended at University of Tartu on 30 September 2016 ⁵⁷⁴ Supreme Court of Estonia, Judgment 3-2-1-38-16 ⁵⁷⁵	No
The term 'front company' has also been referred to in a few court judgments, including at higher level (Supreme Court).	Estonia	<i>e.g.</i> Supreme Court of Estonia, Judgments 3-3-1-30-15, 3-3-1-61-14, 3-3-1-42-13, etc ⁵⁷⁶ .	No
The term 'letterbox companies' is the most used in France (<i>sociétés boîtes aux lettres</i>). In company law/corporate law books, letterbox companies are rarely discussed. The few authors who tackle the phenomenon usually refer to 'fictitious seat'.	France	Publications from : Ph. Merle, with the collaboration of Anne Fauchon, <i>Sociétés commerciales</i> , Dalloz, 2018-2019, n°105; Le Cannu, P. and Dondero, B., <i>Droit des sociétés</i> , LGDJ, 2018, n°419; Charvériat, A., Couret, A., Sébire, M.-E. and Zabala, B., <i>Memento Francis Lefebvre, Sociétés commerciales</i> , 2018, n°1360.	No

⁵⁷⁴ Available at: https://dspace.ut.ee/bitstream/handle/10062/53239/kunnapas_kaido.pdf?sequence=1&isAllowed=y

⁵⁷⁵ Available at: <https://www.riigikohus.ee/en>

⁵⁷⁶ Available at: <https://www.riigikohus.ee/en>

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Concept / understanding	Country	Source	Set in law
For case-law, it is also a question of a fictitious seat when the company separates its statutory and real seats	France	French Supreme Court, Commercial Chamber, 21 October 2014 (n°13-11805) ⁵⁷⁷	No
According to the Ministry of Economy, a letterbox company is 'a company that does not harbour any real economic activity, and which has been registered with the aim of pursuing objectives other than those assigned by law to companies, in particular that of optimising its legal, social or fiscal regulations'.	France	Interview conducted with members of the Ministry of the Economy (July 2019)	No
'The term "shell company/entity" refers to a limited liability company or any other legal/business entity bearing the following characteristics: a) Has no physical presence or activity in the country of incorporation/registration (other than a postal address); [...] b) It has no established business activity, little or no independent economic value and no evidence to the contrary [...]'⁵⁷⁸.	Cyprus	Central Bank of Cyprus, Directive to Credit Institutions on the 'Prevention of Money Laundering and Terrorist Financing'	Yes
Banks, intermediaries and investment management companies are prohibited from establishing and maintaining business relationships or executing transactions with shell companies. For that purpose, a shell arrangement is described as 'a legal person characterised by one or several of the following indications: a) has no affiliation of a legal person to an actual economic activity or the operation of a legal person forms a minor economic value or no economic value at all, and the subject of the Law has no documentary information at its disposal that would prove the contrary; b) laws and regulations of the country where the legal person is registered do not provide for an obligation to prepare and submit financial statements for its activities to the supervisory institutions of the relevant state, including the annual financial statements; c) the legal person has no place (premises) for the performance of economic activity in the country where the relevant legal person is registered'	Latvia	Law on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)	Yes
Indirect reference to letterbox companies: 'The fact that the management company has delegated functions to third parties shall not affect the liability of the management company or the depositary.	Luxembourg	Law of 17 December 2010 relating to undertakings for	Yes

⁵⁷⁷ Available at: <https://www.legifrance.gouv.fr/affichJuriJudi.do?idTexte=JURITEXT000029632512>

⁵⁷⁸ Prevention of Money Laundering and Terrorist Financing, <https://www.centralbank.cy/images/media/pdf/5th-cbc-directive-feb%202019-eng.pdf>

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Concept / understanding	Country	Source	Set in law
The management company does not delegate its functions to such an extent that it would become a letterbox company.'		collective investment, Article 110 (2)	
Letterbox companies have several definitions in the Netherlands, specifically they describe: Companies or institutions, irrespective of their legal form, which are residents and in which non-residents participate, directly or indirectly, through share capital or otherwise, and which have the object and / or significant involvement in, whether or not in combination with other domestic group companies to: maintain assets and liabilities abroad and/or passing on turnover consisting of royalty and license income obtained abroad to foreign group companies and/or generating revenue and costs that mainly come from re-invoicing from and to foreign group companies; Companies where more than 90% of balance sheet total comes from abroad and is also held abroad; A situation where many companies are established at one address and/or where the management of many companies' rests with one natural person or legal person; Companies established in the Netherlands without significant real economic activities in the country. In the Netherlands, the following terms are also used: flow-through company (<i>doorstroomvennootschap</i>), service body (<i>dienstverleningslichaam</i>) and special financial institutions (<i>bijzondere financiële vennootschappen</i>).	Netherlands	Policy documents, parliamentary documents and court judgments	No
Letterbox companies, either domestic or foreign, are defined as a corporate structure created in order to achieve unlawful legal arbitrage, i.e. to hide the true nature of a transaction or to circumvent provisions which would apply under normal circumstances. LBCs do not have no real economic activity in a State, under which law they are governed. Letterbox companies usually have the following characteristics: in corporate and tax fraud cases, LBCs are managed by figurehead as directors, lacking professional or even any experience in the industry/business. the seat of a typical LBC is located in a virtual office or the address of entities providing legal/accounting/business services for a real owner of the LBC; LBCs are set in the form of private LLC having a minimal initial capital required by law – around EUR 1 000 and with no other assets	Poland	Law books, caselaw	No

Concept / understanding	Country	Source	Set in law
Ghost company has the following characteristics: It does not work at the declared headquarters It has associates or administrators who cannot be contacted; It has not filed financial statements to the competent tax authority It does not actually engage in economic activities	Romania	Superior Council of Magistracy's Tax evasion investigation guide (p.17)	No
Fictitious activities/operations, are described as <i>concealing reality by creating the appearance of an operation that does not actually exist</i>.	Romania	Law no. 241/2005 on preventing and combating tax evasion, Article 2, letter (f)	Yes
A 'letterbox company', 'i.e. a company which has no business operations and therefore cannot provide any service'⁵⁷⁹.	Austria	Administrative Court	No
An intermediary company is considered to be a controlled foreign company that has no active business and is liable in the country of residence for less than three-fifths of the corresponding Finnish level of income. Conversely, intermediaries that are in fact established in the State of residence and actually carry out economic activity are not considered to be a CFC as defined in 3 § of the Act on the taxation of shareholders in controlled foreign companies.	Finland	Act on the taxation of shareholders in controlled foreign companies	Yes
A shell bank is a financial institution or company who typically: • has been authorised in a state known as a 'tax haven' • does not carry out financial activities in the state where it is authorised • does not have a place of business in any State • is not subject to public supervision • does not provide information on its owners or beneficial owners or • does not provide reliable information on its activities or financial position	Finland	Financial Supervisory Authority, Standard 2.4 Customer due diligence - Prevention of money laundering and terrorist financing, para. 91	Yes

⁵⁷⁹ Austrian Administrative Court, Ra 2018/15/0057 (2018), available at: https://www.ris.bka.gv.at/Dokument.wxe?Abfrage=Vwgh&Dokumentnummer=JWT_2018150057_20180627L00

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Concept / understanding	Country	Source	Set in law
The main feature of letterbox companies seems to be that such companies do not have any economic activity in the country of origin.	Finland	Government proposal HE 18/2012	No
Domicile companies are described as non-operational companies	Switzerland	Financial sector regulation- Swiss Financial Market Supervisory Authority (FINMA)	Yes
Seat companies are those companies which are only engaged in administrative activities and have no economic activity in Switzerland.	Switzerland	Ordinance of the Swiss Financial Market Supervisory Authority on Combating Money Laundering and Terrorist Financing in the Financial Sector, (Article 2 lit. a)	Yes
For purposes of regulating the issuance of securities, a shell company is described as a corporation required to register with the Commission that has: (1) No or nominal operations; and (2) Either: (i) No or nominal assets; (ii) Assets consisting solely of cash and cash equivalents; or (iii) Assets consisting of any amount of cash and cash equivalents and nominal other assets.	US	Code of Federal Regulations of the United States Securities and Exchange Commission, Title 17, Section 240.12b-2	Yes
For the purpose of the guidance, 'shell companies' are described as 'non-publicly traded corporations, limited liability companies (LLCs), and trusts that typically have no physical presence (other than a mailing address) and generate little to no independent economic value' ⁵⁸⁰ .	US	US Department of the Treasury, Financial Crimes Enforcement Network, Guidance: potential money laundering risks related to shell companies	No
Offshore companies (OFCs) in Panama are defined as <i>Sociedades Anonimas</i> in Spanish (<i>anonymous societies</i>). The main characteristics of OFC in Panama are: confidentiality of shareholders; tax exemptions in panama on the goods, profits, benefits or profits; absence of the obligation to declare offshore activities;	Panama	Law 32/1927	Yes

⁵⁸⁰ US Department of the Treasury, Financial Crimes Enforcement Network, Guidance: potential money laundering risks related to shell companies, 2006, available at: https://www.fincen.gov/sites/default/files/shared/AdvisoryOnShells_FINAL.pdf

Concept / understanding	Country	Source	Set in law
obligation for accounting records; possibility to have a single shareholder; possibility to use another language in addition to Spanish; possibility to have virtual meetings. Moreover, if total confidentiality is preferred, the company having nominative directors, the activities of the company or company may be directed through a general power that does not require registration or registration in the public registry of panama. Finally, the flexibility of Panamanian offshore companies or companies allows them to appear as the owner or holder of all kinds of assets or assets, including bank accounts, located anywhere in the world, without having to be declared in Panama. The creation of OFCs takes three days on average, it could be done without the physical presence of anyone related to the company, does not require a notary registration in the country of origin of the assets or residence of the owners.			
Sole Purpose Trust (SPT) is a type of trust which has no beneficiaries and is instead established for a specified purpose, making it very difficult to determine who might be able to enforce equitable rights against the trustees. They provide the benefit of an LBC for one (mostly only one) specific service to the owners.	Panama	Law 1/1984 (<i>Ley Fideicomiso</i>)	Yes

Annex 3 Quantification of the number of letterbox companies using the Orbis database

A3.1 Research methodology and its limitations

A3.1.1 Orbis database

The prevalence of letterbox companies was described by analysing the Orbis database from Bureau van Dijk. This private database contains (non-)financial information from private companies across the world, making it possible to search and compare standardised company information across borders and to make a distribution by sector of activity.

In 2017, the European Commission noted that the Orbis database has three main advantages⁵⁸¹. Firstly, the data is standardised, meaning there is a certain degree of consistency between data from different countries, which would be impossible to achieve using different national datasets. Secondly, Orbis is a database with commercial access, meaning that the data retrieval could (in practice) be easily repeated. Thirdly, the information provided is very broad, combining balance sheet and ownership information. There are also several disadvantages, which are discussed below.

Among other things, the database provides information about the ownership structures of companies by offering a comprehensive overview of (foreign) subsidiaries and shareholders. It has a search function that allows searches for:

- Address of the company;
- Headquarters;
- Sector of activity;
- Foreign subsidiaries;
- Foreign shareholders;

It also allows for mapping the ownership structures of companies graphically.

Although Orbis is a very rich database, there are some important limitations.

- Orbis utilises information from various domestic sources and there are differences between countries concerning the availability of information. However, another study compared data from commercial registers and previous research to the data in Orbis and found that the coverage of the companies included in Orbis was very good⁵⁸². Nevertheless, there are some exceptions, and it is important to keep in mind that not all companies are included in the database. In addition, as larger firms often have stricter data reporting requirements, they are typically better covered in the database⁵⁸³. Companies included in Orbis are generally larger, older and more productive⁵⁸⁴.

Data is collected from different sources within countries, such as chambers of commerce, local public authorities and credit institutions, and accounting rules can vary between

⁵⁸¹ European Commission (2017). Aggressive tax planning indicators. Final Report. Working paper N0 71 – 2017. Available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp_.pdf. Accessed on 23 May 2019.

⁵⁸² Gerner-Beuerele, C., Mucciarelli, F. M., Schuster, E. P., & Siems, M. M. (2016). Study on the Law Applicable to Companies. Publications Office of the European Union. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1/language-en>. Accessed on 28 June 2019.

⁵⁸³ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

⁵⁸⁴ Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C., & Timmis, J. (2020). Coverage and representativeness of Orbis data. OECD Science, Technology and Industry Working Papers 2020/06. <https://doi.org/10.1787/18151965>

countries. Although the financial data is not completely homogenous⁵⁸⁵, the coverage seems to be well balanced across different industries⁵⁸⁶.

Overall, this partial coverage means that 'in any given economy, only a subset of corporations are represented in the database, and coverage varies considerably across economies and over time'⁵⁸⁷.

More specifically, Orbis has particular difficulties capturing firm distribution characteristics and dynamics such as productivity dispersion, trends over time and the amount of entry and exit⁵⁸⁸.

- The most important limitation of Orbis is incomplete data (see Section 3.2.3). As a result of missing values, separate estimations have to be made if well-founded statements are to be possible. To get an idea of the number of foreign-owned companies, the technique of extrapolation was also utilised in another study⁵⁸⁹. Table 3 of that paper shows, for instance, that the total number of foreign-owned companies jumps from 257 256 to 499 183 and back to 420 429. These two latter are estimates by the researchers based on the share of information available for certain variables and countries.
- Orbis updates its data each week, which assures the user that they have the most up-to-date information. However, this can also lead to inconsistencies in data downloaded a few days apart.
- Orbis sometimes provides values that are themselves estimates, based on ranges from the information provider. These estimates are always indicated in a particular colour. For instance, for certain values of operating revenue and numbers of employees, Orbis provided estimates. This rounding is especially an issue for Czechia, Poland, Slovakia and the US⁵⁹⁰.
- Some downloading issues appear when extracting data from the Orbis database. There is a limit on the amount of data a user can download, depending on the number of variables included. In general, when downloading large volumes of data - often necessary for this research - the platform is rather slow⁵⁹¹.
- Additional access is needed to download certain information, such as specific ownership data (number of recorded shareholders and subsidiaries), which proved impossible with the user account of the researchers. Although the data could be consulted in the online database, it could not be downloaded.

The table below provides an overview of all variables that were selected in the Orbis database.

⁵⁸⁵ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

⁵⁸⁶ Ibid.

⁵⁸⁷ Damgaard, J., Elkjaer, T., and Johannesen, N. (2019:8). What Is Real and What Is Not in the Global FDI Network? IMF Working Paper. Available at: <https://www.imf.org/en/Publications/WP/Issues/2019/12/11/what-is-real-and-what-is-not-in-the-global-fdi-network>

⁵⁸⁸ Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C., & Timmis, J. (2020). Coverage and representativeness of Orbis data. OECD Science, Technology and Industry Working Papers 2020/06. <https://doi.org/10.1787/18151965>

⁵⁸⁹ Gerner-Beuerele, C., Mucciarelli, F. M., Schuster, E. P., & Siems, M. M. (2016). Study on the Law Applicable to Companies. Publications Office of the European Union. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1/language-en>. Accessed on 28 June 2019.

⁵⁹⁰ Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C., & Timmis, J. (2020). Coverage and representativeness of Orbis data. OECD Science, Technology and Industry Working Papers 2020/06. <https://doi.org/10.1787/18151965>

⁵⁹¹ Kalemli-Ozcan, S., Sorensen, B., Villegas-Sanchez, C., Volosovych, V., and Yesiltas, S. (2015). How to construct nationally representative firm level data from the Orbis global database, NBER Working Paper series. Available at: <https://www.nber.org/papers/w21558.pdf>. Accessed on 28 June 2019.

Table 19. Overview of the variables applied in the Orbis database

Variables to filter the data	
Status	This research included only active companies, with inactive companies and companies with an unknown situation excluded.
Standardised legal form	The following forms were included in the scope of this research⁵⁹²: • Public limited companies • Private limited companies • Partnerships • Non-profit organisations • Foreign companies • Other legal forms • Companies with unknown/unrecorded legal forms The forms that were excluded are: • Sole traders/proprietorships • Public authorities • Branches
Location	It was possible to filter data based on the location of the company. This could be done based on geographical world regions, political world regions, countries, and regions in countries. For this research, this filter was sequentially set on EU-28, EU-15, EFTA, individual countries, and some specific regions in the UK (namely Jersey, Isle of Man and Guernsey). Although the political world region EU-13 was not available to select, it was easily calculated by subtracting EU-15 from EU-28.
Ownership data	This filter made it possible to look at companies owned by a foreign shareholder and companies owning a foreign subsidiary. For both, the location of the company and the location of the foreign shareholder/subsidiary could be selected. However, as the location of the shareholder/subsidiary can be unknown, there is an option available to include/exclude shareholders/subsidiaries whose location is not available. Both options were used in this study. In the database, the user can specify the definition of the shareholder and the company of the subsidiary. In this research, it was defined as the (global) ultimate owner. This means that the foreign shareholder must be the ultimate owner of the company, owning a direct or total participation greater than 51% in the company. For a foreign subsidiary to be selected, the company must be the global ultimate owner of the foreign subsidiary, owning at least 51% in its foreign subsidiary. For both the foreign

⁵⁹² Although the public and private limited liability companies are the most common legal forms for companies with a foreign shareholder (93.1% of companies located in the EU-28/EFTA with a foreign shareholder in the EU-28) and companies with a foreign subsidiary (83.8% of companies located in the EU-28/EFTA with a foreign subsidiary in the EU-28), the other legal forms were included in order to be as exhaustive as possible.

shareholder and subsidiary, a company could be considered an ultimate owner if the shareholder is unknown.

Variables to describe the data

Country ISO Code

Street, no., building, etc.

These four variables were included to determine the exact location of the company.

Postcode

City

NACE Rev. 2 Core code (4 digits)

The NACE-code is the statistical classification of economic activity in the European community (from the French *Nomenclature statistique des activités économiques dans la Communauté européenne*) (Eurostat, 2016). This code is useful to define the sector of activity in which the company is active.

Operating revenue (Turnover)

The turnover can be found in the financial data as a key financial indicator. This variable was selected in *EUR thousands* for the last year available.

Profit/loss before tax

The profit or loss before tax was selected in *EUR thousands* for the last year available.

Loans

This financial variable was also selected in *EUR thousands* for the last year available.

Number of employees

The number of employees was also found in the financial data. This number was selected for the last year available.

Last available year

The data of the different variables was always set to 'last available year', as the available information is different for each company and this ensures that the most up-to-date information is provided.

To illustrate, 64% of the companies located in the EU-28 with a foreign shareholder located in the EU-28 or foreign subsidiary located in the EU-28 had 2016, 2017, 2018 or 2019 as last year available. The most common last year available for both these scenarios was 2017, which is in accordance with the described reporting lag of around two years⁵⁹³. However, it is also important to note that around 30% of the selected companies in these two cases (companies located in EU-28 with a foreign shareholder/subsidiary in the EU-28) did not have a value for this variable.

Date of incorporation

The date of incorporation was found under the legal information of the company. A country's accession to the EU could cause a rise in companies located in the new Member States with a foreign

⁵⁹³ Kalemli-Ozcan, S., Sorensen, B., Villegas-Sanchez, C., Volosovych, V., and Yesiltas, S. (2015). How to construct nationally representative firm level data from the Orbis global database, NBER Working Paper series. Available at: <https://www.nber.org/papers/w21558.pdf>. Accessed on 28 June 2019.

majority shareholder. The number of companies with a foreign subsidiary in the EU could also grow.

A3.1.2 Standardised legal form

For the standardised legal form, many different forms were included, as this allows for a broad analysis. In absolute numbers, the private limited companies are the most important category, followed by partnerships, other legal forms, and non-profit organisations (see Table 20). However, when taking in consideration the companies with a foreign majority shareholder located in the EU-28 and companies with a foreign subsidiary located in the EU-28, the public and private limited companies become the largest categories. The other legal forms can thus be regarded as a 'rest category', in terms of foreign ownership and foreign subsidiaries.

A high share of public limited companies had a **foreign majority shareholder** in the EU-28 - 4.7% of companies located in the EU-28 and 5.5% of companies located in the EFTA (see Table 20). However, when looking specifically at the companies with a foreign majority shareholder located in the EU-28, another form also prevails: for companies located in the EU-28 with a foreign majority shareholder located in the EU-28, 87.1% are active as a private limited liability company. Another 6.1% are public limited liability companies. For companies located in the EFTA with a foreign majority shareholder located in the EU-28, the public limited liability company remains the most common legal form, at 54.2%. Another 37.7% of companies located in the EFTA with a foreign majority shareholder in the EU-28 are private limited liability companies.

In general, in both the EU-28 and EFTA, a high percentage of public limited liability companies have a **foreign subsidiary**, at 3.4% and 4.5%, respectively (see Table 20). When looking at the companies with a foreign subsidiary, a different trend can be seen in these two regions. Companies located in the EU-28 with a foreign subsidiary located in the EU-28 often take on the form of a private limited liability company, as they make up 62.0% of the total number of companies. For companies located in the EFTA with a foreign subsidiary in the EU-28, the most popular legal form is a public limited liability company, which make up 59.6% of the total number of companies with a foreign subsidiary.

Table 20. Companies located in the EU-28 and EFTA with foreign majority shareholder in the EU-28 and foreign subsidiaries in the EU-28, by legal form

	Total		Foreign shareholders in the EU-28		Foreign subsidiaries in the EU-28	
	EU-28	EFTA	EU-28	EFTA	EU-28	EFTA
Public limited companies	916 785	214 664	42 952	11 878	31 255	9 621
Private limited companies	16 915 941	567 805	616 107	8 267	91 097	4 595
Partnerships	4 005 067	39 356	6 814	42	3 731	69
Non-profit organisations	3 119 953	146 179	276	9	2 110	251
Foreign companies	289 277	13 880	4	-	28	-
Other legal forms	3 182 955	64 438	19 351	95	898	264
Companies with unknown/unrecorded legal form	1 319 570	119 505	22 214	1 634	17 746	1 331

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Total	29 749 548	1 165 827	707 718	21 925	146 865	16 131
Column percentage						
	Total		Foreign shareholders in the EU-28		Foreign subsidiaries in the EU-28	
	EU-28	EFTA	EU-28	EFTA	EU-28	EFTA
Public limited companies	3.1%	18.4%	6.1%	54.2%	21.3%	59.6%
Private limited companies	56.9%	48.7%	87.1%	37.7%	62.0%	28.5%
Partnerships	13.5%	3.4%	1.0%	0.2%	2.5%	0.4%
Non-profit organisations	10.5%	12.5%	0.0%	0.0%	1.4%	1.6%
Foreign companies	1.0%	1.2%	0.0%	0.0%	0.0%	0.0%
Other legal forms	10.7%	5.5%	2.7%	0.4%	0.6%	1.6%
Companies with unknown/unrecorded legal form	4.4%	10.3%	3.1%	7.5%	12.1%	8.3%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Row percentage						
	Total		Foreign shareholders in the EU-28		Foreign subsidiaries in the EU-28	
	EU-28	EFTA	EU-28	EFTA	EU-28	EFTA
Public limited companies	81.0%	19.0%	4.7%	5.5%	3.4%	4.5%
Private limited companies	96.8%	3.2%	3.6%	1.5%	0.5%	0.8%
Partnerships	99.0%	1.0%	0.2%	0.1%	0.1%	0.2%
Non-profit organisations	95.5%	4.5%	0.0%	0.0%	0.1%	0.2%
Foreign companies	95.4%	4.6%	0.0%	0.0%	0.0%	0.0%
Other legal forms	98.0%	2.0%	0.6%	0.1%	0.0%	0.4%
Companies with unknown/unrecorded legal form	91.7%	8.3%	1.7%	1.4%	1.3%	1.1%
Total	96.2%	3.8%	2.4%	1.9%	0.5%	1.4%

* The absolute numbers mentioned in this table do not always match the other numbers mentioned in this report, as data was downloaded on different days.

A3.1.3 Limitations of the research process

The most important limitation of the research is the fact that the size of letterbox companies in the EU could not be ascertained on the basis of this exercise. This, and the remaining limitations are discussed in more detail in Section 3.2.

A3.2 Number and profile of companies with a foreign majority shareholder

A3.2.1 By country of establishment

The first column of Table 21 shows the total number of companies within a certain Member State. More specifically, it entails the active companies that have one of the following legal forms: public limited company, private limited company, partnership, non-profit organisation, foreign company, other legal form, or company with an unknown or unrecorded legal form⁵⁹⁴. The next columns look in more detail at the number of companies with a foreign majority shareholder in total and that are located in the EU-28, EU-15, EU-13, EFTA and outside the EU/EFTA, respectively.

For example, there are 888 164 companies located in Belgium. 31 744 of these companies have a foreign majority shareholder or a majority shareholder whose location is unknown. Off these, it is certain the majority shareholder is foreign in 20 538, as their location can be identified. For 14 112 companies with a foreign majority shareholder this shareholder is located in the EU-28. More specifically, 12 785 companies have a foreign majority shareholder located in the EU-15, and 1 327 have a foreign majority shareholder located in the EU-13. Finally, of the 20 538 companies with a foreign majority shareholder, 722 are located in the EFTA. The number of companies with a foreign majority shareholder located outside of the EU-28 and EFTA can also be deduced from this table. This number will be around 5 704 (20 538 - 14 112 - 722) if it is assumed that all companies that do not have data available on the location of the foreign majority shareholder have a domestic shareholder), as shown in the last column of Table 21.

This research focused on companies with a foreign majority shareholder located in the EU-28/EFTA.

The lower limit of the number of companies with a foreign majority shareholder can be found in the column 'Total (excl. country n.a.)', as this excludes all companies with a foreign majority shareholder whose location was not available. Both the UK (451 365 companies) and Germany to a lesser extent (103 165 companies) stand out, with high numbers of companies with a foreign majority shareholder⁵⁹⁵.

Of the total number of companies with a foreign majority shareholder located in the EU-28 (1 146 237), 61.7% have a foreign majority shareholder located in the EU-28. However, when only taking the EU-27 into account (EU-28 excluding the UK), this share increases to 66.0% (458 813 / 694 881).

When looking specifically at the number of companies with a foreign shareholder located in the EU-28, the UK is again very prominent, with over 240 000 companies that meet these criteria. This number matches the number of 227 064 foreign-owned companies based in the UK that was calculated in the study by Gerner-Beuerle et al⁵⁹⁶. However, it is important to point out some differences in methodology between that study and this one. The working method followed in that study is different, as it looks only at companies of which all managers are from a Member State other than that in which the company is located, and the majority of these managers have to be shareholders. In the present study, a company is included when the majority shareholder is foreign, not only in the EU-28. Moreover, the scope of legal forms included in the study by Gerner-Beuerle et al. is also

⁵⁹⁴ The total number of EU-28 companies in this study (29 748 428) cannot be compared to the number found in the study by CEPS et al. (2019) (16 835 403), as the latter only covered private and public limited liability companies, whereas the current study also included other legal forms mentioned.

⁵⁹⁵ Excluding the companies for which the location of the (foreign) shareholder is not available.

⁵⁹⁶ Gerner-Beuerle, C., Mucciarelli, F. M., Schuster, E. P., & Siems, M. M. (2016). Study on the Law Applicable to Companies. Publications Office of the European Union. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1/language-en>. Accessed on 28 June 2019.

narrower⁵⁹⁷. In the present report, both private and public limited liability companies are included, together with other legal forms (see Table 20 in Annex A3.1.2). These differences explain the discrepancy in the total number of EU-28 companies with a foreign majority shareholder located in the EU-28. In the study by Gerner-Beuerle et al. this number amounted to 420 429, while this study estimates it at 706 764⁵⁹⁸ (see Table 21). However, it is very important to state that these numbers are not synonymous with the numbers of letterbox companies and should never be understood as such.

Table 21. Number of companies with a foreign majority shareholder

	Number of companies	Total (incl. country n.a.)	Total (excl. country n.a.)	EU-28	EU-15	EU-13	EFTA	Non-EU/EFTA
Belgium	888 164	31 744	20 538	14 112	12 785	1 327	722	5 704
Bulgaria	809 335	104 777	16 876	10 692	8 726	1 966	766	5 418
Czechia	561 283	53 241	49 759	29 454	15 739	13 715	1 400	18 905
Denmark	518 190	19 793	17 090	11 779	11 077	702	2 386	2 925
Germany	2 140 389	108 218	103 165	61 622	54 081	7 541	13 518	28 025
Estonia	252 952	190 101	6 402	4 471	3 566	905	371	1 560
Ireland	252 691	162 975	15 163	9 291	8 981	310	450	5 422
Greece	208 142	6 718	5 085	2 237	1 836	401	207	2 641
Spain	2 482 016	247 064	26 391	20 067	19 662	405	1 588	4 736
France	6 164 866	317 483	33 764	24 449	24 304	145	2 441	6 874
Croatia	174 841	51 715	11 072	7 893	5 184	2 709	524	2 655
Italy	2 132 412	53 494	46 794	26 557	21 378	5 179	3 971	16 266
Cyprus	284 441	19 050	18 091	7 755	6 518	1 237	551	9 785
Latvia	197 165	35 311	17 555	9 044	4 884	4 160	519	7 992
Lithuania	132 558	2 828	2 565	1 991	1 464	527	234	340
Luxembourg	169 683	46 479	44 698	28 031	26 967	1 064	1 933	14 734
Hungary	556 257	3 516	3 476	2 766	2 659	107	277	433
Malta	59 703	37 971	6 250	3 874	3 448	426	297	2 079
Netherlands	1 727 110	42 628	41 214	23 405	22 207	1 198	1 847	15 962
Austria	512 426	17 715	17 154	13 130	11 219	1 911	2 270	1 754
Poland	714 489	82 077	21 493	18 151	15 735	2 416	1 085	2 257

⁵⁹⁷ Ibid.

⁵⁹⁸ This figure is underestimated as it does not take into account companies whose (foreign) shareholder location is not available.

	Number of companies	Total (incl. country n.a.)	Total (excl. country n.a.)	EU-28	EU-15	EU-13	EFTA	Non-EU/ EFTA
Portugal	533 360	321 035	10 949	8 745	8 311	434	407	1 797
Romania	1 032 136	126 949	73 963	51 068	40 327	10 741	1 464	21 431
Slovenia	133 298	55 602	2 536	1 954	1 598	356	160	422
Slovakia	326 294	144 724	30 857	26 334	8 766	17 568	584	3 939
Finland	747 420	78 620	8 726	6 002	4 445	1 557	481	2 243
Sweden	939 143	15 923	14 246	9 243	8 788	455	3 008	1 995
UK	5 097 608	978 317	451 356	247 951	134 991	112 960	7 412	195 993
EU-28	29 748 428	3 387 070	1 146 237	706 764	391 639	315 125	35 198	404 275
EU-27**	24 650 820	2 408 753	694 881	458 813	256 648	202 165	27 786	208 282
Iceland	40 934	941	380	275	272	3	48	57
Liechtenstein	29 985	325	291	111	105	6	151	29
Norway	618 336	10 449	9 482	7 900	7 576	324	416	1 166
Switzerland	477 768	19 517	16 875	13 199	12 925	274	279	3 397
Jersey	36 848	1 248	1 091	331	316	15	66	694
Isle of Man	34 516	929	837	338	319	19	50	449
Guernsey	22 089	690	580	192	185	7	84	304

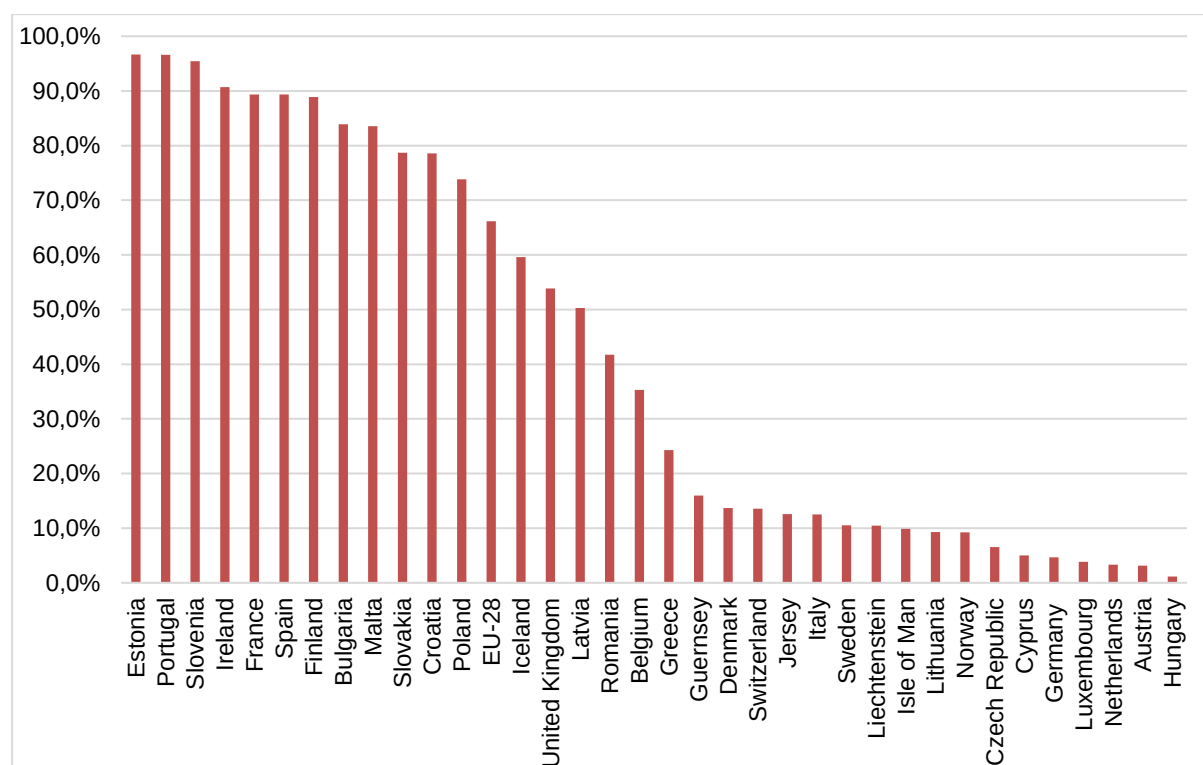
* Data extracted on 19 June 2019

** The EU-27 equals the EU-28 excluding the UK, which takes Brexit into account

Source: Own elaborations based on Orbis

Even though the figures in Table 21 are meaningful, when comparing the columns 'Total (incl. n.a.)' and 'Total (excl. n.a.)' it is clear that for many companies the location of the 'foreign' shareholder is not available. This means that the shareholder could either be foreign or located in the Member State where the company is located, in which case the shareholder is actually not foreign. Figure 10 shows in more detail the percentage of companies with a foreign shareholder whose location is not known. It is remarkable that for 15 Member States the exact location of the foreign shareholder is not known in more than 50% of cases. For Estonia, Portugal, Slovenia and Ireland, in particular, the quality of the data is lacking, as more than 90% of the information about the location of the foreign shareholder is missing. Obviously, this substantial limitation should be kept in mind. It can even be seen as more than a 'limitation', as the data quality is also a good indicator and can lead to a red flag (see Section 3.2.3). However, it should be reiterated that this does not mean that all the companies with a foreign majority shareholder whose location is unknown should immediately be classified as LBCs or even red flag companies. It merely means that they should be looked at further, in combination with other indicators, in order to get a true view of their profile.

Figure 10. Share of companies with a foreign majority shareholder for which the location of the shareholder is unknown



* Data extracted on 19 June 2019

Source: Own elaborations based on Orbis

A methodology was developed to correct this lack of information. On the one hand, the column that includes the shareholders with an unknown location is an overestimation, as not all of those shareholders will be foreign. On the other hand, the column that excludes all companies with a foreign shareholder whose location is unknown is an underestimation, as it assumes that all those shareholders are located in the Member State where the company is located. The real number of companies with a foreign shareholder lies somewhere in between.

To get to an estimate of this real number, a share of the number of companies of which the location of the foreign shareholder is not available should also be included. This was done using the following calculation: the total number of companies with a foreign shareholder, excluding the unknown ones, was divided by the total number of companies minus the number of companies with a foreign shareholder whose location is not available. This represents the share of companies with foreign shareholders where it is certain that the shareholder is actually foreign. The number of companies for which the location of the shareholder is unknown was then multiplied by this share. The number of companies with a foreign shareholder, excluding those whose shareholder location was not available was increased with the outcome of the previous steps.

Table 4 shows the number of companies with a foreign shareholder, using this estimation, as well as the column percentage, with the total number of companies located in the EU-28 with a foreign majority shareholder as the nominator.

A concrete example is given for Belgium, in order to make this calculation easier to understand. The numbers used in the calculation can be found in Table 21, while the outcome is the new estimation of the number of companies with a foreign shareholder, which can be found in Table 4.

Number of companies with a foreign shareholder

= step 3 + [step 2 * step 1]

= total number of companies with a foreign shareholder excl. country n.a. +

[number of companies with a foreign shareholder of which the location is unknown

* $\frac{\text{Total number of companies excl. country n.a.}}{\text{Total number of companies} - \text{number of companies with country n.a.}}$]

= 20,538 + $\left[(31,744 - 20,538) * \frac{20,538}{888,164 - (31,744 - 20,538)} \right]$

= 20,538 + $\left[11,206 * \frac{20,538}{888,164 - 11,206} \right]$

= 20,800

Those countries with a high share of companies whose shareholder location was not available (see Figure 10) saw the number of companies with a foreign shareholder rise sharply. In Estonia, for example, the number grew from 6 402 to 23 384. In total, more than 1.2 million companies with a foreign shareholder are located in the EU-28. In absolute numbers, more than 500 000 companies with a foreign majority shareholder are located in the UK. Germany has over 100 000 such companies, Romania over 75 000 and Czechia over 50 000.

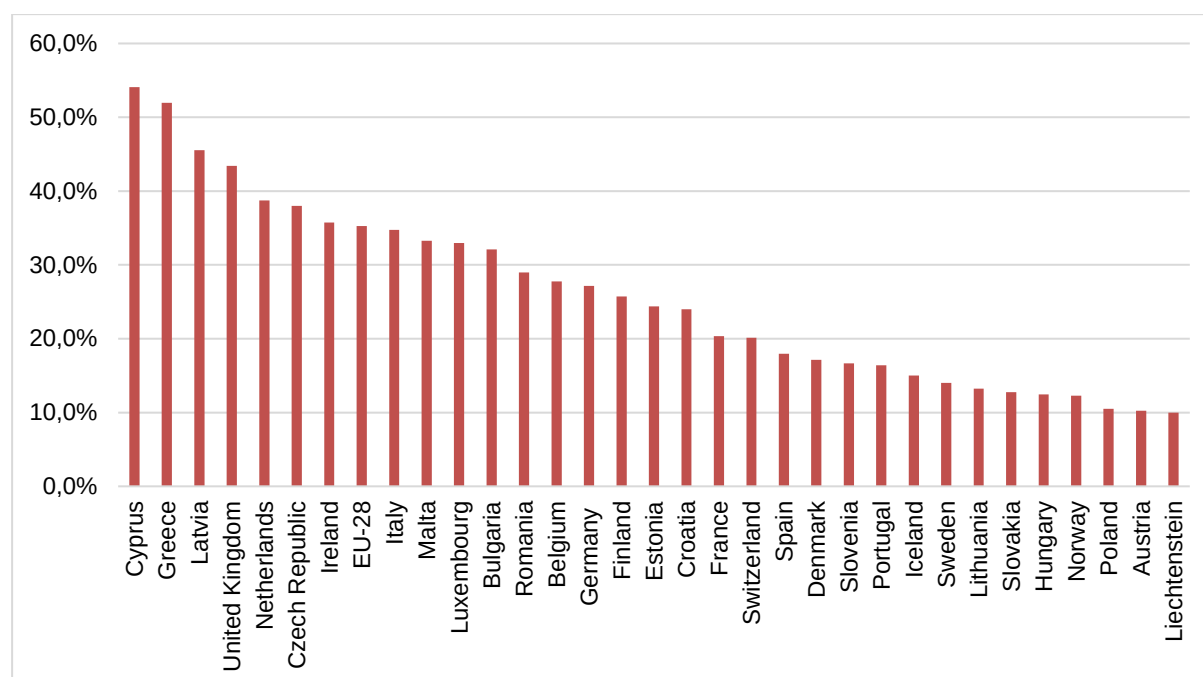
In the study by Gerner-Beuerle et al.⁵⁹⁹, data availability also posed some problems and required correction. They looked at the companies where all managers are from a Member State other than the company's registration and a majority of these managers are shareholders. However, only a certain share of companies had information available on the nationalities of their managers, and only a share of companies with a foreign manager had information available for all managers' nationalities. The original number of companies found in Orbis was divided by the product of these shares in order to correct for this lack of information. Based on migration data, they also excluded a number of companies established by foreigners resident in their country of registration. That study thus used a different methodology to achieve a similar statistic to the present study.

It is also interesting to look at the number of companies with a foreign shareholder located outside the EU-28 and EFTA, which is presented in Figure 11. Limitations in Orbis (see section 3.2) mean that it is not possible to download certain ownership data, such as the location of the foreign majority shareholder, although it can be consulted in the database itself. This could be useful information concerning Figure 11, as it would isolate where foreign shareholders are from when they are located outside of the EU-28/EFTA. However, this would require a labour-intensive task, as it would require manually examining each country outside of the EU-28/EFTA for a given Member State and noting the numbers of foreign majority shareholder located there⁶⁰⁰. Although outside the scope of this research, such an exercise could be useful in future.

⁵⁹⁹ Gerner-Beuerle, C., Mucciarelli, F. M., Schuster, E. P., & Siems, M. M. (2016). Study on the Law Applicable to Companies. Publications Office of the European Union. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1/language-en>. Accessed on 28 June 2019.

⁶⁰⁰ This analysis was attempted for the companies located in Cyprus with a foreign majority shareholder located outside of the EU-28/EFTA, as this was the Member State with the highest share of foreign majority shareholders located outside the EU-28/EFTA (see Figure 11). However, after doing this exercise for 37 countries, only 52.1% of the foreign shareholders could be located. It was found that 20.0% of the foreign majority shareholders of companies located in Cyprus that are located outside of the EU-28/EFTA are located in Russia. A notable number of shareholders are located in the US (4.8%), Ukraine (4.8%), and Israel (4.6%). Although it is possible that there are some countries where a higher share of shareholders are located, this seems unlikely, as most of Cyprus' surrounding states were analysed. Therefore, it seems more likely that the remaining 47.9% of foreign shareholders

Figure 11. Share of companies with a foreign majority shareholder located outside the EU-28/EFTA, from the total number of foreign majority shareholders



* Data extracted on 19 June 2019

Source: Own elaborations based on Orbis

A3.2.2 By year of incorporation

Another interesting variable to look at is the year of incorporation of the company with a foreign majority shareholder, as it might give an indication of certain events in a Member State that may have had an impact on the establishment of companies with a foreign majority shareholder, such as accession to the EU or a change in tax regime. This variable was analysed for several countries that stood out in the previous sections, including Luxembourg, the UK, Slovakia, Romania, Ireland and Cyprus.

Figure 12 shows the year of incorporation for companies with a foreign majority shareholder located in the EU-28, starting from 1992. For all Member States included, the number of companies with a foreign shareholder in the EU-28 has generally increased⁶⁰¹. The graph for Luxembourg shows a low volume of incorporation before 2012, with a small peak around 2007. However, there is a very sharp increase in 2012, from around 500 companies with a foreign shareholder in 2011 to over 2 000 companies in 2012. After a drop in 2014, the number of incorporations again increased and has stayed at the level of around 2 900 companies ever since.

In the UK, a continually rising line can be seen, with an outlier of almost 60 000 companies with a foreign shareholder incorporated in 2018, almost double the amount in 2017. This confirms the trend that was described by Gerner-Beuerle et al. (2016), who found that the number of incorporated foreign-based companies in the UK continued to rise. Furthermore, an article by Deutsche Bank found that from the beginning of the 2000s, the majority of

outside the EU-28/EFTA whose location was not confirmed are scattered over the rest of the world, namely the remaining 126 countries (=195 countries worldwide – 32 EU-28/EFTA countries – 37 analysed countries).

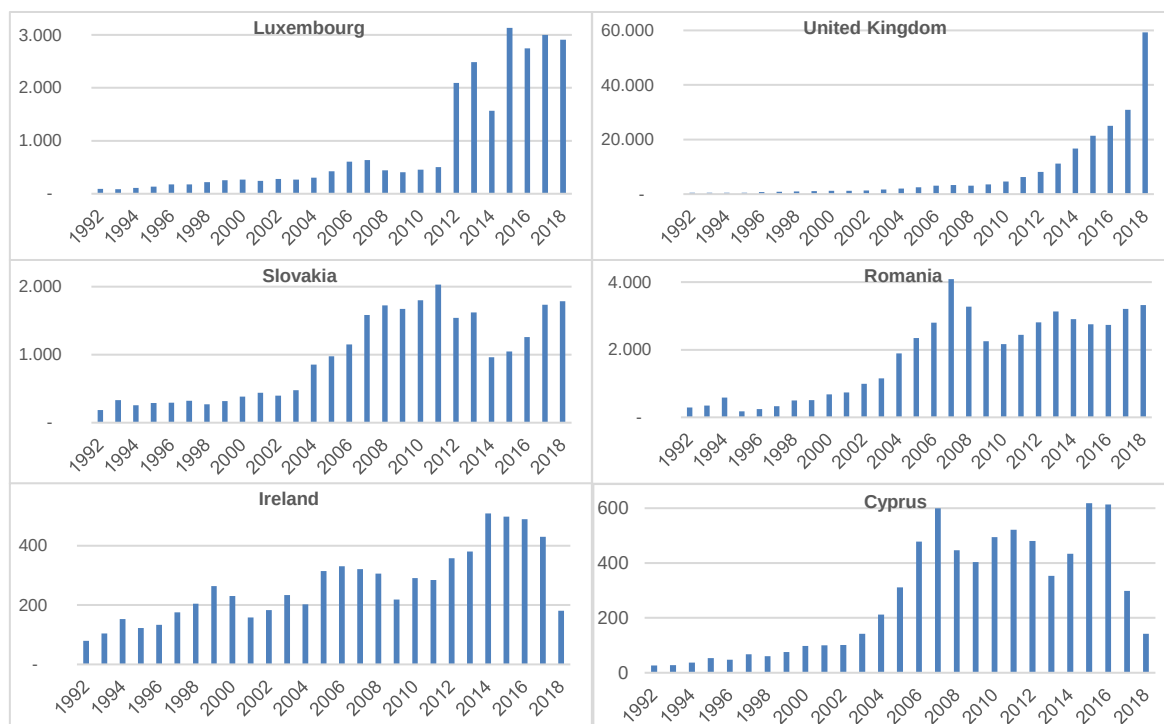
⁶⁰¹ The last value for 2019 was disregarded as data for this year is not yet complete. Caution is also required for 2018 data, as there is a reporting lag of around two years in the Orbis database (Kalemli-Ozcan et al., 2015).

equities in the UK were foreign-owned⁶⁰². This constituted a major transformation from the 1980s, when over 70% of the UK equity market was domestically owned.

Slovakia was also analysed by date of incorporation⁶⁰³, and it was found that the number started to increase from Slovakia's accession to the EU in 2004, with a peak in the early 2010s, after which the number declined again in 2013, 2014 and 2015. The graph in Figure 12 confirms these conclusions, although it can be seen that numbers have recently been on the rise again. In Romania, a similar trend is evident: the number of companies with a foreign shareholder in the EU-28 has increased over the years, with a peak of more than 4 000 companies incorporated in 2007, the year of Romania's accession to the EU. Although the number then declined, it increased again from 2012.

For Ireland, the numbers fluctuated over the years, with a general increase in the number of incorporated companies. Some peaks can be observed in 1994, 1999, 2006 and 2014. Between 2013 and 2014, the number of companies increased from 380 to 509. Finally, the number of companies in Cyprus with a foreign majority shareholder more than quadrupled from 2003 to 2007, going from 142 to 600. The same heights were reached again in 2015 and 2016, when more than 600 companies with a foreign shareholder were incorporated in Cyprus.

Figure 12. Year of incorporation for companies located in Luxembourg, the UK, Slovakia, Romania, Ireland and Cyprus, with a foreign majority shareholder located in the EU-28, 1992-2018



* Data extracted on 19 June 2019

Source: Own elaborations based on Orbis

⁶⁰² Deutsche Bank. (2019, August 22). UK economic notes. Diving up the spoils: a new perspective on weak UK business investment.

⁶⁰³ Gerner-Beuerele, C., Mucciarelli, F. M., Schuster, E. P., & Siems, M. M. (2016). Study on the Law Applicable to Companies. Publications Office of the European Union. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1/language-en>. Accessed on 28 June 2019.

A3.2.3 By sector of activity

An analysis of the sector of activity was also performed for companies located in the EU-28 with a foreign majority shareholder located outside the EU-28. The result of this analysis can be seen in Table 22. This table can be compared to Table 6 in the main report to see the difference with companies located in the EU-28 with a foreign majority shareholder located in the EU-28. This shows that 15 of the 20 most common NACE-codes in both groups match, with the most common NACE-code in both groups 8299 'Other business support service activities n.e.c.'. One NACE-code that shows a relatively large difference is NACE-code 4941 'Freight transport by road'. For companies located in the EU-28 with a foreign majority shareholder located in the EU-28, this was the second most common NACE-code, with 4.7% of companies active under this NACE-code (see Table 6). For companies located in the EU-28 with a foreign majority shareholder located outside the EU-28, however, this was the 25th most common NACE-code, with only 0.9% of companies active under this NACE-code.

Table 22. Top 20 NACE-codes of companies located in the EU-28 with a foreign majority shareholder located outside the EU-28

NACE-code	Number of companies with a foreign majority shareholder outside the EU-28	Column percentage (share of total number of companies with a majority foreign shareholder outside the EU-28)	Share of total number of EU-28 companies by NACE	Description of NACE-code
8299	24 247	5.9%	4.5%	Other business support service activities n.e.c.
5610	17 380	4.2%	2.3%	Restaurants and mobile food service activities
7022	15 910	3.9%	1.9%	Business and other management consultancy activities
6420	15 496	3.8%	2.0%	Activities of holding companies
6202	13 327	3.2%	4.6%	Computer consultancy activities
6820	12 276	3.0%	0.4%	Rental and operating of own or leased real estate
9609	9 372	2.3%	3.5%	Other personal service activities n.e.c.
6810	9 125	2.2%	2.2%	Buying and selling of own real estate
4690	8 321	2.0%	4.4%	Non-specialised wholesale trade
6201	7 940	1.9%	3.1%	Computer programming activities
4120	7 266	1.8%	1.1%	Construction of residential and non-residential buildings
4791	6 806	1.7%	3.6%	Retail sale via mail order houses or via Internet
7010	5 963	1.5%	1.9%	Activities of head offices

NACE-code	Number of companies with a foreign majority shareholder outside the EU-28	Column percentage (share of total number of companies with a majority foreign shareholder outside the EU-28)	Share of total number of EU-28 companies by NACE	Description of NACE-code
6209	5 330	1.3%	4.1%	Other information technology and computer service activities
8690	5 256	1.3%	2.1%	Other human health activities
6499	5 004	1.2%	5.3%	Other financial service activities, except insurance and pension funding n.e.c.
7490	4 817	1.2%	2.0%	Other professional, scientific and technical activities n.e.c.
4110	4 714	1.1%	1.2%	Development of building projects
5210	4 701	1.1%	16.9%	Warehousing and storage
8290	4 677	1.1%	0.8%	Business support service activities

* Data extracted on 10 March 2020

Source: Own elaborations based on Orbis

The further analysis was solely performed on companies located in the EU-28 with a foreign majority shareholder located in the EU-28. The four most frequently used NACE-codes for companies with foreign majority shareholders were looked at in more detail for each Member State: 8299, 4941, 6420, 7022. Table 23 shows this analysis. The 'Total' column shows the total number of companies with this NACE-code in a certain Member State. The column 'Foreign SH' specifies the number of companies with this NACE-code which has a foreign shareholder (the ultimate owner of the company, with at least 51%) located in the EU-28. The '% of total' column is the share of companies with a foreign owner from the total number of companies for the NACE-code concerned⁶⁰⁴. The fourth column for each NACE-code shows the column percentage with the number of companies located in the EU-28 as the denominator (see discussion of important findings in Section 3.2.1 of the main report).

⁶⁰⁴ The number of companies in the EU-28 with a foreign shareholder might differ slightly from the numbers reported in Table 6 because the data from Orbis is updated every week and the data referred to was extracted a few months before publication of this report.

Table 23. Analysis of top 4 NACE-codes of companies with a foreign majority shareholder located in the EU-28

	NACE 8299				NACE 4941				NACE 6420				NACE 7022			
	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %
Belgium	8 021	157	2.0	0.5	7 593	217	2.9	0.7	20 250	630	3.1	2.8	48 471	853	1.8	3.3
Bulgaria	1 957	37	1.9	0.1	17 902	226	1.3	0.8	385	9	2.3	0.0	10 209	233	2.3	0.9
Czechia	389	25	6.4	0.1	7 926	386	4.9	1.3	476	77	16.2	0.3	3 081	238	7.7	0.9
Denmark	1 386	60	4.3	0.2	2 606	65	2.5	0.2	86 653	1 618	1.9	7.1	10 217	259	2.5	1.0
Germany	64 633	3,634	5.6	12.0	7 731	224	2.9	0.8	64 387	3 012	4.7	13.2	50 858	1 663	3.3	6.4
Estonia	6 255	80	1.3	0.3	4 600	54	1.2	0.2	2 433	186	7.6	0.8	9 117	257	2.8	1.0
Ireland	10 848	772	7.1	2.6	1 339	28	2.1	0.1	1 079	121	11.2	0.5	7 030	214	3.0	0.8
Greece	142	11	7.7	0.0	380	1	0.3	0.0	306	16	5.2	0.1	1 176	43	3.7	0.2
Spain	24 078	163	0.7	0.5	37 485	179	0.5	0.6	16 412	924	5.6	4.1	38 586	375	1.0	1.5
France	22 271	205	0.9	0.7	29 605	109	0.4	0.4	120 568	1 394	1.2	6.1	110 993	443	0.4	1.7
Croatia	40	2	5.0	0.0	2 699	73	2.7	0.2	52	8	15.4	0.0	5 361	339	6.3	1.3
Italy	18 331	324	1.8	1.1	23 949	212	0.9	0.7	10 676	530	5.0	2.3	29 133	557	1.9	2.2
Cyprus	62	8	12.9	0.0	466	15	3.2	0.1	3 020	388	12.8	1.7	4 465	467	10.5	1.8
Latvia	483	30	6.2	0.1	3 877	165	4.3	0.6	1 022	128	12.5	0.6	2 859	289	10.1	1.1
Lithuania	326	6	1.8	0.0	6 049	49	0.8	0.2	169	4	2.4	0.0	3 901	51	1.3	0.2
Luxembourg	689	162	23.5	0.5	632	237	37.5	0.8	1 460	173	11.8	0.8	1 227	312	25.4	1.2

Letterbox companies: overview of the phenomenon and existing measures

	NACE 8299				NACE 4941				NACE 6420				NACE 7022			
	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %
Hungary	4 808	17	0.4	0.1	8 460	52	0.6	0.2	2 691	37	1.4	0.2	20 600	45	0.2	0.2
Malta	23	5	21.7	0.0	24	-	0.0	0.0	1 777	311	17.5	1.4	386	51	13.2	0.2
Netherlands	1 968	38	1.9	0.1	8 204	168	2.0	0.6	359 093	7 502	2.1	33.0	60 388	568	0.9	2.2
Austria	75 065	2 833	3.8	9.4	4 878	62	1.3	0.2	7 287	730	10.0	3.2	8 114	229	2.8	0.9
Poland	1 427	52	3.6	0.2	17 668	295	1.7	1.0	2 014	117	5.8	0.5	20 439	780	3.8	3.0
Portugal	4 492	125	2.8	0.4	7 629	72	0.9	0.2	3 647	262	7.2	1.2	12 780	320	2.5	1.2
Romania	6 389	460	7.2	1.5	46 267	1 444	3.1	4.8	487	167	34.3	0.7	28 331	2 777	9.8	10.8
Slovenia	161	1	0.6	0.0	3 117	87	2.8	0.3	419	13	3.1	0.1	6 235	54	0.9	0.2
Slovakia	15 848	1 839	11.6	6.1	8 203	1 154	14.1	3.9	53	8	15.1	0.0	17 626	2 451	13.9	9.5
Finland	1 279	14	1.1	0.0	8 542	51	0.6	0.2	1 308	36	2.8	0.2	16 545	199	1.2	0.8
Sweden	509	10	2.0	0.0	9 716	45	0.5	0.2	8 257	423	5.1	1.9	45 359	347	0.8	1.3
UK	241 502	18 654	7.7	61.8	65 930	24 109	36.6	80.8	42 904	3 328	7.8	14.6	201 671	11 092	5.5	43.0
EU-28	513 382	30 177	5.9	100.0	343 476	29 834	8.7	100.0	759 286	22 752	3.0	100.0	775 158	25 824	3.3	100.0
Iceland	45	-	0.0		427	-	0.0		2 924	37	1.3		1 074	5	0.5	
Liechtenstein	219	4	1.8		17	3	17.6		123	2	1.6		70	2	2.9	
Norway	2 492	56	2.2		4 303	33	0.8		205	4	2.0		11 748	148	1.3	

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	NACE 8299				NACE 4941				NACE 6420				NACE 7022			
	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %	Total	Foreign SH	% of total	Column %
Switzerland	1 016	30	3.0		3 465	49	1.4		9,352	532	5.7		22 129	606	2.7	
Jersey	44	-	0.0		4	-	0.0		6	-	0.0		21	-	0.0	
Isle of Man	42	-	0.0		2	-	0.0		4	-	0.0		21	-	0.0	
Guernsey	36	-	0.0		4	-	0.0		11	-	0.0		9	-	0.0	

A3.3 Number and profile of companies with one or more subsidiaries

A3.3.1 By country of establishment

In addition to looking at companies with a foreign shareholder, it was useful to look at companies with a foreign subsidiary. Table 24 gives an overview of this data. The first column depicts the total number of active companies with one of the selected standardised legal forms (public limited company, private limited company, partnership, non-profit organisation, foreign company, other legal form, or company with an unknown or unrecorded legal form). The 'Total (incl. country n.a.)' and 'Total (excl. country n.a.)' columns show the number of companies with a foreign subsidiary, including the companies where the location of the subsidiary is not available and excluding these companies, respectively. The subsequent columns present the number of companies with foreign subsidiaries in the EU-28, EU-15, EU-13, EFTA and outside the EU/EFTA, respectively.

In total, 200 369 companies located in the EU-28 have a foreign subsidiary. Of these, 73.3%, or 146 895 companies, have a foreign subsidiary located in the EU-28⁶⁰⁵. The total number of companies with a foreign subsidiary, excluding those where the subsidiary's location is not available, is especially high in the UK, the Netherlands and Germany, each with more than 20 000 companies. Companies with a foreign subsidiary located in the EU-28 are commonplace in the UK, the Netherlands, Germany and Luxembourg, as this is the case for more than 10 000 companies in these Member States. It is also instructive to look at the ratio between companies with a foreign subsidiary located in the EU-15 and the EU-13. In contrast to companies with a foreign shareholder located in the EU-28 (which were predominantly located in the EU-15), the location of the subsidiary of companies with a foreign subsidiary located in the EU-28 is more evenly distributed. For Denmark, Estonia, Greece, Cyprus, Latvia, Lithuania, Hungary, Slovenia and Slovakia, the majority of companies with a foreign subsidiary located in the EU-28 see that subsidiary located in the EU-13 rather than the EU-15.

Table 24. Number of companies with a foreign subsidiary

	Number of companies	Total (incl. country n.a.)	Total (excl. country n.a.)	EU-28	EU-15	EU-13	EFTA	Non-EU/EFTA
Belgium	888 164	8 741	8 478	7 303	6 664	639	343	832
Bulgaria	809 335	1 497	1 358	811	414	397	11	536
Czechia	561 283	4 378	4 374	3 694	778	2 916	3	677
Denmark	518 190	9 622	8 491	6 391	5 360	1 031	1 431	669
Germany	2 140 389	23 977	21 212	16 888	12 168	4 720	1 724	2,600
Estonia	252 952	1 745	1 601	1 239	455	784	42	320
Ireland	252 691	3 937	3 604	3 125	2 883	242	76	403
Greece	208 142	7 804	1 542	920	243	677	17	605
Spain	2 482 016	12 667	10 764	6 728	5 607	1 121	230	3,806
France	6 164 866	14 468	13 536	9 931	8 733	1 198	1 062	2,543

⁶⁰⁵ When excluding the UK, and only taking into account the EU-27, the shares are not that different. There are 174 385 EU-27 companies with a foreign subsidiary, of which 73.5% have a subsidiary located in the EU-28.

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	Number of companies	Total (incl. country n.a.)	Total (excl. country n.a.)	EU-28	EU-15	EU-13	EFTA	Non-EU/EFTA
Croatia	174 841	1 089	745	321	161	160	6	418
Italy	2 132 412	16 201	15 152	9 682	6 275	3 407	1 017	4 453
Cyprus	284 441	16 912	15 923	7 218	3 355	3 863	103	8 602
Latvia	197 165	1 029	854	496	171	325	19	339
Lithuania	132 558	1 257	1 158	820	166	654	25	313
Luxembourg	169 683	12 619	12 541	11 575	10 369	1 206	456	510
Hungary	556 257	1 936	1 931	1 371	444	927	6	554
Malta	59 703	3 273	1 844	1 667	1 267	400	22	155
Netherlands	1 727 110	23 304	21 335	17 886	14 911	2 975	851	2 598
Austria	512 426	6 733	6 713	5 591	3 375	2 216	319	803
Poland	714 489	3 275	2 962	1 860	1 022	838	48	1 054
Portugal	533 360	2 861	2 543	1 507	1 357	150	48	988
Romania	1 032 136	798	632	470	342	128	7	155
Slovenia	133 298	1 224	1 205	696	254	442	7	502
Slovakia	326 294	1 851	1 846	1 529	352	1 177	7	310
Finland	747 420	3 028	2 790	2 105	1 335	770	298	387
Sweden	939 143	9 062	8 601	5 858	4 777	1 081	2 463	280
UK	5 097 608	28 348	25 984	18 666	15 180	3 486	1 086	6 232
EU-28	29 748 428	224 325	200 369	146 895	108 912	37 983	11 741	41 733
EU-27**	24 650 820	195 997	174 385	128 229	93 732	34 497	10 655	35 501
Iceland	40 934	577	381	240	199	41	35	106
Liechtenstein	29 985	1 459	1 448	1 168	872	296	97	183
Norway	618 336	6 239	4 047	3 498	2 919	579	72	477
Switzerland	477 768	13 720	13 254	11 345	10 211	1 134	336	1 573
Jersey	36 848	1 014	991	765	695	70	93	133
Isle of Man	34 516	640	560	438	371	67	12	110
Guernsey	22,089	632	628	490	417	73	39	99

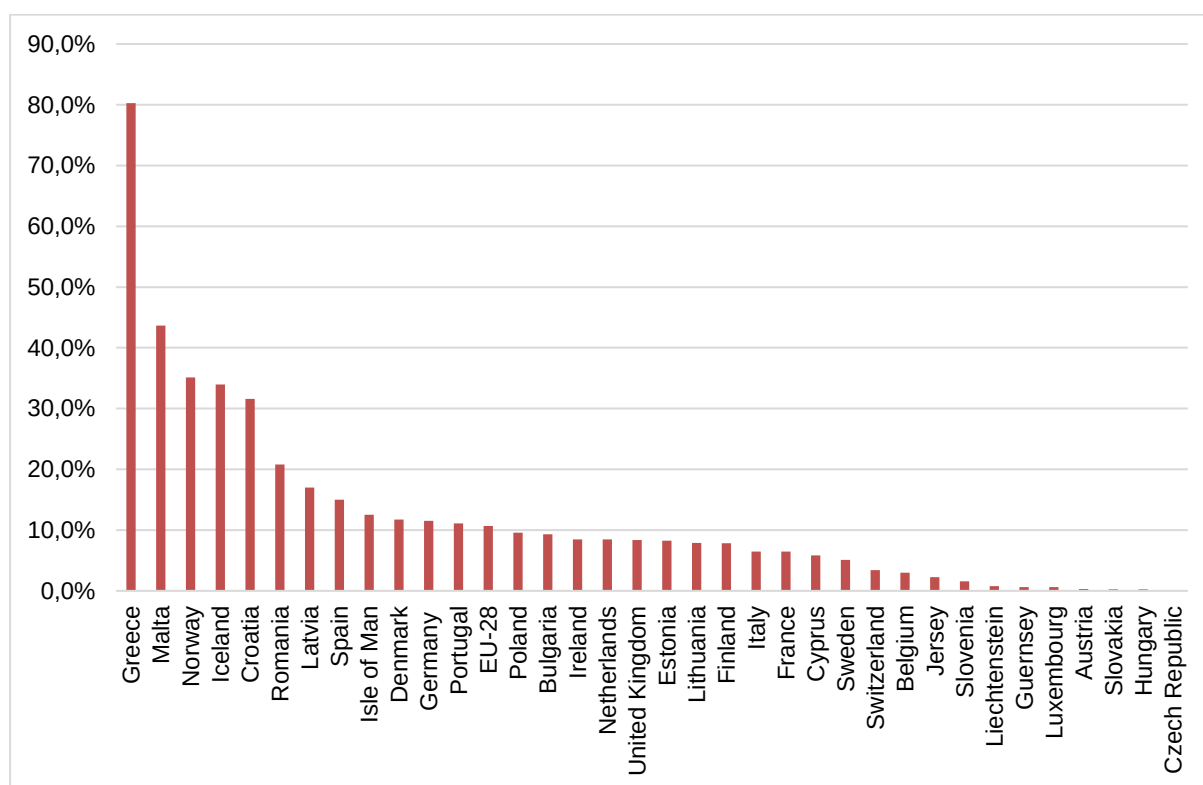
* Data extracted on 19 June 2019

** The EU-27 equals the EU-28 excluding the UK, which takes Brexit into account.

Source: Own elaborations based on Orbis

As was the case for companies with a foreign shareholder, the exact location of the foreign subsidiary is not always available. As a result, either the subsidiary could be located in the Member State where the parent company is located, or it could be located abroad, in which case the subsidiary is genuinely foreign. Figure 13 illustrates the magnitude of this lack of information for all Member States. Greece stands out, as no data is available for the location of the subsidiary for more than 80% of its companies with a foreign subsidiary. However, compared to Figure 10, it is clear that information on the location of a foreign subsidiary is generally more available than information on the location of a foreign shareholder.

Figure 13. Share of companies with a foreign subsidiary where the location of the subsidiary is unknown



* Data extracted on 19 June 2019

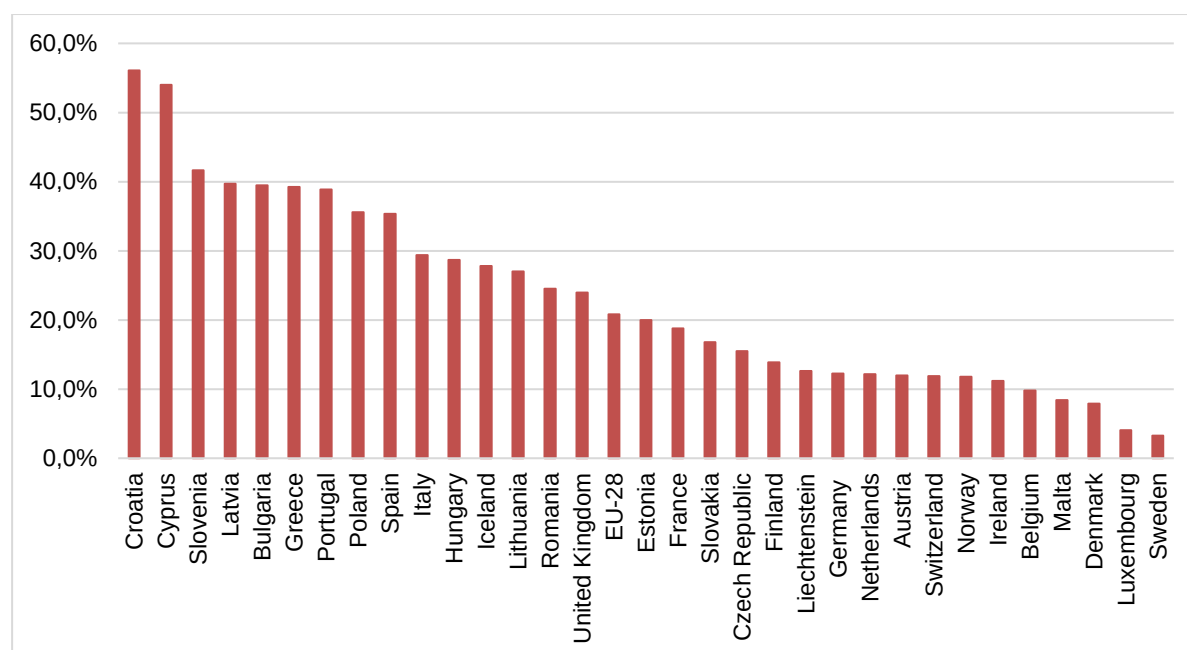
Source: Own elaborations based on Orbis

If the number of foreign subsidiaries excluding the companies for which the location of the subsidiary is unknown is used in the analysis, this will be an underestimation, as some of the 'unknown' subsidiaries could be foreign. Therefore, the number of foreign subsidiaries was increased by making an estimate in order to better reflect reality. The same formula used for foreign shareholders was used for calculating the number of foreign subsidiaries (see Annex A3.2.1), albeit replacing foreign shareholders with foreign subsidiaries. The number of companies with a subsidiary with an unknown location was multiplied by the share of companies with a foreign subsidiary where it is certain that the subsidiary is foreign. This number was then added to the number of companies with a foreign subsidiary, excluding the subsidiaries of which the location is unknown.

Table 8 (in the main report) shows the result of this estimation. In Greece, for instance, the number of companies with a foreign subsidiary increased from 1 542 to 1 590, the highest percentage-based change of all Member States, at 3.1%. The number of companies located in the EU-28 with a foreign subsidiary is estimated at 200 530.

It is also interesting to look at the share of companies with a foreign subsidiary located outside the EU-28/EFTA from the total number of companies with a foreign subsidiary. This is pictured in Figure 14.

Figure 14. Share of companies with a foreign subsidiary located outside the EU-28/EFTA from the total number of foreign subsidiaries



* Data extracted on 19 June 2019

Source: Own elaborations based on Orbis

A3.3.2 By year of incorporation

Various events could have had an impact on the number of companies with a foreign subsidiary established in a specific year (see Annex A3.2.2, on companies with a foreign majority shareholder). This variable was analysed for the five countries that stood out in the previous sections: Luxembourg, Cyprus, the UK, Germany and the Netherlands. Luxembourg and Cyprus were selected because they have the highest share of companies with a foreign subsidiary in the total number of companies (see Figure 6), whereas the remaining three Member States represent the top three EU-28 Member States with the highest number of companies with a foreign subsidiary (see Table 8).

Figure 15 shows the number of incorporations per year for companies with a foreign subsidiary located in the EU-28, from 1992 to 2018. Luxembourg shows an overall growth over the years, with peaks of incorporations of companies with a foreign subsidiary in 2000, 2007 and 2014. The growth from 2009 to 2014 was very strong, with the number of companies with a foreign subsidiary more than trebling. However, after every peak, a drop can be seen, most notably in 2009 and 2018.

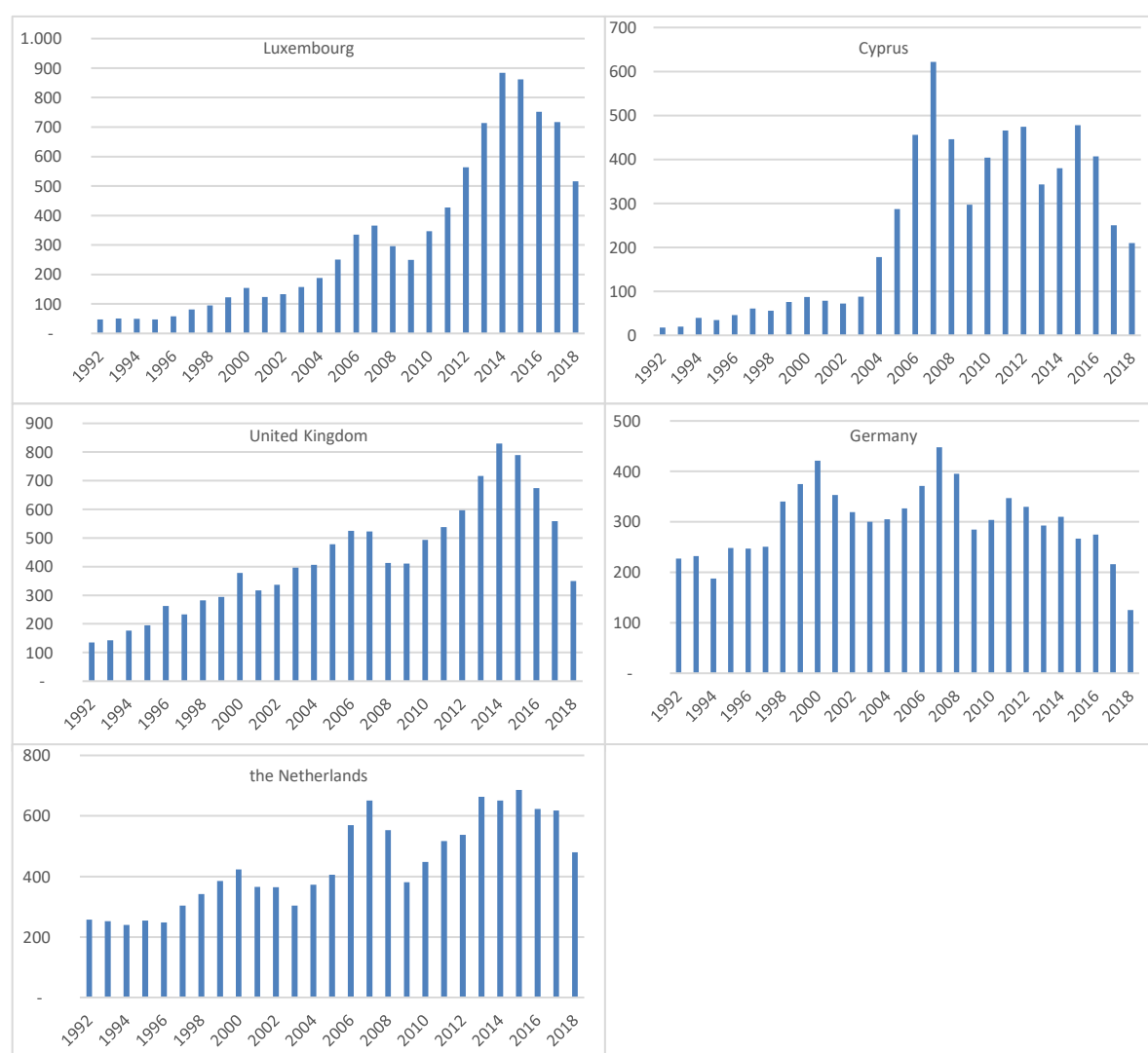
In Cyprus, the number of companies with a foreign subsidiary located in the EU-28 remained rather low from 1992 until 2003. However, after its accession to the EU in 2004, a sharp increase is evident, with a peak in 2007. While only 88 companies with a foreign subsidiary were incorporated in 2003, this number grew to over 620 in 2007. In the following years, the number of incorporations of companies with a foreign subsidiary continued to be relatively high compared to the situation before its accession.

In the UK, a rising line can be seen up until 2014, after which the number of companies with a foreign subsidiary dropped sharply. The number of companies with a foreign subsidiary in 2018 is at the same level as in 2000.

The number of companies located in Germany with a foreign subsidiary in the EU-28 was already relatively high in 1992 and has remained that way ever since. Over the years, there were certain peaks, like in 2000 and 2007, when more than 400 companies with a foreign subsidiary were incorporated. However, as could also be seen in Luxembourg, Cyprus and the UK, the number of companies with a foreign subsidiary recently decreased. The number of companies with a foreign subsidiary that were incorporated in 2017 equalled the number of companies in 1992.

Finally, the number of companies in the Netherlands with a foreign subsidiary also fluctuated over the years, although it remained stable from 1992 until 1996. Starting from 1997, the number seemed to fluctuate more, with peaks of incorporations in 2000, 2007 and 2015. Although a drop in the number of incorporations from 2015 can be seen in the Netherlands, this seems less severe than in the other Member States examined.

Figure 15. Year of incorporation for companies located in Luxembourg, Cyprus, the UK, Germany and the Netherlands with a foreign subsidiary located in the EU-28, 1992-2018



* Data extracted on 21 October 2019

Source: Own elaborations based on Orbis

A3.3.3 By sector of activity

Table 25 presents the analysis of the sector of activity for companies located in the EU-28 with a foreign subsidiary located outside the EU-28. This table can be compared to Table 10 in the main report to see the difference with the companies located in the EU-28 with a foreign subsidiary located in the EU-28. Of the top 20 most common NACE-codes in both groups, 18 match and the top three are identical. This means that for EU-28 companies with a foreign subsidiary, activities such as holding companies, head offices, and business and other management consultancy are the most common.

Table 25. Top 20 NACE-codes of companies located in the EU-28 with a foreign subsidiary located outside the EU-28

NACE-code	Number of companies with a foreign subsidiary outside EU-28	Column percentage (share of total number of companies with a foreign subsidiary outside EU-28)	Share of total number of EU-28 companies	Description of NACE-code
6420	5 406	17.0%	0.7%	Activities of holding companies
7010	1 668	5.2%	0.5%	Activities of head offices
7022	1 269	4.0%	0.2%	Business and other management consultancy activities
6499	879	2.8%	0.9%	Other financial service activities, except insurance and pension funding
4690	856	2.7%	0.5%	Non-specialised wholesale trade
7112	812	2.6%	0.2%	Engineering activities and related technical consultancy
8299	775	2.4%	0.1%	Other business support service activities
6201	680	2.1%	0.3%	Computer programming activities
6820	646	2.0%	0.0%	Rental and operating of own or leased real estate
6202	415	1.3%	0.1%	Computer consultancy activities
4669	341	1.1%	0.4%	Wholesale of other machinery and equipment
6209	331	1.0%	0.3%	Other information technology and computer service activities
7490	321	1.0%	0.1%	Other professional, scientific and technical activities
5229	309	1.0%	0.4%	Other transportation support activities
6810	297	0.9%	0.1%	Buying and selling of own real estate

4120	282	0.9%	0.0%	Construction of residential and non-residential buildings
6430	262	0.8%	0.2%	Trusts, funds and similar financial entities
6619	250	0.8%	0.2%	Other activities auxiliary to financial services, except insurance and pension funding
7311	204	0.6%	0.1%	Advertising agencies
4110	194	0.6%	0.0%	Development of building projects

* Data extracted on 10 March 2020

Source: Own elaborations based on Orbis

The following analysis was only performed for companies located in the EU-28 with a foreign subsidiary located in the EU-28. Member States were examined more closely for the four most common NACE-codes for companies with a foreign subsidiary located in the EU-28. Table 26 gives an overview of these four NACE-codes. For each NACE-code, the first column provides the total number of companies in a certain Member State, the second column gives the number of companies with a foreign subsidiary located in the EU-28, while the third column shows the share of the number of companies with a foreign shareholder located in the EU-28 of the total number of companies. Finally, the fourth column presents the column percentage of the number of companies with a foreign subsidiary located in the EU-28 from the total number of companies located in the EU-28 with a foreign subsidiary located in the EU-28. An analysis of this table can be found in Section 3.2.2 of the main report.

Table 26. Analysis of top 4 NACE-codes of companies with a foreign subsidiary located in the EU-28

	NACE 8299				NACE 7010				NACE 6420				NACE 7022			
	Total	Foreign sub	% of total	Column %	Total	Foreign sub	% of total	Column %	Total	Foreign sub	% of total	Column %	Total	Foreign sub	% of total	Column %
Belgium	8 021	120	1.5	3.9	2 886	164	5.7	2.1	20 250	1 341	6.6	6.8	48 471	1 132	2.3	23.5
Bulgaria	1 957	-	0.0	0.0	279	2	0.7	0.0	385	20	5.2	0.1	10 209	41	0.4	0.9
Czechia	389	5	1.3	0.2	301	47	15.6	0.6	476	99	20.8	0.5	3 081	60	1.9	1.2
Denmark	1 386	16	1.2	0.5	808	119	14.7	1.5	86 653	1 768	2.0	9.0	10 217	199	1.9	4.1
Germany	64 633	527	0.8	17.2	162 045	2,198	1.4	28.3	64 387	1 423	2.2	7.2	50 858	288	0.6	6.0
Estonia	6 255	25	0.4	0.8	242	21	8.7	0.3	2 433	102	4.2	0.5	9 117	121	1.3	2.5
Ireland	10 848	254	2.3	8.3	8 179	526	6.4	6.8	1 079	36	3.3	0.2	7 030	73	1.0	1.5
Greece	142	-	0.0	0.0	13	-	0.0	0.0	306	23	7.5	0.1	1 176	10	0.9	0.2
Spain	24 078	103	0.4	3.4	849	68	8.0	0.9	16 412	700	4.3	3.5	38 586	230	0.6	4.8
France	22 271	73	0.3	2.4	24 561	546	2.2	7.0	120 568	1 474	1.2	7.5	110 993	291	0.3	6.0
Croatia	40	-	0.0	0.0	94	5	5.3	0.1	52	6	11.5	0.0	5 361	19	0.4	0.4
Italy	18 331	56	0.3	1.8	6 365	693	10.9	8.9	10 676	604	5.7	3.1	29 133	207	0.7	4.3
Cyprus	62	-	0.0	0.0	97	12	12.4	0.2	3 020	363	12.0	1.8	4 465	224	5.0	4.7
Latvia	483	1	0.2	0.0	93	1	1.1	0.0	1 022	62	6.1	0.3	2 859	19	0.7	0.4
Lithuania	326	5	1.5	0.2	305	29	9.5	0.4	169	21	12.4	0.1	3 901	49	1.3	1.0
Luxembourg	689	34	4.9	1.1	698	-	0.0	0.0	1 460	84	5.8	0.4	1 227	28	2.3	0.6
Hungary	4 808	6	0.1	0.2	771	18	2.3	0.2	2 691	113	4.2	0.6	20 600	65	0.3	1.4

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	NACE 8299				NACE 7010				NACE 6420				NACE 7022			
	Total	Foreign sub	% of total	Column %	Total	Foreign sub	% of total	Column %	Total	Foreign sub	% of total	Column %	Total	Foreign sub	% of total	Column %
Malta	23	2	8.7	0.1	4	-	0.0	0.0	1 777	348	19.6	1.8	386	31	8.0	0.6
Netherlands	1 968	18	0.9	0.6	52 511	806	1.5	10.4	359 093	8 175	2.3	41.4	60 388	324	0.5	6.7
Austria	75 065	465	0.6	15.2	8 116	702	8.6	9.0	7 287	788	10.8	4.0	8 114	145	1.8	3.0
Poland	1 427	5	0.4	0.2	7 107	30	0.4	0.4	2 014	27	1.3	0.1	20 439	44	0.2	0.9
Portugal	4 492	21	0.5	0.7	655	62	9.5	0.8	3 647	280	7.7	1.4	12 780	91	0.7	1.9
Romania	6 389	5	0.1	0.2	116	3	2.6	0.0	487	14	2.9	0.1	28 331	28	0.1	0.6
Slovenia	161	1	0.6	0.0	109	17	15.6	0.2	419	30	7.2	0.2	6 235	54	0.9	1.1
Slovakia	15 848	101	0.6	3.3	14	2	14.3	0.0	53	2	3.8	0.0	17 626	209	1.2	4.3
Finland	1 279	15	1.2	0.5	404	38	9.4	0.5	1 308	62	4.7	0.3	16 545	114	0.7	2.4
Sweden	509	12	2.4	0.4	3 049	406	13.3	5.2	8 257	544	6.6	2.8	45 359	401	0.9	8.3
UK	241 502	1 192	0.5	38.9	24 215	1,270	5.2	16.3	42 904	1 272	3.0	6.4	201 671	316	0.2	6.6
EU-28	513 382	3 061	0.6	100.0	304 886	7,780	2.6	100.0	759 286	19 742	2.6	100.0	775 158	4 812	0.6	100.0
Iceland	45	-	0.0		14	2	14.3		2 924	45	1.5		1 074	10	0.9	
Liechtenstein	219	29	13.2		14	-	0.0		123	28	22.8		70	7	10.0	
Norway	2 492	35	1.4		239	6	2.5		205	17	8.3		11 748	66	0.6	
Switzerland	1 016	17	1.7		2 562	223	8.7		9 352	1 823	19.5		22 129	519	2.3	

* Data extracted on 25 June 2019

Source: Own elaborations based on Orbis

A3.4 Identifying relevant indicators and red flags

A3.4.1 Relevant literature and regulations

A3.4.1.1 Defined by the Regulations on the coordination of social security systems⁶⁰⁶

According to Article 14(2) of the Implementing Regulation, the words 'which normally carries out its activities there' refer to 'an employer that ordinarily performs substantial activities, other than purely internal management activities, in the territory of the Member State in which it is established, taking account of all criteria characterising the activities carried out by the undertaking in question. The relevant criteria must be suited to the specific characteristics of each employer and the real nature of the activities carried out.' In terms of the criteria that apply to determine whether an employer normally carries out its activities in the 'posting' State, the practical guide of the Commission defines a series of objective factors. However, it states that 'it should be noted that this is not an exhaustive list, as the criteria should be adapted to each specific case and take account of the nature of the activities carried out by the undertaking in the State in which it is established.'

- The place where the posting undertaking has its registered office and its administration;
- The number of administrative staff of the posting undertaking present in the Member State of origin and in the host Member State;
- The place of recruitment of the posted worker;
- The place where the majority of contracts with clients are concluded;
- The law applicable to the contracts signed by the posting undertaking with its clients and with its workers;
- The number of contracts executed in the Member State of origin and the host Member State;
- The turnover achieved by the posting undertaking in the Member State of origin and in the host Member State during an appropriate typical period (e.g., turnover of approximately 25 of total turnover in the Member State of origin could be a sufficient indicator, but cases where turnover is under 25 would warrant greater scrutiny);
- The length of time an undertaking is established in the Member State of origin.

In Case C-73/06 *Planzer Luxembourg*, the CJEU ruled that the term 'business establishment' means the place where the essential decisions concerning the general management of a company are adopted and where the functions of its central administration are carried out. The Court elaborated on this in the following terms:

'Determination of a company's place of business requires a series of factors to be taken into consideration, foremost amongst which are its registered office, the place of its central administration, the place where its directors meet and the place, usually identical, where the general policy of that company is determined. Other factors, such as the place of residence of the main directors, the place where general meetings are held, the place where administrative and accounting documents are kept, and the place where the company's financial, and particularly banking, transactions mainly take place, may also need to be taken into account.'

⁶⁰⁶ Basic Regulation (EC) No 883/2004 and Implementing Regulation (EC) No 987/2009.

A3.4.1.2 Defined by the Enforcement Directive (Directive 2014/67/EU)

An important part of the Enforcement Directive is the identification of a genuine or abusive situation of posting.

Article 4(2) of the Enforcement Directive states that 'in order to determine whether an undertaking genuinely performs substantial activities, other than purely internal management and/or administrative activities, the competent authorities shall make an overall assessment of all factual elements characterising those activities, taking account of a wider timeframe, carried out by an undertaking in the Member State of establishment, and where necessary, in the host Member State'. Such elements may include:

- the place where the undertaking has its registered office and administration, uses office space, pays taxes and social security contributions and, where applicable, in accordance with national law, has a professional licence or is registered with the chambers of commerce or professional bodies;
- the place where posted workers are recruited and from which they are posted;
- the law applicable to the contracts concluded by the undertaking with its workers, on the one hand, and with its clients, on the other;
- the place where the undertaking performs its substantial business activity and where it employs administrative staff;
- the number of contracts performed and/or the size of the turnover realised in the Member State of establishment, taking into account the specific situation of, inter alia, newly established undertakings and SMEs.

A3.4.1.3 Defined by the specific rules applicable to freight transport by road

Regulation (EC) No 1071/2009 introduced some important requirements for all transport undertakings authorised by a Member State, helping to clamp down on the phenomenon of letterbox companies. The core requirements for engagement in the occupation of road transport operator are summarised in Article 3(1) of Regulation (EC) No 1071/2009 as follows:

- have an effective and stable establishment;
- be of good repute;
- have appropriate financial standing; and
- have the requisite professional competence.

Undertakings engaged in the occupation of road transport operator should have 'an effective and stable establishment' in a Member State. In order to satisfy this requirement, Article 5 of the Regulation provides that an undertaking will, in the Member State concerned:

- a) have an establishment situated in that Member State with premises in which it keeps its core business documents, in particular its accounting documents, personnel management documents, documents containing data relating to driving time and rest and any other document to which the competent authority must have access in order to verify compliance with the conditions laid down in this Regulation. Member States may require that establishments on their territory also have other documents available at their premises at any time;
- b) once an authorisation is granted, have at its disposal one or more vehicles which are registered or otherwise put into circulation in conformity with the legislation of that Member State, whether those vehicles are wholly owned or, for example, held under a hire-purchase agreement or a hire or leasing contract;

- c) conduct effectively and continuously with the necessary administrative equipment, its operations concerning the vehicles mentioned in point (b) and with the appropriate technical equipment and facilities at an operating centre situated in that Member State.

A3.4.1.4 Defined by Directive (EU) 2017/1132 relating to certain aspects of company law

Directive 2017/1132 as amended by Directive (EU) 2019/2121 creates a legal framework for companies to move to another Member State (by carrying out a cross-border conversion) while maintaining their legal personality and to carry out cross-border divisions, and updates the previously existing rules on cross-border mergers. It requires that Member State authorities check the compliance of a cross-border conversion, division or merger with the law of that Member State. If all procedures and formalities are properly completed in the departure Member State, a so-called 'pre-operation certificate' is issued by the authorities. However, it also provides for an 'anti-abuse' check. Where the authorities see a risk that the cross-border conversion, merger or division could be used for abusive, fraudulent or criminal activities (that can also be conducted by using a letterbox companies, as seen in Section 4) that could breach or evade EU or national law, it will be refused. This pre-operation check provides a safeguard mechanism to prevent and detect abusive or illegal cross-border uses of letterbox companies.

Recital 36 provides more detail about how such a check is to be carried out: 'Where the competent authority has serious doubts that the cross-border operation is set up for abusive or fraudulent purposes, the assessment should consider all relevant facts and circumstances, and should take into account, where relevant, at a minimum, indicative factors relating to the characteristics of the establishment in the Member State in which the company or companies are to be registered after the cross-border operation, including the intent of the operation, the sector, the investment, the net turnover and profit or loss, number of employees, the composition of the balance sheet, the tax residence, the assets and their location, equipment, beneficial owners of the company, the habitual place of work of the employees and of specific groups of employees, the place where social contributions are due, the number of employees posted in the year prior to the conversion within the meanings of Regulation (EC) No 883/2004 of the European Parliament and of the Council and Directive 96/71/EC of the European Parliament and of the Council, and the number of employees working simultaneously in more than one Member State within the meaning of Regulation (EC) No 883/2004 and the commercial risks assumed by the company or companies before and after the cross-border operation. The assessment should also take into account the relevant facts and circumstances related to employee participation rights, in particular as regards negotiations on such rights where those were triggered by the four-fifths of the applicable national threshold. All these elements should only be considered as indicative factors in the overall assessment and therefore should not be regarded in isolation. The competent authority may consider it as an indication of absence of circumstances leading to abuse or fraud if the cross-border operation results in having the place of the effective management and/or the economic activity of the company in the Member State, where the company or companies are to be registered after the cross-border operation.'

A3.4.2 Overview of indicators and red flags

Table 27 below provides an overview of the indicators and red flags, which were based on literature review and the experiences of the national experts. They have been subdivided into several categories: identification indicators, financial indicators and indicators that specify corporate obligations. In each case, it is noted whether it is possible to analyse them in the Orbis database. This study does not focus on individual companies or persons (micro-level), nor on the global picture for certain Member States (macro-level) and

indicators are thus situated at the meso-level. This makes it possible to identify specific companies that can be analysed in the larger industrial setting.

Table 27. Overview of indicators and red flags

Indicator	Red flag	Orbis	Comments
Identification indicators			
Name and identification of shareholder	Different names in different countries	No, micro level	Solution: unique identification
Address	Multiple companies at the same address; companies that have their permanent address at a flexible space; no physical headquarters	Yes, see Section 3.2.3	Pay attention to different spellings
Corporate structure and ownership	Complex corporate structure, for example many subsidiaries; the same owners for many different companies	Yes, but requires access to ownership database in order to download data	Focuses more on LBCs for tax evasion reasons
Employees (Member State of incorporation)	No or few employees at Member State of incorporation	Yes, but only general number of employees, not per Member State ⁶⁰⁷ . See Section 3.2.3	
Clients	Only one permanent client; the company does not gain new clients	No, identification not possible	
Activity	General NACE-codes could be an indication of a 'shelf company' - companies are formed without any specific activity in mind and are later sold to business entrepreneurs who need to incorporate quickly	Yes, see Sections 3.2.1 and 3.2.2 and following	However, now that online incorporation is often possible, the need for quick incorporation has declined
	No promotion or sales activities in Member State of establishment. No economic activity in the Member State of incorporation	Not possible to see in Orbis	
Legal form	In the EU, mainly private limited companies are used in criminal activities. Some forms might make it easier to form an LBC (e.g. no starting capital requirement, anonymity for shareholders, etc.)	Yes, but not further developed in this report	Difficult to put into practice as there are different rules and legal forms in different Member States

⁶⁰⁷ The example of Arcelormittal s.a. is a useful illustration. In the company report, it can be seen that it employed 209 000 people in 2018. However, these 209 000 employees are spread out over the 757 subsidiaries the company holds. The individual company report shows where these subsidiaries are located and the number of employees in each subsidiary. For instance, of the 757 subsidiaries, 169 are located in the US, 63 in Canada and 47 in Germany. 194 380 employees of the total 209 000 could also be allocated to the exact location of the subsidiary. For instance, 27 683 employees are located at JSC Arcelormittal Temirtau in Kazakhstan, 20 763 at Public Joint Stock Company ArcelorMittal Kryvyi Rih in Ukraine, and 15 500 at Arcelormittal USA LLC in the US. Although it is possible to see this type of information per company, it is not possible to download the data. Thus, certain variables that would be interesting for this research, for instance number of subsidiaries, location of subsidiaries and number of employees at subsidiaries, cannot be utilised, and only the total number of employees is used here (data extracted on 7 August 2019).

Indicator	Red flag	Orbis	Comments
Creditors and suppliers	Majority of creditors and suppliers are not located in the Member State of incorporation	No, identification not possible	
Lifespan	Shorter lifespan compared to domestic companies	Yes, but not further developed in this report. To go back further than 10 years, access is needed to the Orbis Historical database	'Historical companies' will not be active anymore
Financial indicators			
Turnover	When majority of turnover is realised in country of subsidiary, not in country of incorporation	It is not possible to see distribution of profits between mother and daughter company. However, the total amount can be consulted. See Section 3.3.3	
Turnover/number of employees	High turnover but (almost) no employees	Yes, see Section 3.2.3	
Pre-tax corporate profit	When this is much higher for foreign firms than for local firms (profitability gap)	Yes, see Section 3.2.3	
Profit shifting	Pre-tax profit to total assets or pre-tax profit to number of employees is higher than for domestic companies	Yes, see Section 3.2.3	
Capital	When the minimum capital requirement is not met	Yes, but not further discussed in this report	Different rules, depending on legal forms and Member State
	Having a high amount of foreign capital	No, only total amount of capital can be seen	
Average labour cost	When this is much lower than the average labour cost in the country of establishment	Yes, but not further developed in this report	
Loans/number of employees	High amount of loans but no or few employees	Yes, see Section 3.2.3	
Dividends/number of employees	High number of dividends but no or few employees	Yes, but not further developed in this report	
Assets	No assets	Yes, but not further developed in this report	
Corporate obligations			

Indicator	Red flag	Orbis	Comments
Annual accounts	Same accounts as last year, or no filing at all. Not fulfilling the reporting obligations	Yes, see Section 3.2.3 in the broader sense of information availability	

A3.4.3 Address

The address indicator was examined in more detail for the UK, Luxembourg and Slovakia. The first country that was examined is the UK. Table 28 shows the addresses that were most common for companies with a foreign majority shareholder located in the EU-28⁶⁰⁸. The numbers in this table, and all other tables to follow, are for active companies with the withheld legal forms (see Annex A3.1.2).

Column A in Table 28 shows the number of companies with a foreign majority shareholder located in the EU-28. Column B shows the number of companies with a foreign majority shareholder. This number is an estimation based on the formula described in Annex A3.2.1, which lies between the number of companies with a foreign shareholder including the shareholders of which the location was unavailable and the number of companies excluding these shareholders. More specifically, the share of companies with foreign shareholders where it is certain that the shareholder is actually foreign was multiplied by the number of companies where the location of the shareholder is unknown. This number was then added to the number of companies with a foreign shareholder, excluding those where the location of the shareholder was not available. Column C gives the total number of companies located at a certain address.

It is noteworthy that more than 15 000 companies are located at certain addresses, with the 20-22 Wenlock address in London housing more than 30 000 companies⁶⁰⁹. This particular address also surfaced in the Paradise Papers.

The share of companies with a foreign majority shareholder located in the EU-28 from the total number of companies with a foreign majority shareholder shows the most popular addresses for companies with an EU-28 shareholder. This is especially the case for the addresses in Warrington and Birmingham, with more than 65% of the companies with a foreign shareholder located there.

The final column reveals the share of companies with a foreign majority shareholder from the total number of companies located at a certain address.

Table 28. Address of UK-based companies with a foreign majority shareholder

Address	Number of companies with a foreign majority shareholder	Estimation of number of companies with a foreign majority	Total number of companies (C)	Share of companies with a foreign majority shareholder located in the EU-28 of total number of companies with a	Share of companies with a foreign majority shareholder of total number of companies (B/C)

⁶⁰⁸ It is possible that there are other addresses that are more important for companies with a foreign majority shareholder located outside the EU-28. However, as Table 28 shows, the numbers are already impressive, and it seems unimaginable that there are addresses where even more companies are located with foreign majority shareholders that are located outside of the EU-28.

⁶⁰⁹ It is not surprising to see so many companies registered at the same address, as it only takes a simple Google search to find websites to set up a virtual office at these addresses. For instance <https://www.companiesmadesimple.com/blog/start-up-education/use-20-22-wenlock-road-company/> for the Wenlock Road address, or https://www.yourcompanyformations.co.uk/address/registered-office/?gclid=CjwKCAjwx_boBRA9Eiwa4klELspdMdlr4hQ43A4n2l2N17tn237mPgJJbDT4ejKi4-vss3T1CcjiRoCW8sQAvD_BwE to set up a company at Kemp House 160 City Road in London.

	located in the EU-28 (A)	shareholder (B)		foreign majority shareholder (A/B)	
20-22 WENLOCK ROAD, LONDON	4 296	7 648	31 451	56.2%	24.3%
71-75 SHELTON STREET, LONDON	3 299	6 705	22 967	49.2%	29.2%
ROMAN HOUSE, BIRMINGHAM	2 376	2 894	3 017	82.1%	95.9%
27 OLD GLOUCESTER STREET, LONDON	1 354	3 334	9 255	40.6%	36.0%
BRUNEL HOUSE, WARRINGTON	1 125	1 661	15 312	67.7%	10.8%
KEMP HOUSE 160 CITY ROAD, LONDON	1 060	5 104	18 007	20.8%	28.3%

* Data extracted on 4 July 2019

Source: Own elaborations based on Orbis

It was also useful to look at the address of companies with a certain NACE-code. For instance, NACE-code 4941 'Freight transport by road'. For UK-companies with NACE-code 4941 with a foreign shareholder in the EU-28, only 0.01% of the addresses were unknown.

The first three columns of Table 29 present the number of companies with a foreign shareholder located in the EU-28 with this NACE-code, the total number of companies with this NACE-code, and the total number of companies. The fourth column shows the share of companies with a foreign majority shareholder located in the EU-28 with NACE-code 4941 of the total number of companies with NACE-code 4941. This clearly shows that the addresses in Derby and Rushden are particularly favoured by transport companies with a foreign shareholder located in the EU-28, as more than 90% of the transport companies located there have an EU-28 shareholder. Finally, it is possible to calculate the addresses that are particularly popular for companies active in the field of road transport, which is shown in the last column. This is the case for the addresses in Rugby and Rushden, where more than 80% of the companies located there operate under NACE-code 4941 'Freight transport by road'. On the other hand, the low share for that code (0.7%) at Wenlock Road demonstrates that this address is frequently used by companies active in sectors other than the road transport sector.

Compared to other studies, it is intriguing to see that the same addresses surface when investigating possible letterbox companies. A study of the Belgian road freight transport sector within the European context also encountered the Clifton Road address in Rugby⁶¹⁰. They found that 235 transport companies were located at this address, of which 129 had a foreign shareholder.

This analysis clearly shows that it is doubtful that all these companies comply with the requirements set out in Regulation (EC) No 1071/2009 for transport undertakings (see Annex A3.4.1.3). The requirement to have an 'effective and stable establishment' where the company keeps its accounting documents, personnel management documents,

⁶¹⁰ De Wispelaere, F. and Pacolet, J. (2018) Economic analysis of the road freight transport sector in Belgium within a European context: Employees and employers in 'survival mode'? Report, HIVA-KU Leuven. Available at: <https://hiva.kuleuven.be/nl/nieuws/docs/hiva%20report%20economic%20analysis%20of%20the%20road%20freight.pdf>. Accessed on 23 May 2019.

documents containing data relating to driving time and rest, and other core business documents seems unlikely to be met by more than 100 companies at one address (see the case study on road transport in Annex 4).

Table 29. Address of UK-based companies with a foreign majority shareholder with NACE-code 4941 'Freight transport by road'

Address	Number of companies with a foreign majority shareholder located in the EU-28 with NACE-code 4941 (A)	Total number of companies with NACE-code 4941 (B)	Total number of companies (C)	Share of companies with a foreign majority shareholder located in the EU-28 with NACE-code 4941 of total number of companies with NACE-code 4941 (A/B)	Share of companies with NACE-code 4941 of total number of companies (B/C)
32 THE CRESCENT, SPALDING	113	263	681	43.0%	38.6%
64 DERWENT CLOSE, RUGBY	110	517	610	21.3%	84.8%
21-23 CLIFTON ROAD, RUGBY	109	203	250	53.7%	81.2%
VERNON HOUSE VERNON STREET, DERBY	84	90	135	93.3%	66.7%
11/11A THE PRECINCT, RUSHDEN	70	76	88	92.1%	86.4%
20-22 WENLOCK ROAD, LONDON	61	231	31,451	26.4%	0.7%

* Data extracted on 4 July 2019

Source: Own elaborations based on Orbis

Luxembourg also warrants a closer look. Table 30 shows the most common addresses for companies located in Luxembourg with a foreign shareholder in the EU-28. The number of companies with a foreign majority shareholder at these addresses (column B) was estimated using the same methodology as for the UK (see Annex A3.2.1). The total number of companies located at a certain address is also provided.

Overall, it is obvious that the city of Luxembourg is the most attractive for companies with a foreign shareholder. More specifically, for companies with a foreign shareholder in the EU-28, the addresses of Rue Lou Hemmer, Rue Jean Piret and Heienhaff seem to be popular, as more than 75% of companies with a foreign shareholder based at these locations have a shareholder that is located in the EU-28.

The final column gives the share of companies with a foreign shareholder of the total number of companies based at a certain address. Both the addresses in Rue Guillaume Kroll 5 and Avenue Charles de Gaulle 2 were also found in the Luxembourg leaks⁶¹¹. These leaked files showed how big companies had disclosed secret tax deals in Luxembourg.

⁶¹¹ Obermayer, B. (2014, December 5). Day in a Fiscal Paradise: Chasing Letterbox Leads in Luxembourg. International Consortium of Investigative Journalists. Available at: <https://www.icij.org/investigations/luxembourg-leaks/day-fiscal-paradise-chasing-letterbox-leads-luxembourg/>. Accessed on 10 July 2019.

These confidential tax rulings from Luxembourg officials assured companies that they would get favourable treatment for their tax-saving manoeuvres⁶¹².

Table 30. Address of Luxembourg-based companies with a foreign majority shareholder

Address	Number of companies with a foreign majority shareholder located in the EU-28 (A)	Estimation of number of companies with a foreign majority shareholder (B)	Total number of companies (C)	Share of companies with a foreign majority shareholder located in the EU-28 of total number of companies with a foreign majority shareholder (A/B)	Share of companies with a foreign majority shareholder of total number of companies (B/C)
RUE EUGENE RUPPERT 6, LUXEMBOURG	409	1 019	1 822	40.2%	55.9%
RUE GUILLAUME KROLL 5, LUXEMBOURG	390	822	1 609	47.4%	51.1%
HEIENHAFF 5, SENNINGERBERG	280	369	1 044	76.0%	35.3%
RTE D'ESCH 412F, LUXEMBOURG	267	513	1 309	52.1%	39.2%
AVE CHARLES DE GAULLE 2, LUXEMBOURG	237	550	1 117	43.1%	49.2%
RUE JEAN PIRET 1, LUXEMBOURG	188	230	720	81.6%	32.0%
AVE DE LA FAIENCERIE 121, LUXEMBOURG	185	390	882	47.5%	44.2%
RUE LOU HEMMER 8, LUXEMBOURG	189	224	455	84.2%	49.3%
RUE EDWARD STEICHEN 14, LUXEMBOURG	164	474	836	34.6%	56.7%
RUE DE BITBOURG 19, LUXEMBOURG	141	373	961	37.8%	38.8%

* It should be noted that the address variable was not always consistent, as there were several different spellings for the same address. For example, 'RTE D'ESCH 412F' was also spelled as 'RTE D'ESCH 412 F' and 'RTE D EISCH 412F'. It is unclear why these differences appear. It could be a synchronisation issue or an honest mistake. Therefore, for every country discussed in this paragraph, a check was always carried out for different spellings in order to capture the total number of companies at the same address.

* Data extracted on 4 July 2019

Source: Own elaborations based on Orbis

⁶¹² Fitzgerald, A., and Walker Guevara, M. (2014, December 9). New Leak Reveals Luxembourg Tax Deals for Disney, Koch Brothers Empire. International Consortium of Investigative Journalists. Available at: <https://www.icij.org/investigations/luxembourg-leaks/new-leak-reveals-luxembourg-tax-deals-disney-koch-brothers-empire/>. Accessed on 10 July 2019.

Finally, companies located in Slovakia with a foreign majority shareholder were also looked at in more detail. Table 31 follows the same methodology as Table 28 for the UK and Table 30 for Luxembourg. Although in absolute numbers, the average total number of companies based at one address is lower than for the top addresses in the UK and Luxembourg, it is nevertheless striking to see several hundred companies located at the same address. The first address, Karpatske Namestie 10 in Bratislava, accommodates more than 2 000 companies. In general, Bratislava, Slovakia's capital, seems to be a popular city to locate a company with a foreign majority shareholder.

In terms of popularity with companies with a foreign shareholder located in the EU-28, the Hlavna, Parkova and Druzstevna addresses stand out, as more than 80% of the companies with a foreign shareholder at this location have a shareholder that is located in the EU-28. On the other hand, the addresses at Karpatske Namestie and Tallerova are slightly more favoured by companies with a foreign majority shareholder outside the EU-28, as less than 50% of the companies with a foreign shareholder have a shareholder that is located in the EU-28.

The final column can be compared to the percentage calculated in Figure 5 (in the main report), which shows the overall share of companies with a foreign shareholder on the total number of companies.

Table 31. Address of Slovakia-based companies with a foreign majority shareholder

Address	Number of companies with a foreign majority shareholder located in the EU-28 (A)	Estimation of number of companies with a foreign majority shareholder (B)	Total number of companies (C)	Share of companies with a foreign majority shareholder located in the EU-28 of total number of companies with a foreign majority shareholder (A/B)	Share of companies with a foreign majority shareholder of total number of companies (B/C)
KARPATSKÉ NAMESTIE 10A, BRATISLAVA	334	804	2,013	41.5%	40.0%
KOPCIANSKA 10, BRATISLAVA	243	364	911	66.8%	39.9%
HLAVNA 22, STUROVO	206	243	334	84.8%	72.7%
TALLEROVA 4, BRATISLAVA	175	351	878	49.9%	39.9%
PARKOVA 45, BRATISLAVA	160	190	361	84.1%	52.7%
DRUZSTEVNA 8, KOMARNO	110	123	164	89.2%	75.2%

* Data extracted on 4 July 2019

Source: Own elaborations based on Orbis

The addresses of Slovakian companies with a foreign shareholder active in the 'Freight transport by road' sector were looked at more closely. All addresses were available for Slovakia-based companies active under NACE-code 4941 with a foreign majority shareholder located in the EU-28.

Table 32 shows the number of companies with NACE-code 4941 with a foreign shareholder located in the EU-28 and the total number of companies with that code. The total number of companies is also provided. When dividing the number of transport companies with a foreign shareholder located in the EU-28 by the total number of transport companies, it is

clear that the addresses Hranicna, Komenskeho and Male Kosihy are very popular with transport companies with an EU-28 shareholder, as more than 80% of the transport companies located there have a majority shareholder located in the EU-28. In particular, the second address is notable, as all of the transport companies located there have a majority shareholder located in the EU-28.

The final column shows how frequently these addresses are used for companies in the transport sector, as it gives the share of companies with NACE-code 4941 of the total number of companies located there. Overall, these five addresses seem to be more popular for companies active in other fields, as the shares are not very high.

However, some of these addresses are frequently encountered in literature about possible letterbox companies. Another study mentioned the two addresses in Bratislava, stating that 16 (letterbox) transport companies with a Belgian shareholder were registered at the address Hranicna 18, Bratislava⁶¹³. However, this was even an underestimation, as an analysis of the Slovakian business register⁶¹⁴ by ACV-Transcom found some 39 companies with a link to Belgium at this address. This underestimation could be due to missing companies/information in Orbis, which is likely the case in the current study as well. Therefore, it is important to keep in mind that most figures reported give an idea of the minimal size of the phenomenon.

The first address listed, Hranicna 18, Bratislava, is also mentioned in the black book by the Belgian transport union on social dumping in Slovakia⁶¹⁵. According to the Slovakian trade register, at least 110 companies were registered at this address, including some 20 Belgian transport companies. Table 32 shows around 140 companies now registered at this address, including 21 transport companies. When looking further into Orbis, it can indeed be seen that for 12 of these 21 companies, the shareholder's nationality was Belgian (for two shareholders no information was available).

Table 32. Address of Slovakia-based companies with a foreign majority shareholder with NACE-code 4941 'Freight transport by road'

Address	Number of companies with a foreign majority shareholder located in the EU-28 with NACE-code 4941 (A)	Total number of companies with NACE-code 4941 (B)	Total number of companies (C)	Share of companies with a foreign majority shareholder located in the EU-28 with NACE-code 4941 of total number of companies with NACE 4941 (A/B)	Share of companies with NACE-code 4941 of total number of companies (B/C)
HRANICNA 18, BRATISLAVA	18	21	142	85.7%	14.8%
KOMENSKEHO 317/135, STUROVO	14	14	51	100.0%	27.5%
TRZNICNE NAMESTIE 4810, KOMARNO	9	21	172	42.9%	12.2%

⁶¹³ De Wispelaere, F. and Pacolet, J. (2018) Economic analysis of the road freight transport sector in Belgium within a European context: Employees and employers in 'survival mode'? Report, HIVA-KU Leuven. Available at: <https://hiva.kuleuven.be/nl/nieuws/docs/hiva%20report%20economic%20analysis%20of%20the%20road%20freight.pdf>. Accessed on 23 May 2019.

⁶¹⁴ <http://orsr.sk/default.asp?lan=en>

⁶¹⁵ Belgische Transport Bond (2017). The road to Slovakia – Social dumping: this is how it works. Available at: https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek-2017-ENG-DIGITAAL.pdf. Accessed on 4 July 2019.

MALE KOSIHY 2, MALE KOSIHY	12	15	48	80.0%	31.3%
TALLEROVA 4, BRATISLAVA	12	88	878	13.6%	10.0%

* Data extracted on 4 July 2019

Source: Own elaborations based on Orbis

A3.4.4 Financial indicators

The financial indicators used in this research were chosen to identify the lack of companies' economic activity or substance and do not include indicators that may point to tax avoidance or ATP. Three distinct financial indicators were examined: turnover, pre-tax corporate profit, and loans, all in combination with the number of employees. These variables were first compared between domestic and foreign-owned companies. Afterwards, foreign-owned companies with the highest values were scrutinised further in order to get an idea of their specific profile.

A3.4.4.1 Turnover per employee

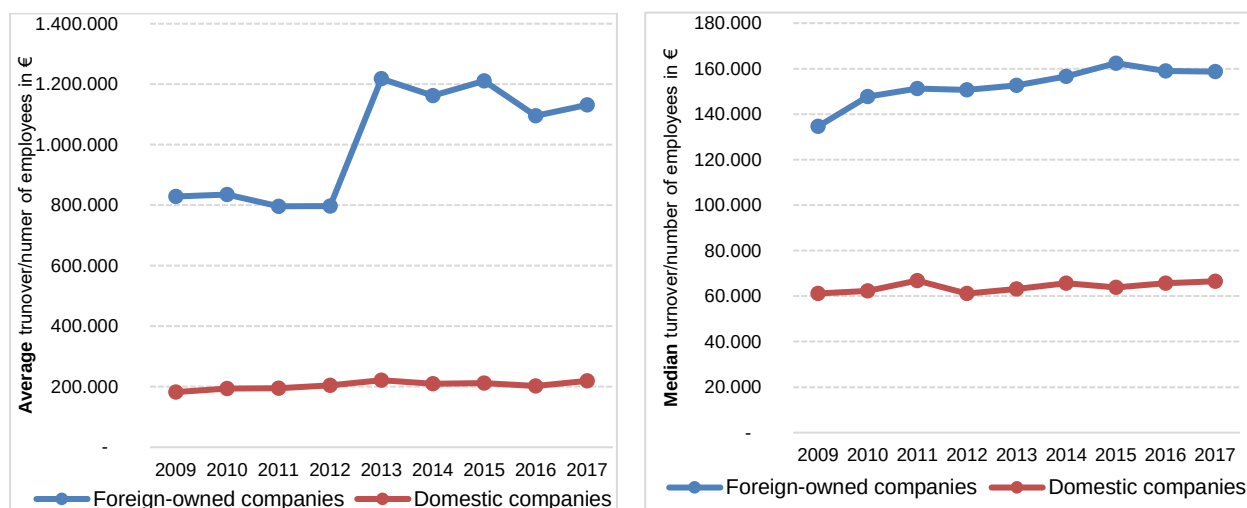
Seeing exactly where turnover is created would be useful in discovering where the true economic activity of a company takes place. It is not possible to see this in Orbis, however. An alternative is to uncover the companies with an absence of economic activity by looking at the number of companies that reported EUR 0 of turnover. While this share of companies was only 1.45% for EU-28 companies without a foreign majority shareholder, this share amounted to 4.17% of the EU-28 companies with a foreign majority shareholder in the EU-28⁶¹⁶. Although the difference in these shares is striking, turnover alone remains a rather weak indicator.

The combination of numbers of employees and turnover was then looked at more closely. The average and median of this indicator was analysed first, comparing the group of companies in the EU-28 with a foreign majority shareholder in the EU-28 with the group of companies without a foreign majority shareholder. This comparison is shown in Figure 16. The average shows an impressive surge from 2012 to 2013 for foreign-owned companies. However, as this is not visible for the median, it can be deduced that at the right-hand side of the spectrum some companies increased the average, meaning that certain foreign-owned companies' turnover increased greatly, or their numbers of employees decreased considerably.

There is a significant difference between the average of foreign-owned companies and domestic companies - almost five times bigger. This means that while a domestic firm in the EU-28 earns an average turnover of around EUR 205 000 per employee, a foreign-owned firm earns an average turnover of EUR 1 100 000 per employee. Whereas the difference in median is smaller, the median foreign-owned company still earns more than double the turnover per employee compared to a domestic company.

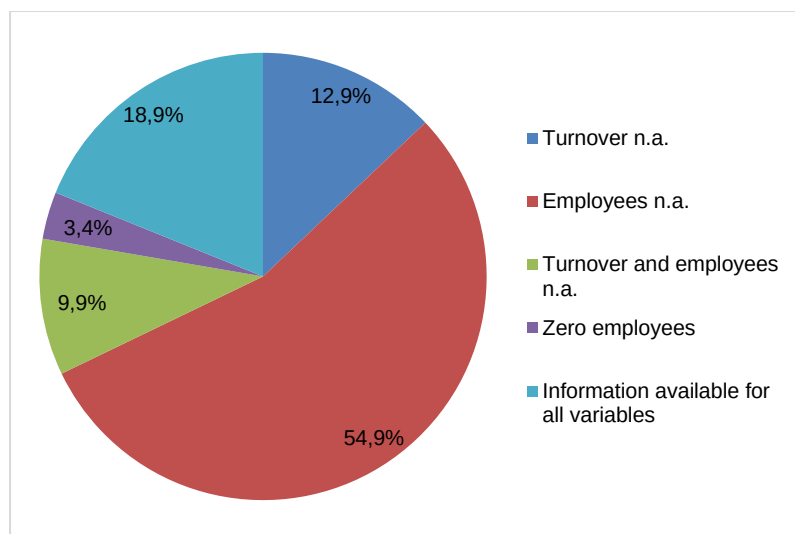
⁶¹⁶ These percentages did not change when estimates were included/excluded.

Figure 16. Average and median turnover per number of employees for companies located in the EU-28 with a foreign majority shareholder in the EU-28 (foreign-owned companies) and companies located in the EU-28 without a foreign majority shareholder (domestic companies), 2009-2017



As this indicator is quite telling, the analysis went a step further and looked at the EU-28 companies with a foreign majority shareholder in the EU-28. Of this group, companies with the highest values were identified as those with a red flag. The average turnover per number of employees of 2016 was taken as the limit (EUR 1 095 281); all companies above were regarded as companies of interest, as they have a proportionally high amount of turnover or low number of employees. It should first be noted, however, that there is a considerable lack of information (see Figure 17). Only 22.3% of companies in the EU-28 with a foreign majority shareholder in the EU-28 had information available on both the amount of turnover and number of employees. This 22.3% already includes the 3.4% of companies that reported having zero employees. As a result, the analysis could only be performed on 18.9% of the companies. For 9.9% of the companies, information on turnover was unavailable, and the same was true of 12.9% of the companies for information on employees. In addition, 54.9% of the companies had no information available on turnover or number of employees.

Figure 17. Data availability for indicator 'turnover per number of employees for companies located in the EU-28 with a foreign majority shareholder located in the EU-28'



* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

The following analysis focuses on the companies that reported data for both amount of turnover and number of employees (18.9% in Figure 17). For 10 960 companies with a foreign majority shareholder in the EU-28, the indicator turnover/number of employees exceeded 1 095 281. This equals 1.6% of the total number of EU-28 companies with a foreign EU-28 shareholder (706 764 companies), or 8.2% of the number of companies that had all necessary information available (133 446 companies).

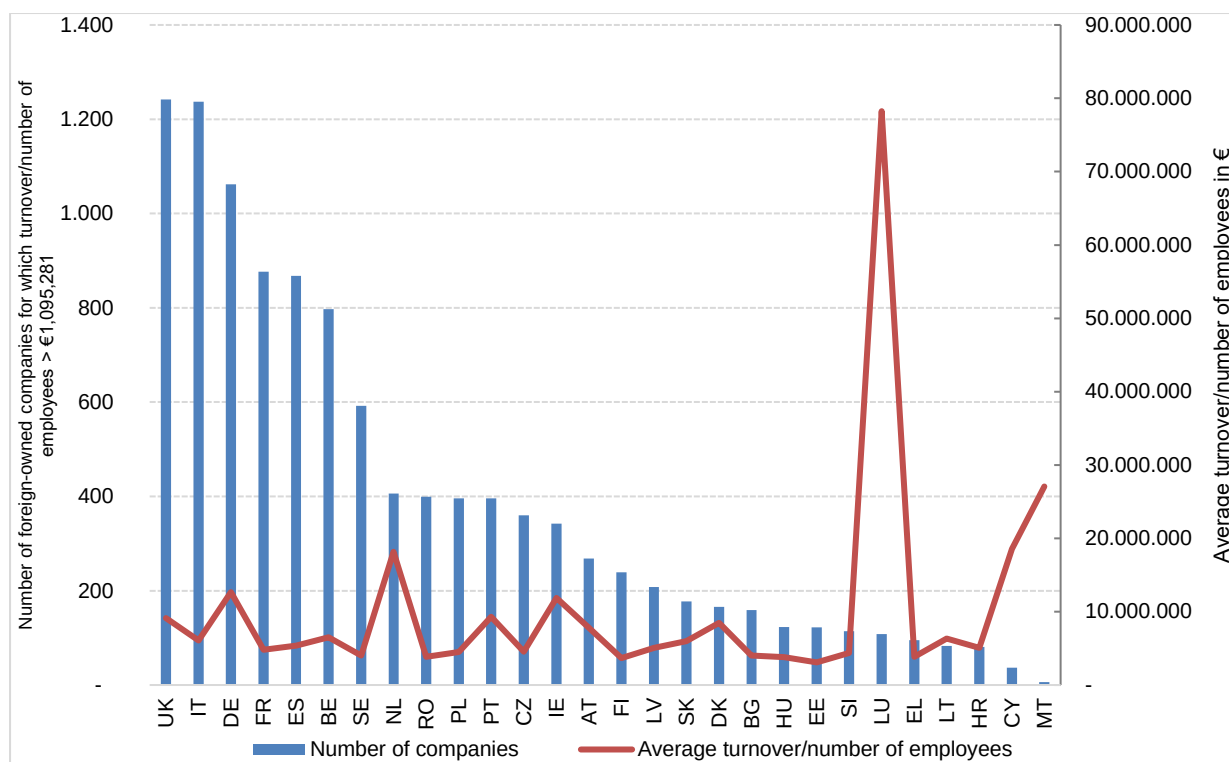
Figure 18 shows the number of companies with a value higher than 1 095 281 for this indicator, as well as the average of this indicator for these companies. Over 3 500 companies of the 10 960 companies (32%) are located in either the UK, Italy or Germany. Many foreign-owned companies that exceed this indicator are located in France, Spain and Belgium. Most of these companies seem to be located in EU-15 Member States.

The line on Figure 18 (which should be looked at using the axis on the right) shows the average turnover per number of employees for the selected companies. It is especially interesting to look at certain outliers. For instance, in Luxembourg and Malta, the total number of foreign-owned companies that have a turnover of over EUR 1 095 281 per employee is not as high (at 106 and 6, respectively). However, the average turnover per number of employees amounts to more than EUR 78 billion in Luxembourg, and EUR 27 billion in Malta. This average also exceeds EUR 10 billion in Cyprus, the Netherlands, Germany and Ireland.

Six companies with a foreign majority shareholder located in the EU-28 had a turnover of more than EUR 1 billion per employee. Three were located in Luxembourg, two in Germany, and one in Belgium. The three companies in Luxembourg had a turnover of more than EUR 2 billion per employee.

Figure 18 shows the companies that should be looked at more carefully, as they have an extremely high turnover, very low number of employees, or both. This raises questions as to how the turnover is created.

Figure 18. Companies located in the EU-28 with a foreign majority shareholder located in the EU-28 whose turnover per number of employees exceeds EUR 1 095 281

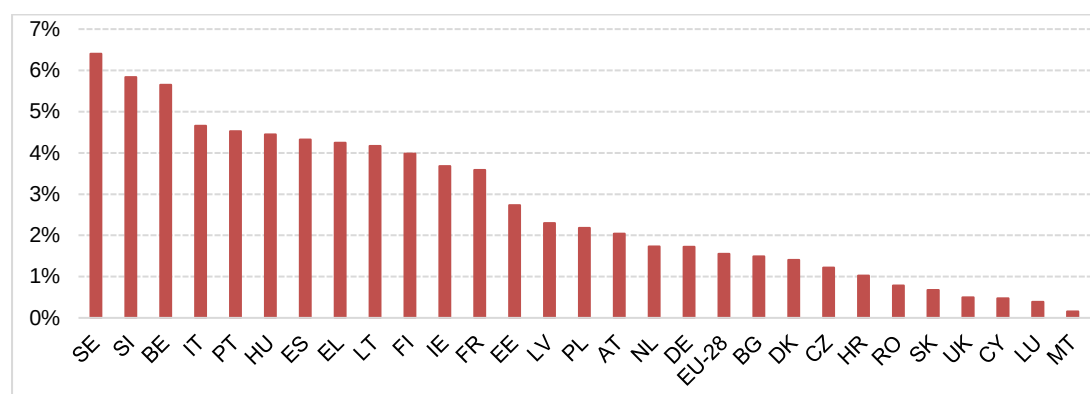


* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

Although Figure 18 is very telling, it is nevertheless interesting to look at the relative shares to put the absolute numbers in perspective. Figure 19 shows the share of EU-28 companies with a foreign majority shareholder in the EU-28 that earn more than EUR 1 095 281 turnover per employee on the total number of EU-28 companies with a foreign majority shareholder in the EU-28. In Sweden, Slovenia and Belgium, more than 5% of the companies with a foreign EU-28 majority shareholder exceed the limit of EUR 1 095 281 turnover per employee. Although Sweden and Belgium were more on the left-hand side in Figure 18, meaning that in absolute numbers many companies exceeded the set limit, Slovenia was somewhat hidden, with only around 100 companies surpassing the limit. In total in the EU-28, 1.6% of the companies with a foreign majority shareholder in the EU-28 earn a turnover of more than EUR 1 095 281 per employee.

Figure 19. Share of EU-28 companies with a foreign majority shareholder in the EU-28 that earn more than EUR 1 095 281 turnover per employee of the total number of EU-28 companies with a foreign majority shareholder in the EU-28



* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

Besides analysing the companies by Member State of incorporation, a look at the industry distribution was also useful. Table 33 shows the 10 most common NACE-codes for companies that exceeded this limit. It is no surprise that seven of these NACE-codes correspond to the top 20 NACE-codes of the total number of companies located in the EU-28 with a foreign majority shareholder located in the EU-28. The three 'new' NACE-codes that occur for companies that have a very high turnover per number of employees are NACE-code 4646 'Wholesale of pharmaceutical goods', 4675 'Wholesale of chemical products' and 4511 'Sale of cars and light motor vehicles'.

It seems likely that companies operating under certain NACE-codes might have a high turnover while only employing a limited number of people, for example holding companies, wholesale activities or electricity production. However, certain NACE-codes appear in the list that were already described Sections 3.2.1 and 3.2.2 as rather all-encompassing, meaning everything and nothing, like activities of head offices or other business support service activities.

Table 33. Top 10 NACE-codes for companies located in the EU-28 with a foreign majority shareholder in the EU-28 that have a turnover of more than EUR 1 095 281 per employee

NACE-code	Number of companies	Column percentage	Description of NACE-code
4646	368	3.4%	Wholesale of pharmaceutical goods
6420	319	2.9%	Activities of holding companies
4675	318	2.9%	Wholesale of chemical products
6820	314	2.9%	Renting and operating of own or leased real estate
4511	306	2.8%	Sale of cars and light motor vehicles
3511	237	2.2%	Production of electricity
7010	236	2.2%	Activities of head offices

8299	228	2.1%	Other business support service activities n.e.c.
4669	227	2.1%	Wholesale of other machinery and equipment
4690	218	2.0%	Non-specialised wholesale trade

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

A3.4.4.2 Pre-tax corporate profit on employees

Pre-tax corporate profit is often mentioned as an important indicator, especially for profit shifting⁶¹⁷. This profit is much higher for foreign owned than local firms. The profitability gap occurs when foreign firms shift the profits generated in higher tax countries to lower tax countries, thus partaking in so-called profit shifting⁶¹⁸.

In practice, there are three ways to do this⁶¹⁹. Firstly, companies can optimise the 'transfer prices' on intra-group transactions to achieve certain tax advantages. Secondly, intangible assets (e.g., intellectual property) and their associated income can be strategically concentrated in low-tax countries. Thirdly, the debt can be strategically located. For instance, it is more profitable to locate debt (and its interest payments) in a subsidiary in a higher tax country as the interest payments on debt can often be deducted from taxable income. This particular indicator was examined more closely in respect of loans and employment (see below). It is found that profit shifting seems to occur more with large MNEs, MNEs operating in many countries, and patenting MNEs⁶²⁰.

To measure the occurrence of profit shifting, the true profitability of a company should be determined. This is done by looking at the ratio of pre-tax profits to total assets⁶²¹. Alternatively, the ratio of pre-tax profits to employment can be used. It is important not to use a denominator like turnover, as this variable will be influenced by profit shifting and will not reflect the true economic activity of a company.

The ratio pre-tax corporate profit per number of employees was analysed. It is possible, for instance, that most of the foreign-owned companies are MNEs that simply make more profit than domestic firms while also employing more persons. Comparing this profit to the number of employees shed some light on whether this is indeed the case. Figure 20 shows that the average and median profit or loss before tax per employees are both still (strikingly) higher for foreign-owned than for domestic companies. The pre-tax profit or

⁶¹⁷ EPRS (2018). An overview of shell companies in the European Union. Available at: http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf. Accessed on 06 May 2019.

Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

McGauran, K. (2016). The impact of letterbox-type practices on labour rights and public revenue. Available at: https://www.etuc.org/sites/default/files/publication/files/ces_letterbox_compagnies_gb_juin_ok.pdf. Accessed on 06 May 2019.

⁶¹⁸ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

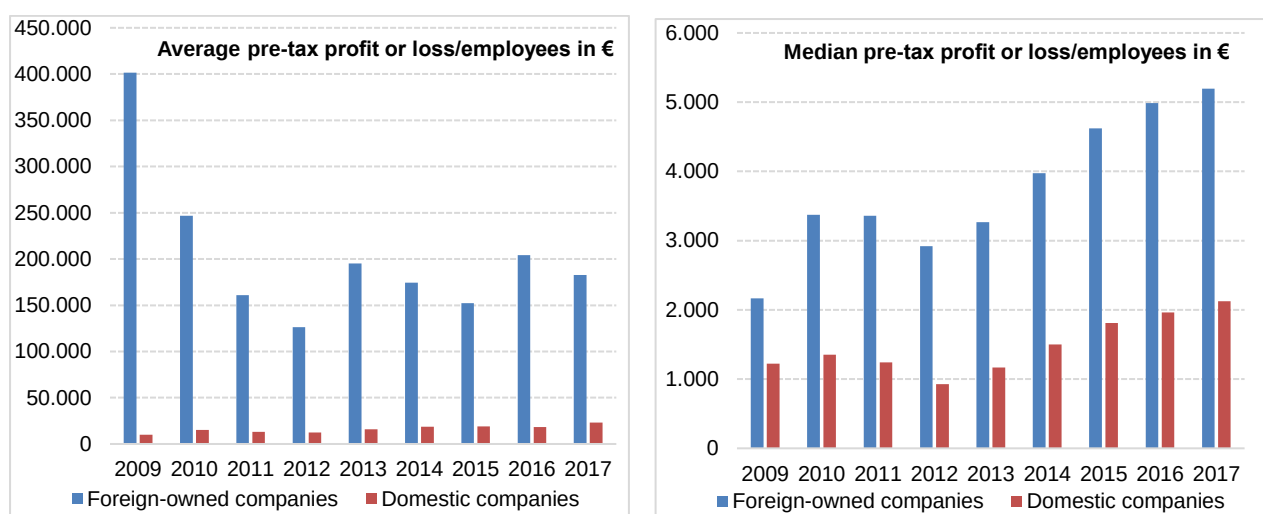
⁶¹⁹ Ibid. McGauran, K. (2016). The impact of letterbox-type practices on labour rights and public revenue. Available at: https://www.etuc.org/sites/default/files/publication/files/ces_letterbox_compagnies_gb_juin_ok.pdf. Accessed on 06 May 2019.

⁶²⁰ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

⁶²¹ Ibid.

loss on employees was on average 12 times higher for foreign-owned than domestic companies over the period 2009-2017. This is a striking difference, as it means that foreign-owned companies have a high amount of pre-tax profit, a low number of employees, or both, compared to domestic companies. Although this indicator is only 2.5 times higher for the median foreign-owned companies, the difference is still striking albeit expected, in light of the indicator of turnover on number of employees (see A3.4.4.1).

Figure 20. Average and median profit or loss before tax per number of employees for companies located in the EU-28 with a foreign majority shareholder located in the EU-28 (foreign-owned companies) and companies located in the EU-28 without a foreign majority shareholder (domestic firms), 2009-2017



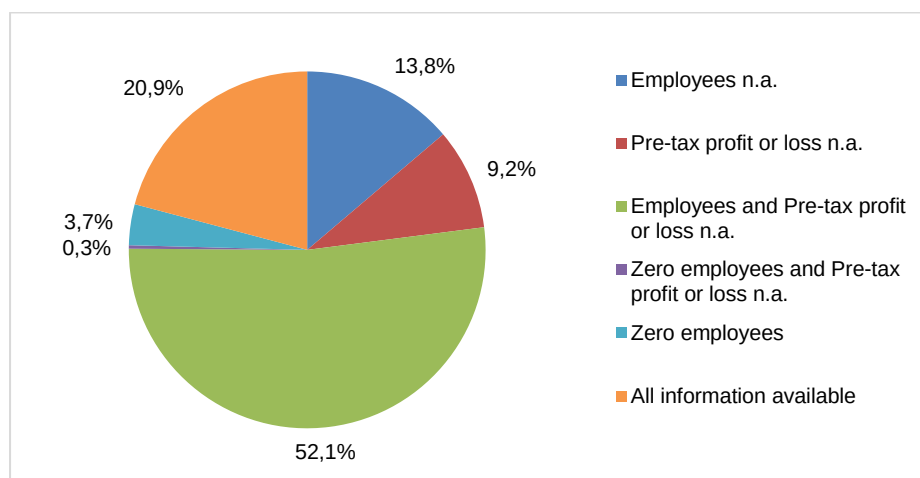
* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

In order to determine the number of companies with a red flag, the average pre-tax profit or loss on number of employees from 2016 was set as a limit, i.e., all EU-28 companies with a foreign majority shareholder located in the EU-28 exceeding this limit received a red flag.

Before developing this analysis, it is important to reiterate the issue of data availability for this indicator. Figure 21 shows that the actual analysis could only be performed on 143 691 companies, or 21% of all EU-28 companies with a foreign majority shareholder located in the EU-28. All other companies were missing data for number of employees, pre-tax corporate profit or loss, or both. Moreover, 3.7% of the companies had data available for pre-tax profit but reported zero employees.

Figure 21. Data availability for indicator pre-tax profit or loss per number of employees for companies located in the EU-28 with a foreign majority shareholder located in the EU-28



* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

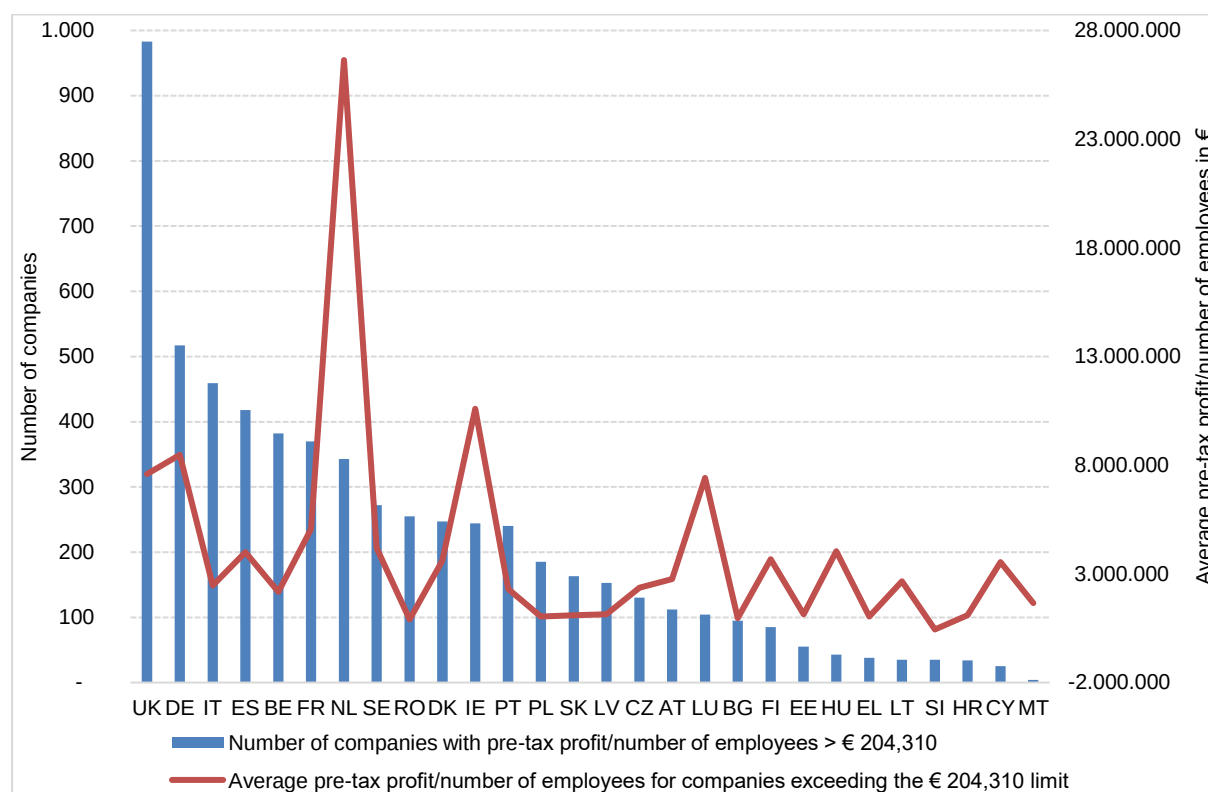
The red flag limit of pre-tax profit per number of employees was set at EUR 204 310. In total, there are 6 026 EU-28 companies with a foreign majority shareholder in the EU-28 that exceeded this limit, 4.2% of all companies for which information was available (20.9% in Figure 21). For 416 companies, the pre-tax profit per number of employees exceeded EUR 10 000 000. The top 10 companies reported over EUR 550 000 000 pre-tax profit per employee. It is notable that of these 10 companies, five are located in the Netherlands. The others are located in Ireland, the UK, France, Germany and Denmark. One company reported over EUR 1.8 billion pre-tax profit per employee.

Figure 22 shows the number of companies in each Member State that exceeded the EUR 204 310 limit, as well as the average pre-tax profit per employees for these companies. Almost 1 000 companies in the UK earned more than EUR 204 310 pre-tax profit per employee. In Germany, Italy and Spain, more than 400 companies with a foreign majority shareholder in the EU-28 exceeded this limit. However, when looking at the line in the table, the Netherlands again stands out, with an average pre-tax profit per employee for companies that exceed the EUR 204 310 limit being higher than EUR 26.6 million. This means that these companies earn, on average, EUR 26.6 million pre-tax profit per employee. This average is skewed, as there are a few companies at the top with a very high indicator. However, this is still noteworthy.

The average pre-tax profit per employee for companies exceeding the limit also surpassed EUR 7 million in Luxembourg, the UK, Germany and Ireland. These countries overlap with those where it was found that a particularly high profitability gap existed between local and foreign firms, indicating profit shifting⁶²².

⁶²² EPRS (2018). An overview of shell companies in the European Union. Available at: http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf. Accessed on 06 May 2019.

Figure 22. Number of companies with a foreign majority shareholder in the EU-28 that earn more than EUR 204 310 pre-tax profit per employee and average pre-tax profit per number of employees for these companies



* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

The NACE-code was examined to find out the industries in which companies with high pre-tax profit on number of employees are active. Table 34 shows the top 10 NACE-codes for companies with a foreign majority shareholder in the EU-28 earning over EUR 204 310 pre-tax profit per employee. 10% of the companies are active as holding companies, while certain codes reappear that were detected for foreign-owned companies with a high value for the variable turnover on number of employees (see Annex A3.4.4.1), such as activities of head offices and other business support service activities.

Table 34. Top 10 NACE-codes for companies located in the EU-28 with a foreign majority shareholder in the EU-28 that earn over EUR 204 310 pre-tax profit per employee

NACE-code	Number of companies	Column percentage	Description of NACE-codes
6420	600	10%	Activities of holding companies
7010	448	7%	Activities of head offices
6820	441	7%	Renting and operating of own or leased real estate
8299	197	3%	Other business support service activities n.e.c.
7022	178	3%	Business and other management consultancy activities

3511	177	3%	Production of electricity
6810	148	2%	Buying and selling of own real estate
6499	130	2%	Other financial service activities, except insurance and pension funding n.e.c.
4110	101	2%	Development of building projects
4646	94	2%	Wholesale of pharmaceutical goods

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

To get a more detailed view of the NACE-codes, the top 10 NACE-codes that appear for companies that exceeded the limit (Table 34) were examined for the Member States of particular interest in Figure 22 - the Netherlands, Luxembourg, the UK, Germany and Ireland. The shares pictured in Table 35 represent the occurrence of a certain NACE-code in the total number of companies with a foreign majority shareholder in the EU-28 that surpassed the limit of EUR 204 310 pre-tax profit per employee. The coloured cells represent the NACE-code that was most frequently reported in a certain Member State. Table 35 shows that in the Netherlands, for foreign-owned companies exceeding the limit, activities of holding companies are the most important. For the UK and Germany, most companies that surpassed this limit perform activities of head offices. In Luxembourg and Ireland, finally, the most common activity is 'other business support service activities'.

Table 35. Share of companies located in NL, LU, UK, DE and IE with a foreign majority shareholder located in the EU-28 that exceeded the limit of EUR 204 310 pre-tax corporate profit per employee, for the top 10 NACE-codes that appear for all foreign-owned companies located in the EU-28 exceeding this limit

	Column percentages per Member State				
NACE-code*	NL	LU	UK	DE	IE
6420	39.7%	1.0%	10.7%	11.6%	0.0%
7010	3.2%	0.0%	15.9%	19.1%	8.6%
6820	0.6%	0.0%	2.8%	4.1%	0.0%
8299	0.0%	2.9%**	10.6%	4.3%	10.7%
7022	0.6%	0.0%	0.7%	1.4%	4.1%
3511	0.6%	0.0%	3.6%	1.0%	0.0%
6810	0.3%	0.0%	1.0%	5.4%	1.2%
6499	0.6%	0.0%	3.6%	0.6%	10.2%
4110	0.0%	0.0%	1.5%	1.0%	0.0%
4646	3.2%	0.0%	1.0%	1.9%	0.4%
All NACE-codes***	100% (n = 343)	100% (n = 104)	100% (n = 983)	100% (n = 517)	100% (n = 244)

* The top 10 NACE-codes were selected based on all Member States, as pictured in Table 34. They represent the top 10 NACE-codes that occurred for companies located in the EU-28 with a foreign majority shareholder in the EU-28 that exceed the limit of € 204,310 pre-tax corporate profit per employee. For the five selected Member States, the share of companies that exceeded this limit was then given for each of these 10 NACE-codes. The grey cells indicate the NACE-code that was most common for companies located in the Member State concerned which surpassed the limit of € 204,310 pre-tax corporate profit per employee.

**Most of the companies located in Luxembourg operated under NACE 8290, which is not an official NACE-code. This refers to the three-digit code '829 Business support service activities n.e.c.' Therefore, this is the most common NACE-code for companies with a foreign majority shareholder located in the EU-28 that earn over € 204,310 pre-tax profit per employee. The total share of companies under NACE-code 829 equals 38.5% (2.9% under NACE-code 8299 and 35.6% under NACE-code 8290).

*** n stands for the total number of companies located in the mentioned Member State with a foreign majority shareholder located in the EU-28 that exceed the limit of € 204,310 pre-tax corporate profit per employee.

* Data extracted on 18 July 2019 / Source: Own elaborations based on Orbis

A3.4.4.3 Loans per employees

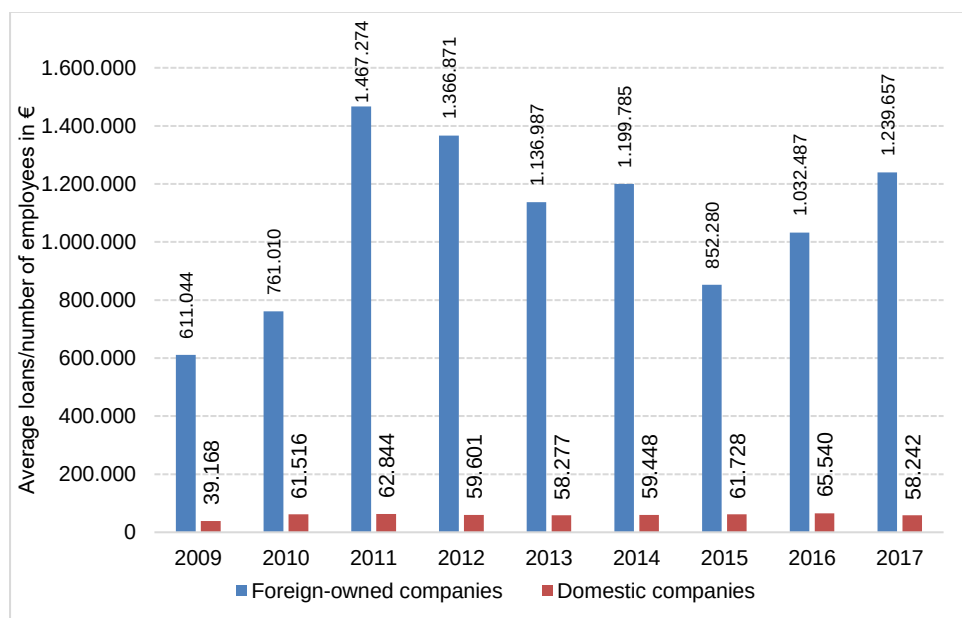
Another important indicator is the amount of loans, especially in relation to the number of employees. A study notes the occurrence of companies that report millions or even billions of loans and dividends, but do not seem to employ a single person⁶²³. This indicator is closely related to the previous one of pre-tax corporate profit, as it is used to shift profit. High loans are sometimes given to subsidiaries, as the interest paid on these loans is tax-deductible in certain Member States, giving the companies considerable tax advantages⁶²⁴.

The amount of loans on the number of employees was further analysed (see Figure 23). As expected, this average is again considerably higher for foreign-owned companies compared to domestic companies. This indicates that foreign-owned companies take on higher loans, or employ fewer people, or both.

⁶²³ Obermayer, B. (2014, December 5). Day in a Fiscal Paradise: Chasing Letterbox Leads in Luxembourg. International Consortium of Investigative Journalists. Available at: <https://www.icij.org/investigations/luxembourg-leaks/day-fiscal-paradise-chasing-letterbox-leads-luxembourg/>. Accessed on 10 July 2019.

⁶²⁴ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firm-level evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, <https://doi.org/10.1787/9ea89b4d-en>.

Figure 23. Average amount of loans per number of employees for companies located in the EU-28 with a foreign majority shareholder in the EU-28 (foreign-owned companies) and companies located in the EU-28 without a foreign majority shareholder (domestic companies), 2009–2017, EUR

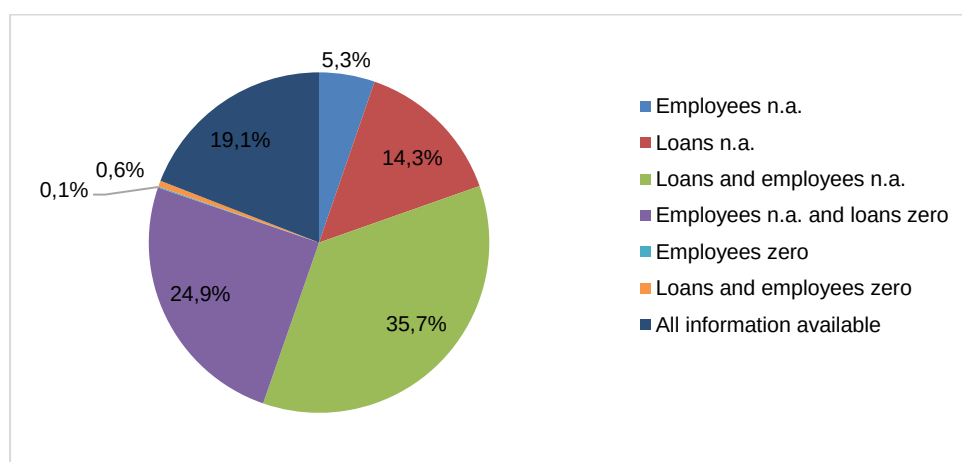


* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

In order to single out foreign-owned companies of interest, the limit of loans per employees was set at EUR 1 032 487, the average in 2016. In total, 2 281 companies exceeded this limit. However, data availability again came into play regarding this variable. Figure 24 shows the data availability for the variables in the indicator 'amount of loans per number of employees'. Approximately 80.2% of the companies located in the EU-28 with a foreign majority shareholder in the EU-28 did not have data available for the amount of loans (14.3%), the number of employees (30.2% = 5.3% + 24.9%), or both (35.7%). Furthermore, 0.7% of the companies reported having zero employees, of which 0.6% also reported EUR 0 in loans. As a result, the analysis below could only be performed on 19.1% of all foreign-owned companies and the results should be interpreted with caution.

Figure 24. Data availability for indicator 'amount of loans on number of employees' for companies located in the EU-28 with a foreign majority shareholder located in the EU-28



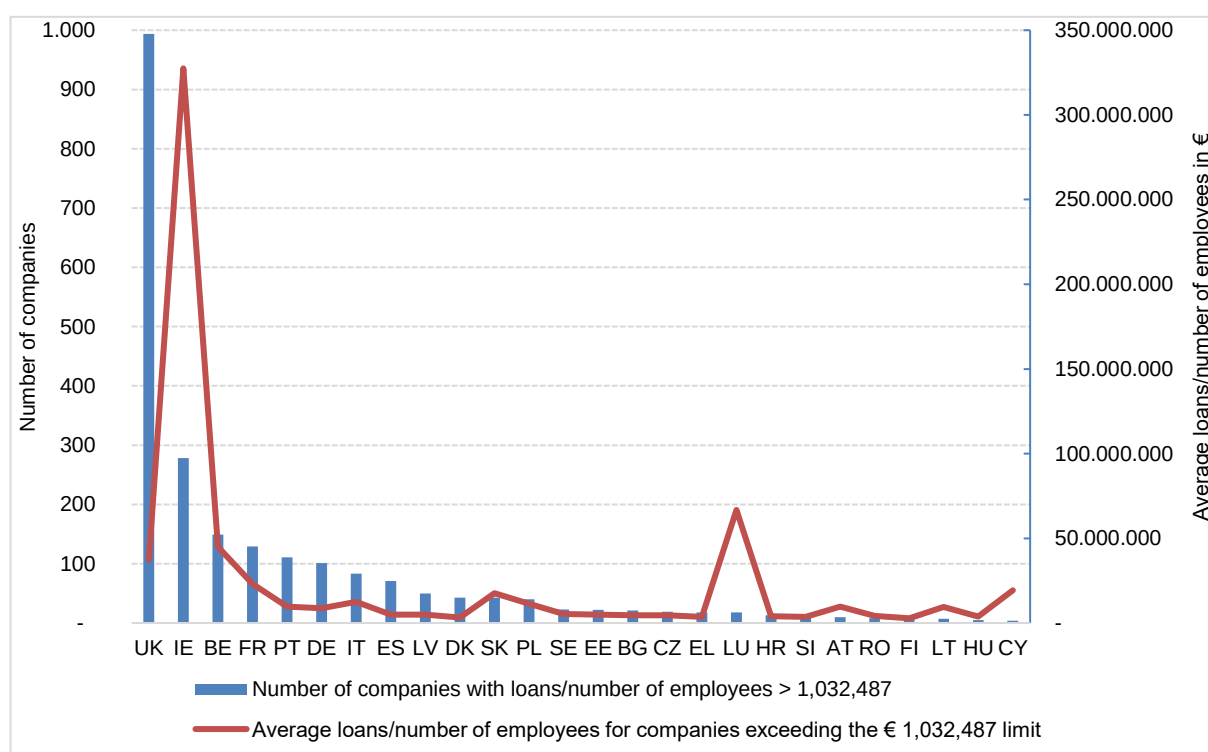
* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

Of the 2 281 companies that exceeded the limit of EUR 1 032 487 loans per number of employees, 11 reported loans of over EUR 1 billion per employee. Five of these companies were located in Ireland, three in the UK, two in Belgium and one in France. Figure 25 shows in which countries the 2 281 selected companies were located. The UK stands out, with over 994 foreign-owned companies located there, having loans over EUR 1 032 487 per employee, equivalent to almost 44% of the total number of foreign-owned companies exceeding this limit (2 281 companies). Ireland and Belgium complete the top three, as the Member States where most companies with a high indicator loans on number of employees are located.

Although in absolute numbers the UK is the undisputed number one, the average amount of loans per employee for companies with a foreign EU-28 majority shareholder located there was only around EUR 37 million for the companies that exceeded the EUR 1 032 487 limit. In Ireland, on the other hand, this average amounted to more than EUR 327 million. In Luxembourg, for foreign-owned companies with more than EUR 1 032 487 in loans per employee, the average amount of loans per employee equalled EUR 67 million. Moreover, in Belgium, France, Cyprus, Slovakia, Poland, and Italy, the average was higher than EUR 10 million.

Figure 25. Number of companies with a foreign majority shareholder in the EU-28 with more than EUR 1 032 487 in loans per employee and average amount of loans on number of employees for these companies



* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

Table 36 shows the top 10 NACE-codes that appeared for EU-28 companies with a foreign majority shareholder in the EU-28 with more than EUR 1 032 487 in loans per employee. It is striking that almost 13% of these companies operate under NACE-code 7010

'Activities of head offices', a NACE-code frequently encountered in this research. Unsurprisingly, holding companies seem to be important again, as they are mostly used for financing and do not require many employees.

Table 36. Top 10 NACE-codes for companies located in the EU-28 with a foreign majority shareholder in the EU-28 with more than EUR 1 032 487 in loans per employee

NACE-code	Number of companies	Column percentage	Description of NACE-code
7010	289	12.7%	Activities of head offices
6420	236	10.4%	Activities of holding companies
6820	151	6.6%	Rental and operating of own or leased real estate
8299	125	5.5%	Other business support service activities n.e.c.
6810	99	4.3%	Buying and selling of own real estate
3511	95	4.2%	Production of electricity
6499	74	3.2%	Other financial service activities, except insurance and pension funding n.e.c.
6491	64	2.8%	Financial leasing
4110	58	2.5%	Development of building projects
7022	56	2.5%	Business and other management consultancy activities

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

A3.4.4.4 Summary financial indicators

In order to truly capture the profile of the companies that surpassed the set limit for the financial indicators, all three indicators were combined. The companies that were examined in more detail are those located in the EU-28 with a foreign majority shareholder in the EU-28 that earned more than EUR 1 095 281 turnover per employee, more than EUR 204 310 pre-tax corporate profit per employee, and had more than EUR 1 032 487 in loans per employee. Table 37 shows that in total, 517 foreign-owned companies met these criteria. There were also companies that exceeded the limit in two of the three indicators, but not the third.

Table 37. Number of companies located in the EU-28 with a foreign majority shareholder located in the EU-28 that exceeded the limits set for turnover/employees (>EUR 1 095 281), pre-tax corporate profit/employees (>EUR 204 310) and loans/employees (>EUR 1 032 487)

Companies that exceeded the set limits* for...	Number of companies	Share of total number of companies
Turnover	10 960	1.6%
Pre-tax corporate profit	6 026	0.9%

Loans	2 281	0.3%
Turnover and pre-tax corporate profit but not loans	2 553	0.4%
Turnover and loans but not pre-tax corporate profit	411	0.1%
Pre-tax corporate profit and loans but not turnover	347	0.1%
Turnover, pre-tax corporate profit and loans	517	0.1%
Total number of companies	688 287	100.0%

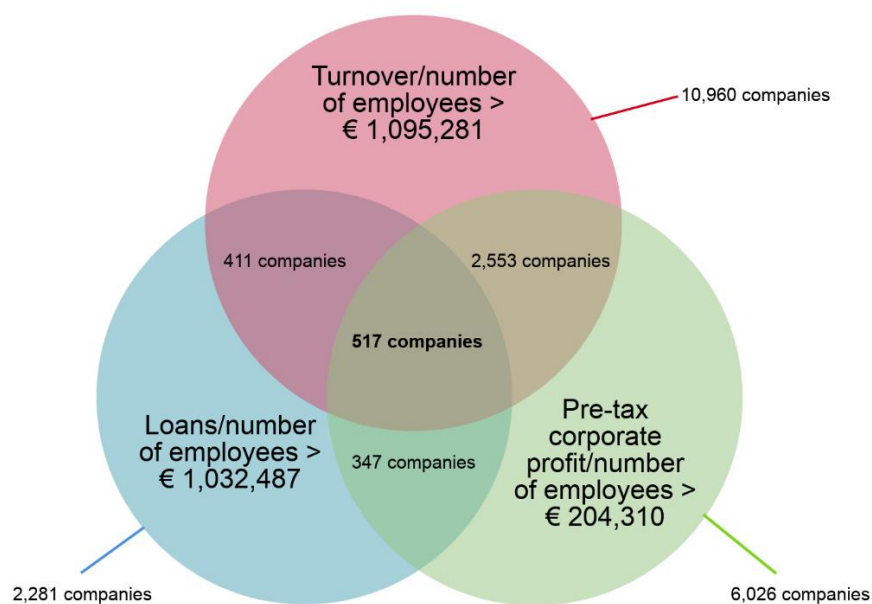
*The set limits are turnover/number of employees >EUR 1 095 281 (turnover), pre-tax corporate profit/number of employees >EUR 204 310 (pre-tax corporate profit), and loans/number of employees >EUR 1 032 487.

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

Figure 26 gives a visual representation of Table 37. The companies situated around the middle represent those that exceeded two of the three limits, while the numbers outside the figure indicate the total number of companies that exceeded the limit of the variable in the circle. It thus includes the companies that exceeded multiple indicators. For example, there were 10 960 foreign-owned companies that exceeded the limit of EUR 1 095 281 turnover per employee. 411 companies also exceeded the limit of EUR 1 032 487 loans per employee, and 2 553 exceeded the limit of EUR 204 310 pre-tax corporate profit per employee, while 517 companies exceeded all three limits. As a result, it can be deduced that only 7 479 companies of the 10 960 companies that exceeded the turnover limit exceeded this limit (10 960 - 411 - 2 553 - 517).

Figure 26. Number of companies located in the EU-28 with a foreign majority shareholder located in the EU-28 that exceeded the three limits set for turnover, pre-tax corporate profit and loans

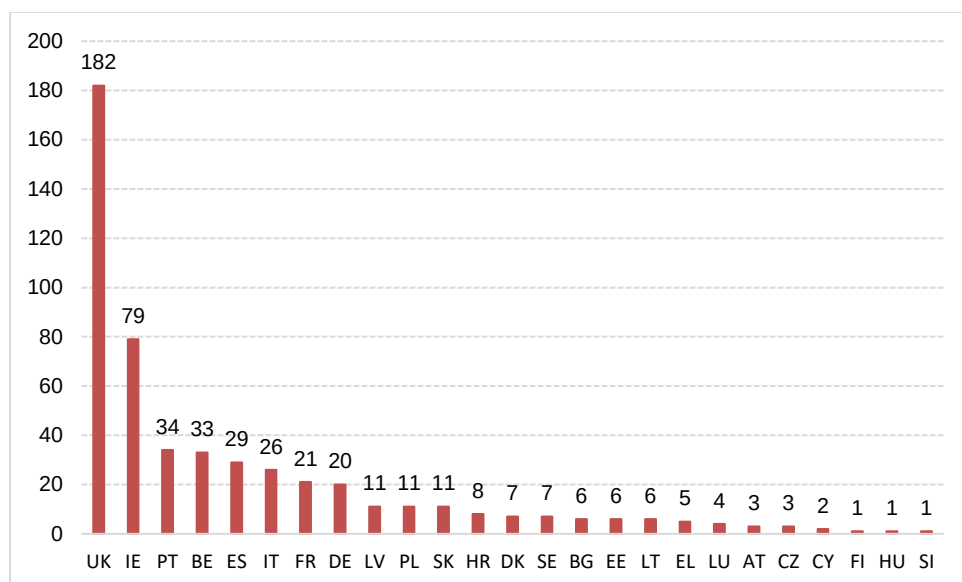


* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

The characteristics of the 517 foreign-owned companies mentioned in Table 37 and in the middle of Figure 26 were analysed further, as they exceeded all three limits of the financial variables. Figure 27 shows the location of these companies. The UK stands out, with 182 foreign-owned companies exceeding the limit of the three indicators located there. A high volume of companies is also located in Ireland (79), Portugal (34) and Belgium (33).

Figure 27. Location of companies with a foreign majority shareholder located in the EU-28 that have turnover/number of employees >EUR 1 095 281, pre-tax corporate profit/number of employees >EUR 204 310 and loans/number of employees >EUR 1 032 487



* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

In addition to the location of these companies, their activities could also be examined further. Table 38 gives an overview of the 10 NACE-codes that were most common among foreign-owned companies that surpassed the set limits on turnover per employees, pre-tax corporate profit on employees, and loans on employees.

Table 38. Top 10 NACE-codes of companies located in the EU-28 with a foreign majority shareholder located in the EU-28 that exceeded the limits set for turnover/employees (>EUR 1 095 281), pre-tax corporate profit/employees (>EUR 204 310) and loans/employees (>EUR 1 032 487)

NACE-code	Number of companies	Column percentage	Description of NACE-code
6820	48	9.3%	Renting and operating of own or leased real estate
3511	46	8.9%	Production of electricity
7010	36	7.0%	Activities of head offices
6499	28	5.4%	Other financial service activities, except insurance and pension funding n.e.c.
8299	28	5.4%	Other business support service activities n.e.c.
6420	26	5.0%	Activities of holding companies
6810	22	4.3%	Buying and selling of own real estate
4110	17	3.3%	Development of building projects

6491	13	2.5%	Financial leasing
6832	9	1.7%	Management of real estate on a fee or contract basis

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

The analysis above gives a good indication of the profile of the companies that exceeded the limit for the financial variables. However, these financial variables only highlight one facet of a company. Many more indicators should be analysed in order to grasp the complete profile of a company. Nor is it possible to state that these 517 companies are letterbox companies simply because they exceeded the limit for the financial variables.

A3.4.5 Data availability and the filing of annual accounts

Looking at the years with available accounts and the latest year for which annual accounts are available, a comparison was made between foreign-owned companies and domestic companies in the EU-28, as shown in Table 39.

Accounts were available in the years 2010 to 2016 for less than one-quarter of both groups. Instead of looking at the availability of annual accounts in each of these years, one specific year can be singled out. In literature, a two-year time lag was reported for the Orbis database, although this differs substantially between Member States⁶²⁵. For instance, in Belgium, when a new company is established it can be present in the Orbis database after a few days or weeks. Therefore, in principle, Orbis should contain all available data from 2016. However, as can be seen in Table 39, only 52.8% of foreign-owned and 38% of domestic companies have an annual account available for 2016.

The variable 'latest year of accounts' was also analysed. For 4.1% of foreign-owned and 5.3% of domestic companies, the annual accounts filed for 2016 are the latest available. Looking back in time, this percentage falls, but it is nevertheless notable that for 3 056 foreign-owned companies and 208 872 domestic companies, the annual accounts of 2010 are the latest available.

Overall, Table 39 shows that it is not only foreign-owned companies that do not file their annual accounts. Even domestic firms have limited information available in terms of annual accounts, as the share of companies with an available account from 2010-2016 or in 2016 alone is lower for domestic companies than for foreign-owned companies. These percentages are striking, particularly as only active companies were selected. However, there is different legislation across the Member States, with some not requiring certain types of companies to submit annual accounts.

Table 39. Share of companies with accounts available, for companies located in the EU-28 with a foreign majority shareholder located in the EU-28 (foreign-owned companies) and companies located in the EU-28 without a foreign majority shareholder (domestic companies)

	Foreign-owned companies	Domestic companies
Total number of companies	100% (n = 688 278)	100% (n = 25 112 510)

⁶²⁵ Kalemli-Ozcan, S., Sorensen, B., Villegas-Sanchez, C., Volosovych, V., and Yesiltas, S. (2015). How to construct nationally representative firm level data from the Orbis global database, NBER Working Paper series. Available at: <https://www.nber.org/papers/w21558.pdf>. Accessed on 28 June 2019.

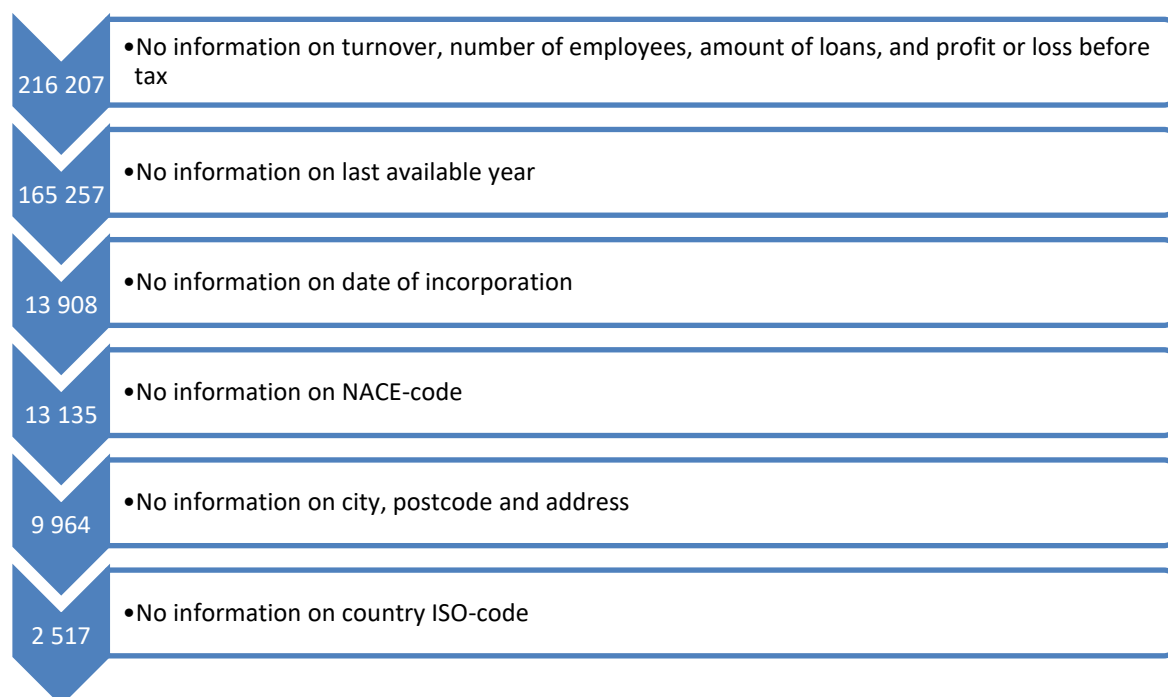
Years with available accounts		
Accounts available in 2010, 2011, 2012, 2013, 2014, 2015 and 2016	24.6% (n = 169 263)	16.2% (n = 4 057 446)
Accounts available in 2016	52.8% (n = 363 125)	38.0% (n = 9 531 704)
Latest year of accounts		
Last year of accounts 2016	4.1% (n = 28 390)	5.3% (n = 1 339 451)
Last year of accounts 2015	2.0% (n = 13 455)	2.2% (n = 542 011)
Last year of accounts 2014	1.3% (n = 8 887)	1.4% (n = 340 148)
Last year of accounts 2013	0.7% (n = 5 100)	1.3% (n = 332 181)
Last year of accounts 2012	1.1% (n = 7 806)	0.9% (n = 233 594)
Last year of accounts 2011	0.7% (n = 5 005)	0.9% (n = 216 216)
Last year of accounts 2010	0.4% (n = 3 056)	0.8% (n = 208 872)

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

When assessing the availability of information in the annual accounts, it is possible to look at combinations of variables. Undoubtedly, the worst is where a company provides no information other than its name. For EU-28 companies with a foreign majority shareholder in the EU-28, this was the case for 2 517 companies, or 0.37% of the total number of companies. Depending on the variable(s) that were used initially in the analysis, many different combinations are possible. Figure 28 illustrates how a group of companies with missing values can be defined. The number of companies with no information on turnover, number of employees, amount of loans, or profit/loss before tax was calculated and found to be 216 207. Of these, 165 257 did not have a value for the variable last available year of the annual accounts. Going further, 13 908 out of these 165 257 companies did not have a value for the date of incorporation, and so on. At the bottom of the figure are the 2 517 companies that do not have any information available save their name.

Figure 28. Number of EU-28 companies with a foreign majority shareholder in the EU-28 with missing values for consecutive variables



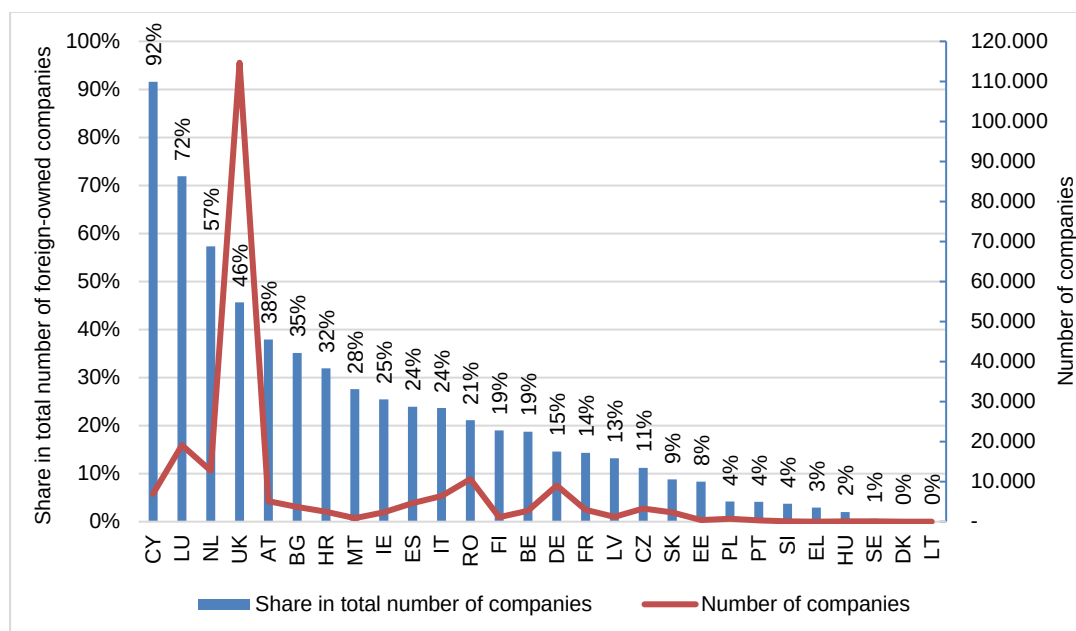
* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

The 216 207 companies that do not have any financial value available (meaning turnover, profit or loss before tax, loans and number of employees), were analysed more closely. Figure 29 illustrates the absolute number of such companies in each Member State, as well as the relative share of these companies with missing information of the total number of companies with a foreign majority shareholder in the EU-28. In Cyprus, Luxembourg and the Netherlands, particularly, many companies with a foreign majority shareholder located in the EU-28 did not have information available on turnover, employees, loans, and pre-tax profit or loss, as more than 50% of the total number of foreign-owned companies did not provide this information. In the UK, Austria, Bulgaria and Croatia, more than 30% of the companies with a foreign majority shareholder in the EU-28 did not have this information available.

When looking at the line in the graph (which should be read following the right axis), the UK is again an outlier. In absolute numbers, more than 114 000 companies located in the UK with a foreign majority shareholder located in the EU-28 did not provide information on the selected financial variables. In Luxembourg, the Netherlands and Romania, more than 10 000 companies with a foreign majority shareholder in the EU-28 did not provide this information.

Figure 29. Number and share of companies with a foreign majority shareholder located in the EU-28 that do not have a value available for turnover, number of employees, amount of loans and profit or loss before tax of total number of companies with a foreign majority shareholder in the EU-28



* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

It is also worth having a closer look at the sectors of activity of the 216 207 companies with a foreign majority shareholder in the EU-28 that did not provide any information on turnover, employees, loans and pre-tax profit or loss. Table 40 shows the top 10 NACE-codes for these companies. As expected, more than 17% of these companies did not have a NACE-code available. Almost 13 000 of the 216 207 companies that do not have information available on these financial variables are active in the transport sector. Certain activities reappear once more, such as holding companies and other business support service activities.

Table 40. Top 10 most common NACE-codes for EU-28 companies with a foreign majority shareholder located in the EU-28 that did not provide information on turnover, number of employees, amount of loans and profit or loss before tax

NACE-code	Number of companies	Column percentage	Description of NACE-code
n.a.	37 850	17.5%	
4941	12 981	6.0%	Freight transport by road
6420	9 370	4.3%	Activities of holding companies
8299	8 329	3.9%	Other business support service activities n.e.c.
4120	7 768	3.6%	Construction of residential and non-residential buildings
7022	7 617	3.5%	Business and other management consultancy activities

Letterbox companies: overview of the phenomenon and existing measures

9609	5 467	2.5%	Other personal service activities n.e.c.
5610	4 076	1.9%	Restaurants and mobile food service activities
6810	3 950	1.8%	Buying and selling of own real estate
6202	3 902	1.8%	Computer consultancy activities
Total	216 207	100.0%	

* Data extracted on 18 July 2019

Source: Own elaborations based on Orbis

Annex 4 Case study on freight transport by road

This case study focuses on the use of letterbox companies in the transport sector - more specifically, companies active under the NACE-code 4941 'Freight transport by road'. This was the second most frequently used NACE-code by companies located in the EU-28 with a foreign majority shareholder located in the EU-28⁶²⁶ (see Table 6). Companies with a foreign shareholder were significantly more active in this sector than those without a foreign shareholder (see Table 7). A high share of companies that did not have information available on financial variables in their annual accounts were active under NACE 4941 (see Section 3.2.3). The transport sector has also been examined in other relevant research regarding the occurrence of letterbox companies⁶²⁷.

A general overview of companies in the EU-28 active in the field of road transport is obtained from two data sources. Firstly, the types of transport and the evolution of the sector is analysed in detail using data from Eurostat. Secondly, the Orbis database is used to provide an overview and profile of the companies active under NACE-code 4941 'Freight transport by road'. Closer attention is paid to companies with a foreign shareholder. Both the definition and occurrence of letterbox companies in the transport sector are discussed in general.

The case study then looks more closely at Bulgaria and Slovakia. In Slovakia, around 15% of all companies have a foreign majority shareholder, placing it third after Luxembourg (26.6%) and Malta (22.3%) (see Figure 5). Research shows that many companies are located at the same address in Slovakia, specifically in the transport sector (see Section 3.2.3 and Annex A3.4.3). These elements can be seen as red flags for letterbox companies, making Slovakia a relevant Member State to investigate. The Belgian transport trade union has created a 'black book' on social dumping practices and letterbox companies in Slovakia specifically, as it is often used for these kinds of practices⁶²⁸.

Bulgaria is important in looking at periphery countries for letterbox companies as almost 42% of the Bulgarian companies in the freight transport sector with a foreign majority shareholder have that shareholder located outside of the EU-28. In addition, the Bulgarian country report for this study noted that around 1 900 letterbox companies were identified in the transport sector.

⁶²⁶ 4.7% of all companies with a foreign majority shareholder in the EU-28 had this NACE-code. The most common NACE-code was 8299 'Other business support service activities n.e.c.' (4.7% of all companies) (data extracted on 14 October 2019).

⁶²⁷ McGauran, K. (2016). The impact of letterbox-type practices on labour rights and public revenue. Available at: https://www.etuc.org/sites/default/files/publication/files/ces_letterbox_compagnies_gb_juin_ok.pdf. Accessed on 06 May 2019.

Belgische Transport Bond (2017). The road to Slovakia – Social dumping: this is how it works. Available at: https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek-2017-ENG-DIGITAAL.pdf. Accessed on 4 July 2019.

Belgische Transport Bond (2019). The road to Slovakia is still busy. The ABC of social dumping and how nothing has changed... The BTB continues to investigate. Retrieved from https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek_2019_EN_WEB.pdf

De Wispelaere, F. and Pacolet, J. (2018) Economic analysis of the road freight transport sector in Belgium within a European context: Employees and employers in 'survival mode'? Report, HIVA-KU Leuven. Available at: <https://hiva.kuleuven.be/nl/nieuws/docs/hiva%20report%20economic%20analysis%20of%20the%20road%20freight.pdf>. Accessed on 23 May 2019.

Borkowski, P. and Bąk, M. (2018). Short and Long-Term Consequences of Further Regulation of the European Union Road Haulage Market. *Journal of Management and Financial Sciences*, 11 (33), pp. 9-23.

⁶²⁸ Belgische Transport Bond (2017). The road to Slovakia – Social dumping: this is how it works. Available at: https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek-2017-ENG-DIGITAAL.pdf. Accessed on 4 July 2019.

For both Member States, several factors that facilitate letterbox companies are discussed, including wages and labour taxes, ease of setting up a company, different interpretations of the concepts of 'habitual place of work' and 'place of business', and the lack of enforcement. The prevalence of letterbox companies in Bulgaria and Slovakia is then analysed based on several indicators, such as address, ownership structure, and financial situation.

A4.1 Overview of freight transport by road in the EU-28

A4.1.1 Evolution of the sector

In 2016, some 76.2% of all freight transport in the EU-28 took place over roads⁶²⁹. In Bulgaria, the road freight transport represents 55.7% of all freight transport, with the share at 61.7% in Slovakia. Some 575 000 companies provided road haulage services in 2016, representing a turnover of around EUR 330 billion⁶³⁰. The road transport sector is a major employer in the EU, employing more than 3.15 million persons in 2016. Most of the companies are located in Spain (more than 105 000 or 18% of the total number of companies), Poland (85 838 companies, 15% of total) and Italy (64 016, 11% of total). However, in terms of employment, the sector employs most people in Germany (413 817 people or 13% of the total number of persons employed), Poland (355 330, 11% of total) and France (344 982, 11% of total). In Bulgaria, around 12 700 companies were active in road transport in 2016, or 2.2% of the total number of road transport companies in the EU-28. In Slovakia, this number was 9 266, or 1.6% of the total companies in the EU-28. Bulgarian road haulage companies employed around 68 544 people in 2016 (2.2% of the total number of persons employed in the EU-28) and Slovakian road haulage companies 45 327 people (1.4% in total).

Figure 30 provides a general overview of the freight transport sector from 2009 to 2017. From 2012 onwards, continuous growth can be seen in the total road freight transport activity in the EU-28. In 2017, around 64% of all such activity was national transport and the remaining 34% was international transport. In 2017, the road freight transport activity in the EU-28 amounted to 1 921 billion tonne-km (Figure 30). In Bulgaria and Slovakia, the transport sector amounted to around 35 000 million tonne-km each⁶³¹. The share of international transport in total road freight transport amounted to 76% in Bulgaria and 82% in Slovakia.

Figure 30 shows that 2012 was a key turning point, after which more international transport operations (in terms of tonne-km) was provided by EU-13 hauliers than EU-15 hauliers. In 2017, 63% of the total international transport was provided by EU-13 hauliers, and only 37% by EU-15 hauliers. This is a remarkable change compared to 2009, for example, when 55% of international transport was still provided by EU-15 hauliers and 45% by EU-13 hauliers.

The upsurge in companies flagging out is also evident. 'Flagging out' is an important cost reduction strategy, and perhaps even a survival strategy for road freight transport companies. It enables companies to profit from lower standards and thus from lower costs in a labour-intensive and price-sensitive sector⁶³². In this regard, Western European

⁶²⁹ See Eurostat [tran_hv_frmod].

⁶³⁰ See Eurostat [sbs_na_1a_se_r2].

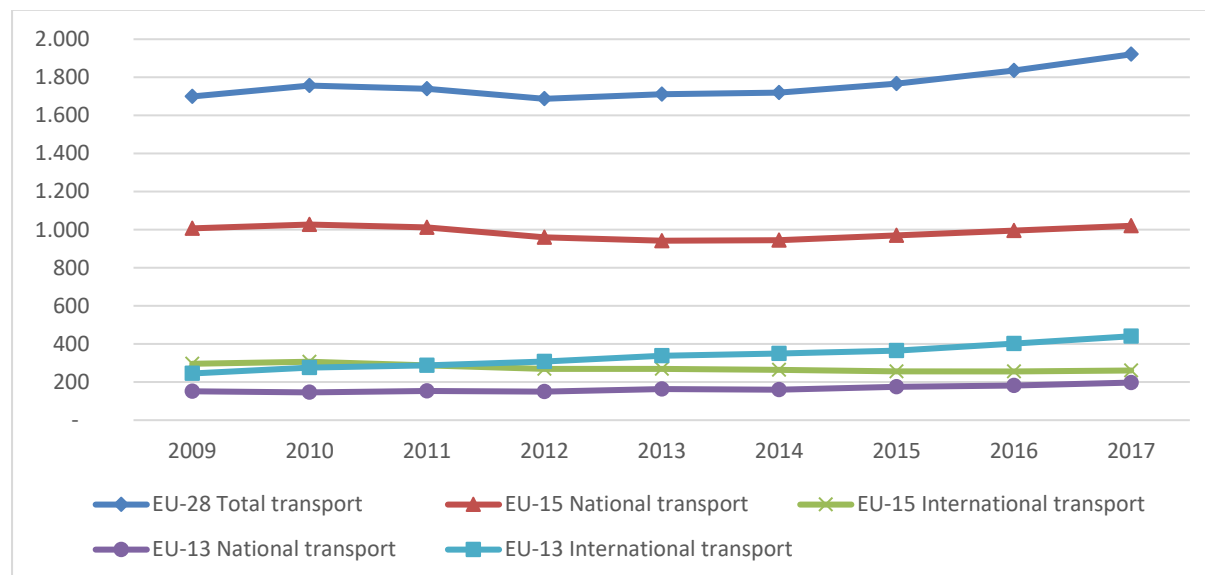
⁶³¹ See Eurostat [road_go_ta_tot].

⁶³² Kummer, S., Dieplinger, M. and Fürst, E. (2014). Flagging out in road freight transport: a strategy to reduce corporate costs in a competitive environment. Results from a longitudinal study in Austria. *Journal of Transport Geography*, 36, pp. 141-150.

Yannopoulos, G. N. (1988). The Economics of "Flagging Out". *Journal of Transport Economics and Policy*, 22 (2), pp. 197-207.

transport companies might have taken advantage of the EU enlargement to found a subsidiary in a new Member State⁶³³.

Figure 30. Annual road freight transport by type of transport, in billion tonne-km, EU-15 vs EU-13, 2009-2017



Source Eurostat [road_go_ta_tott]

It is possible to make a distinction between different types of international transport. More specifically, breakdowns in goods loaded in the reporting country, goods unloaded in the reporting country, cross-trade and cabotage (i.e., national transport undertaken by hauliers from another Member State).

In general, in the EU-28, the transport sector grew around 13% between 2009 and 2017 (Table 41). However, the magnitude of the growth differs considerably between the types of transport as well as between EU-13 and EU-15 Member States. Whereas national transport only increased by 5%, cabotage increased by 158%. The growth in the transport sector is clearly situated in the EU-13 Member States, as it grew by 61% in these Member States and decreased by 2% in the EU-15 Member States. In the EU-13 Member States, the growth was mainly concentrated in the cabotage and cross-trade sectors.

The final two columns in Table 41 show the evolution for Bulgaria and Slovakia from 2008 to 2016. Freight transport by road has grown considerably in Bulgaria, at over 130%. The growth in both Member States is chiefly due to the growth in international transport, which more than doubled in Bulgaria and increased by one-third in Slovakia. The growth in cabotage is also notable, growing by over 1 700% in Bulgaria and over 440% in Slovakia.

Table 41. Evolution of national and international freight transport by road, in tonne-km, EU-28, EU-15 and EU-13 2009-2017, and Bulgaria and Slovakia 2008-2016

	EU-28	EU-15	EU-13	BG	SK
Total transport	13%	-2%	61%	131%	23%
National transport	5%	1%	30%	3%	-10%
International transport	30%	-12%	80%	243%	33%

⁶³³ The road freight transport sector followed the example of the maritime and aviation sectors (Jorens et al., 2015).

* goods loaded in reporting country	12%	-12%	51%	59%	19%
* goods unloaded in reporting country	14%	-13%	55%	162%	14%
* cross-trade	72%	-12%	105%	524%	42%
* cabotage	158%	5%	529%	1,780%	448%

* For the EU-28, EU-15 and EU-13 the evolution from 2009 to 2017 is shown. For Bulgaria (BG) and Slovakia (SK), the evolution from 2008 to 2016 is reported, as data for 2009 and 2017 was incomplete. However, the periods have the same length and only differ by one year.

Source Eurostat [road_go_ta_tott]

A4.1.2 Road haulage companies with a foreign majority shareholder

Before examining the possible occurrence of letterbox companies in freight transport by road, an overall view of the sector is provided by Orbis, using the same working method as for the quantification of letterbox companies (see Section 3.2)⁶³⁴. Table 42 provides an overview of the road transport sector in the EU-28, according to which around 361 000 companies were active in this sector in 2019. However, when analysing this data, it is important to keep in mind differences in figures available from Eurostat and Orbis; Box 7 below describes the main differences between Orbis and Eurostat, in terms of both their scope and method used.

Box 7. Comparison of Orbis and Eurostat data

In both the Orbis database and the Structural Business Statistics of Eurostat it is possible to retrieve the number of companies active under NACE-code 4941 'Freight transport by road'. However, as can be seen in Table 7 below, the absolute numbers differ quite significantly. While Orbis points to a total of 361 253 road transport companies in the EU-28, Eurostat finds 587 325. Moreover, the relative share of the countries also differs. The most remarkable differences occur for Spain, Poland, Romania and the United Kingdom. In the Orbis database, 13.8% of all EU-28 road transport companies were located in Romania and 19.8% in the United Kingdom, while according to Eurostat, these shares only amount to 5.4% and 8.5% respectively. The opposite is also true for Spain and Poland, whose shares are higher in the Eurostat data (ES: 17.2%; PL: 17.0%) than in the Orbis one (ES: 10.5%; PL: 4.9%).

A possible reason could be the entities that are included in each dataset. In Eurostat, it concerns the number of enterprises, which according to its definition⁶³⁵ also includes sole traders for instance. In the Orbis database on the other hand, e.g. sole traders and branches were excluded⁶³⁶. Furthermore, the Orbis data used covers all companies

⁶³⁴ This means that only active companies were taken into account with the discussed standard legal forms (public limited companies, private limited companies, partnerships, non-profit organisations, foreign companies, and other legal forms (see Table 19 in Annex A3.1.1)). Shareholder here always means the majority shareholder, namely the ultimate owner of the company that owns a direct or total participation greater than 51% of the company. This case study only takes into account companies active under the NACE-code 4941 'Freight transport by road'.

⁶³⁵ An enterprise is an organisational unit producing goods or services which has a certain degree of autonomy in decision-making. An enterprise can carry out more than one economic activity and it can be situated at more than one location. An enterprise may consist out of one or more legal units. Legal units include legal persons whose existence is recognised by law independently of the individuals or institutions which may own them or are members of them, such as general partnerships, private limited partnerships, limited liability companies, incorporated companies etc. Legal units as well include natural persons who are engaged in an economic activity in their own right, such as the owner and operator of a shop or a garage, a lawyer or a self-employed handicraftsman.' (Eurostat (n.d.). Glossary: Enterprise. Retrieved from <https://ec.europa.eu/eurostat/statisticsexplained/index.php?title=Glossary:Enterprise>).

⁶³⁶ See Table 19 in A3.1.1.

incorporated until the date of data extraction (here October 2019), while the Eurostat data encompasses the number of companies as from 2018.

Finally, the most important explanation for the difference in numbers and relative shares is to be found in the data methodology. Data for Eurostat's *Structural Business Statistics* are generally collected by the National Statistical Institutes among enterprises, through statistical surveys, business registers or administrative sources⁶³⁷. An advantage of the Structural Business Statistics is the detail available, at European level in particular. Since the data collection exercise is regulated by EU legislation, data is standardised and easily comparable among Member States. As to *Orbis* database, it is not an administrative dataset⁶³⁸. Firms included in Orbis only represent a fraction of the entire firm population, and the firms included in the database are on average larger, older and more productive⁶³⁹. Furthermore, data is also missing for certain variables in several countries, primarily because of differences in accounting rules and requirements regarding the provision of information from a country to another. Additionally, data is collected from different sources across countries, such as chambers of commerce, local public authorities, and credit institutions⁶⁴⁰. As a result, the availability of information might differ between countries and sectors⁶⁴¹. As a result, not all companies active in the EU-28 are represented in the Orbis database, and the difference in sources used by Member States may lead to different interpretations.

It is therefore important to keep this difference in the methodologies used when comparing data from different sources.

Table 7 Number of companies active under NACE-code 4941 'Freight transport by road', 2019 for Orbis data, 2018 for Eurostat data

	Orbis*	Row % Orbis	Eurostat**	Row % Eurostat
Belgium	7,670	2.1%	7,958	1.4%
Bulgaria	17,985	5.0%	13,553	2.3%
Czechia	8,262	2.3%	31,668	5.4%
Denmark	2,592	0.7%	4,680	0.8%
Germany	9,154	2.5%	35,605	6.1%
Estonia	4,538	1.3%	3,175	0.5%
Ireland	1,336	0.4%	4,661	0.8%
Greece	394	0.1%	16,371	2.8%
Spain	37,889	10.5%	101,145	17.2%
France	30,606	8.5%	30,753	5.2%
Croatia	2,893	0.8%	5,430	0.9%

⁶³⁷ Eurostat (n.d.). Structural business statistics (sbs). Retrieved from https://ec.europa.eu/eurostat/cache/metadata/en/sbs_esms.htm

⁶³⁸ European Commission (2017). Aggressive tax planning indicators. Final Report. Working paper N0 71 – 2017. Retrieved from https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp_.pdf
Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firmlevel evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355. OECD Publishing: Paris. <https://doi.org/10.1787/9ea89b4d-en>

⁶³⁹ Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C., & Timmis, J. (2020). Coverage and representativeness of Orbis data. OECD Science, Technology and Industry Working Papers 2020/06. <https://doi.org/10.1787/18151965>

⁶⁴⁰ Johansson, A., Bieltvedt Skeie, O., Sorbe, S., and Menon, C. (2017). Tax planning by multinational firms: firmlevel evidence from a cross-country database. OECD Economics Department Working Papers, No. 1355. OECD Publishing: Paris. <https://doi.org/10.1787/9ea89b4d-en>

⁶⁴¹ Ahmad, S., Oliver, S., & Peters, C. (2018). Using firm-level data to compare productivities across countries and sectors: possibilities and challenges. Office of Economics Working Paper 2018-07-A. Retrieved from https://www.usitc.gov/publications/332/working_papers/final_draft_ahmad_oliver_peters_20180727.pdf

Tørsløv, T. R., Wier, L. S., & Zucman, G. (2018). The missing profits of nations. NBER Working Paper, 24701. doi: 10.3386/w24701

Italy	25,229	7.0%	61,576	10.5%
Cyprus	463	0.1%	783	0.1%
Latvia	3,893	1.1%	3,130	0.5%
Lithuania	6,647	1.8%	6,066	1.0%
Luxembourg	661	0.2%	394	0.1%
Hungary	8,449	2.3%	14,438	2.5%
Malta	24	0.0%	306***	0.1%
Netherlands	8,332	2.3%	12,144	2.1%
Austria	5,138	1.4%	6,152	1.0%
Poland	17,532	4.9%	99,974	17.0%
Portugal	10,029	2.8%	7,696	1.3%
Romania	49,845	13.8%	31,574	5.4%
Slovenia	3,141	0.9%	5,648	1.0%
Slovakia	8,485	2.3%	10,255	1.7%
Finland	8,471	2.3%	8,722	1.5%
Sweden	10,044	2.8%	13,551	2.3%
United Kingdom	71,551	19.8%	49,917	8.5%
EU-28	361,253	100.0%	587,325	100.0%

* The Orbis data concern all active companies active under NACE 4941, located in the EU-28, incorporated until October 2019, with all standardized legal forms, excluding sole traders/proprietorships, public authorities, and branches.

** The Eurostat data concern all companies active under NACE 4941, located in the EU-28, in 2018.

*** For Malta, the number of road transport companies found in Eurostat data concerns the year 2015 as this was the latest available data.

Source Own elaborations based on Orbis [Data extracted on 24 October 2019] and Eurostat [sbs_na_1a_se_r2]

Of all companies active in this sector, a high share was located in the UK, Romania, Spain, France and Italy.

Focusing only on the Orbis database, it was possible to see whether or not the road transport companies in the Orbis database had a foreign majority shareholder. It is estimated that around 40 936 companies in the EU-28 in the road transport sector had a foreign majority shareholder. Approximately 7% were in Slovakia, 5% in Romania, and 4% in Estonia (see column 7 of Table 42). It appears that the highest percentage of the EU-28 companies in the road transport sector with a foreign majority shareholder was in the UK, but this result should be treated with caution given the substantial differences in numbers between Orbis and Eurostat databases, as explained above in the box. It is interesting to compare the third and seventh columns of Table 42, namely the column percentage of the total number of road transport companies and the column percentage of the number of companies with a foreign shareholder. This shows an overrepresentation of the UK in companies with a foreign majority shareholder. A similar observation can be made for Slovakia, but to a lesser extent: around 2.3% of the companies in the freight transport sector were located in Slovakia, while 6.6% of the transport companies with a foreign shareholder are located here. This comparison can already be seen as a first risk indicator for the presence of letterbox companies.

For each Member State, the share of companies with a foreign shareholder of the total number of companies was estimated (column 8 (column C/A)). On average, 11.3%⁶⁴² of the EU-28 road transport companies had a foreign shareholder. However, it is clear that there are some outliers. In the UK and Luxembourg, more than 40% of the road transport companies had a foreign shareholder, as do a high share of companies in Estonia and Slovakia. On the other hand, in Lithuania, Sweden, Spain, France, Hungary and Greece, less than 1% of the companies active under NACE-code 4941 had a foreign shareholder.

The location of the foreign shareholder was then analysed, with a breakdown between foreign shareholder in the EU-28 (divided between EU-15 and EU-13) and outside the EU-28. Naturally, this breakdown could only be provided for companies with a foreign

⁶⁴² This average is strongly influenced by the UK, where almost 75% of companies with a foreign shareholder are located. The unweighted average amounts to 8.8% of road transport companies in the EU-28 with a foreign majority shareholder. When disregarding the UK, the share amounts to 3.6% of EU-27 transport companies with a foreign majority shareholder.

shareholder whose location is known. Therefore, the sum of this breakdown between intra- and extra-EU (column D and F respectively) will be equal to the number of companies with a foreign shareholder, excluding those whose location is unknown (column B).

In total, 31 561 of the road haulage companies with a foreign majority shareholder had a shareholder located in the EU-28 (column D), whereas the remaining 3 690 had a shareholder located outside of the EU-28 (column F). On average 89.5%⁶⁴³ of the EU companies with a foreign majority shareholder had a shareholder located in the EU-28. Only 10.5% of the foreign-owned companies in the road transport sector had a foreign shareholder located outside of the EU-28. Nevertheless, when analysing the EU-27, 26.6% of the EU-27 transport companies with a foreign shareholder had a shareholder located outside the EU-28. Only in two Member States do more than half of the road haulage companies with a foreign majority shareholder had a shareholder located outside the EU-28, namely Latvia and Italy. Additionally, more than 40% of the foreign-owned road transport companies in Slovenia, Belgium, Croatia, Bulgaria and Estonia were owned by shareholders outside of the EU-28.

Table 42 provides a breakdown for road transport companies with a foreign shareholder located in the EU-28 between shareholders located in the EU-15 and shareholders located in the EU-13. In total, 25 482 of the 31 561 companies with a foreign shareholder in the EU-28 had a shareholder located in the EU-13, or 80.7%⁶⁴⁴. On the one hand, more than 50% of the companies located in the UK, Slovakia, Finland, Italy and Latvia with a foreign shareholder in the EU-28 had a foreign shareholder located in the EU-13. The opposite situation can be seen in Ireland, Greece, France, Cyprus, Hungary and Malta, however, with none of the companies located in these Member States with a foreign shareholder located in the EU-28 having a shareholder in the EU-13.

⁶⁴³ This average is strongly influenced by Member States with a high absolute number of companies with a foreign shareholder. The unweighted average amounts to 76.5% of road transport companies with a foreign shareholder in the EU-28 of the total number of companies with a foreign shareholder. Excluding the UK, the share amounts to 73.4% of EU-27 companies with a foreign majority shareholder located in the EU-28.

⁶⁴⁴ This share is strongly influenced by the UK, as 23 696 of the 25 482 companies with a foreign shareholder located in the EU-13 are located there. The unweighted average amounts to 21.7% of companies with a foreign majority shareholder in the EU-28 with a shareholder located in the EU-13. When the UK is excluded, only 29.6% of the EU-27 companies with a foreign majority shareholder in the EU-28 have a shareholder located in the EU-13.

Letterbox companies: overview of the phenomenon and existing measures

Table 42. Number of companies active under NACE-code 4941 'Freight transport by road'

	Number of companies (A)	Column % of number of companies	Number of companies with a foreign majority shareholder (including n.a.)	Number of companies with a foreign majority shareholder (excluding n.a.) (B)	Estimation of number of companies with a foreign majority shareholder (C)	Column % of number of companies with a foreign majority shareholder	Share of total number of companies (C/A)	Number of companies with a foreign majority shareholder in EU-28 (D)	Share EU-28 of total number of companies with a foreign majority shareholder (D/B)	Number of companies with a foreign majority shareholder in EU-15	Number of companies with a foreign majority shareholder in EU-13 (E)	Share EU-13 of total number with a foreign majority shareholder in EU-28 (E/D)	Number of companies with a foreign majority shareholder extra EU-28 (F)	Share non-EU-28 of total number of companies with a foreign majority shareholder (F/B)
Belgium	7 670	2.1%	555	424	431	1.1%	5.6%	240	56.6%	201	39	16.3%	184	43.4%
Bulgaria	17 985	5.0%	3 419	399	480	1.2%	2.7%	233	58.4%	214	19	8.2%	166	41.6%
Czechia	8 262	2.3%	590	552	555	1.4%	6.7%	397	71.9%	204	193	48.6%	155	28.1%
Denmark	2 592	0.7%	83	70	70	0.2%	2.7%	60	85.7%	55	5	8.3%	10	14.3%
Germany	9 154	2.5%	361	343	344	0.8%	3.8%	261	76.1%	178	83	31.8%	82	23.9%
Estonia	4 538	1.3%	4 342	95	1 481	3.6%	32.6%	56	58.9%	48	8	14.3%	39	41.1%
Ireland	1 336	0.4%	1 151	32	197	0.5%	14.7%	26	81.3%	26	-	0.0%	6	18.8%
Greece	394	0.1%	5	1	1	0.0%	0.3%	1	100.0%	1	-	0.0%	-	0.0%
Spain	37 889	10.5%	7 133	205	251	0.6%	0.7%	187	91.2%	183	4	2.1%	18	8.8%
France	30 606	8.5%	5 258	164	197	0.5%	0.6%	118	72.0%	118	-	0.0%	46	28.0%
Croatia	2 893	0.8%	995	148	209	0.5%	7.2%	85	57.4%	52	33	38.8%	63	42.6%

Letterbox companies: overview of the phenomenon and existing measures

	Number of companies (A)	Column % of number of companies	Number of companies with a foreign majority shareholder (including n.a.)	Number of companies with a foreign majority shareholder (excluding n.a.) (B)	Estimation of number of companies with a foreign majority shareholder (C)	Column % of number of companies with a foreign majority shareholder	Share of total number of companies (C/A)	Number of companies with a foreign majority shareholder in EU-28 (D)	Share EU-28 of total number of companies with a foreign majority shareholder (D/B)	Number of companies with a foreign majority shareholder in EU-15	Number of companies with a foreign majority shareholder in EU-13 (E)	Share EU-13 of total number with a foreign majority shareholder in EU-28 (E/D)	Number of companies with a foreign majority shareholder extra EU-28 (F)	Share non-EU-28 of total number of companies with a foreign majority shareholder (F/B)
Italy	25 229	7.0%	562	525	526	1.3%	2.1%	249	47.4%	100	149	59.8%	276	52.6%
Cyprus	463	0.1%	21	21	21	0.1%	4.5%	18	85.7%	18	-	0.0%	3	14.3%
Latvia	3 893	1.1%	813	355	402	1.0%	10.3%	166	46.8%	82	84	50.6%	189	53.2%
Lithuania	6 647	1.8%	78	62	62	0.2%	0.9%	50	80.6%	41	9	18.0%	12	19.4%
Luxembourg	661	0.2%	274	266	269	0.7%	40.7%	252	94.7%	248	4	1.6%	14	5.3%
Hungary	8 449	2.3%	54	53	53	0.1%	0.6%	52	98.1%	52	-	0.0%	1	1.9%
Malta	24	0.0%	10	1	2	0.0%	6.7%	1	100.0%	1	-	0.0%	-	0.0%
Netherlands	8 332	2.3%	256	253	253	0.6%	3.0%	173	68.4%	168	5	2.9%	80	31.6%
Austria	5 138	1.4%	72	68	68	0.2%	1.3%	56	82.4%	42	14	25.0%	12	17.6%
Poland	17 532	4.9%	2 457	325	370	0.9%	2.1%	302	92.9%	267	35	11.6%	23	7.1%
Portugal	10 029	2.8%	7 365	104	377	0.9%	3.8%	88	84.6%	83	5	5.7%	16	15.4%

Letterbox companies: overview of the phenomenon and existing measures

	Number of companies (A)	Column % of number of companies	Number of companies with a foreign majority shareholder (including n.a.)	Number of companies with a foreign majority shareholder (excluding n.a.) (B)	Estimation of number of companies with a foreign majority shareholder (C)	Column % of number of companies with a foreign majority shareholder	Share of total number of companies (C/A)	Number of companies with a foreign majority shareholder in EU-28 (D)	Share EU-28 of total number of companies with a foreign majority shareholder (D/B)	Number of companies with a foreign majority shareholder in EU-15	Number of companies with a foreign majority shareholder in EU-13 (E)	Share EU-13 of total number with a foreign majority shareholder in EU-28 (E/D)	Number of companies with a foreign majority shareholder extra EU-28 (F)	Share non-EU-28 of total number of companies with a foreign majority shareholder (F/B)
Romania	49 845	13.8%	4 697	2 103	2 218	5.4%	4.5%	1 572	74.8%	1 388	184	11.7%	531	25.2%
Slovenia	3 141	0.9%	2 064	158	402	1.0%	12.8%	84	53.2%	69	15	17.9%	74	46.8%
Slovakia	8 485	2.3%	5 584	1 342	2 684	6.6%	31.6%	1 199	89.3%	342	857	71.5%	143	10.7%
Finland	8 471	2.3%	2 049	82	107	0.3%	1.3%	58	53.2%	19	39	67.2%	24	29.3%
Sweden	10 044	2.8%	72	71	71	0.2%	0.7%	48	67.6%	46	2	4.2%	23	32.4%
UK	71 551	19.8%	35 101	27 029	30 466	74.4%	42.6%	25 529	94.5%	1 833	23 696	92.8%	1 500	5.5%
EU-28	361 253	100.0%	85 421	35 251	40 936	100.0%	11.3%	31 561	89.5%	6 079	25 482	80.7%	3 690	10.5%
EU-27*	289 702		50 320	8 222	10 470		3.6%	6 032	73.4%	4 246	1 786	29.6%	2 190	26.6%

* The EU-27 equals the EU-28 excluding the UK, which takes Brexit into account.

Source Own elaborations based on Orbis [Data extracted on 24 October 2019]

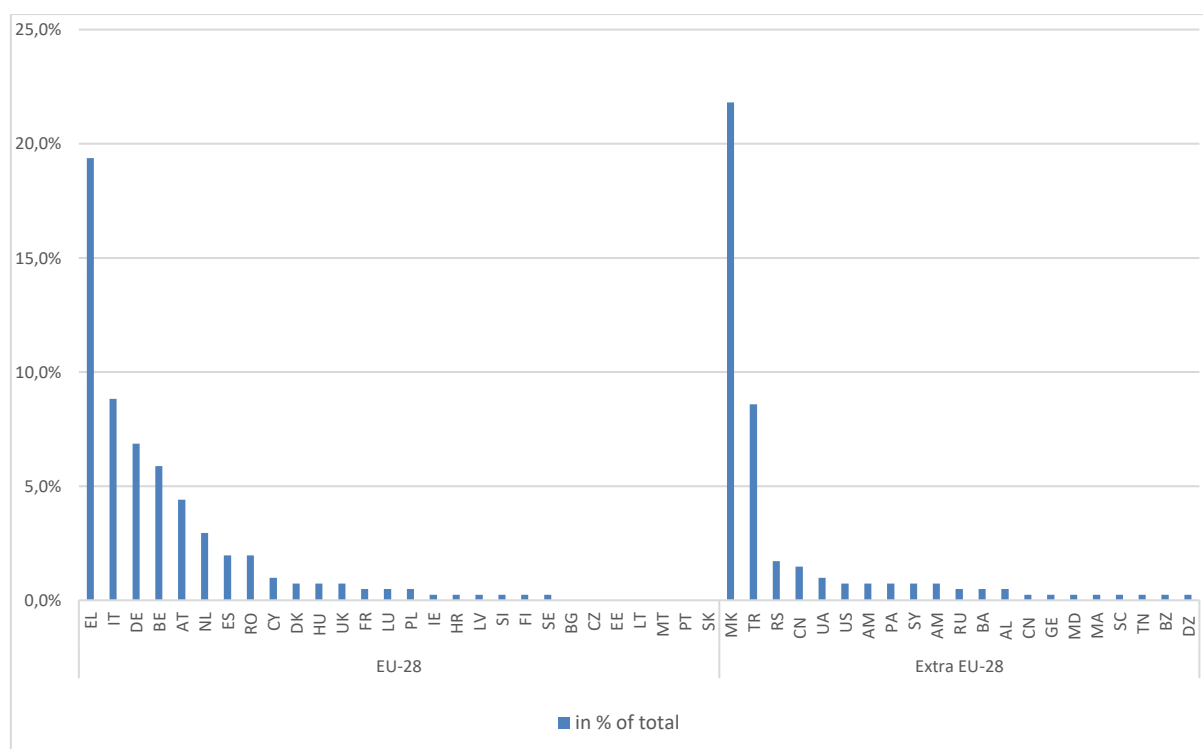
Next, the analysis looked at Bulgaria and Slovakia with regard to the presence of road freight transport companies with a foreign majority shareholder. Table 42 shows that an estimated 2.7% of the road transport companies in Bulgaria were owned by foreign shareholders, with this share amounting to 31.6% for companies in Slovakia. Further analysis looked at the number of companies with a foreign shareholder excluding those whose location is unknown. Therefore, the number of road transport companies of interest is 399 for Bulgaria and 1 342 for Slovakia.

The exact location of these foreign shareholders is also interesting. It was already evident that 41.6% of the foreign-owned companies in Bulgaria were owned by shareholders outside of the EU-28, with this share amounting to 10.7% in Slovakia (Table 42).

In Orbis it is possible to see exactly where the foreign shareholder is located. Figure 31 and Figure 32 show the locations of the foreign shareholders of road transport companies located in Bulgaria and Slovakia, respectively. More than 21% of road freight transport companies located in Bulgaria with a foreign shareholder have a shareholder located in North Macedonia, a non-EU country (Figure 31) and almost 20% of the companies have a Greek foreign shareholder. This is not surprising, as these are neighbouring countries of Bulgaria. More than 5% of the companies with a foreign shareholder have a shareholder located in Turkey, Italy, Germany, or Belgium.

A similar exercise was conducted for road freight transport companies located in Slovakia with a foreign shareholder. One clear outlier in Figure 32 is Hungary, which is the location of the foreign shareholder for 40% of the road transport companies with a foreign shareholder. A high share of Slovakian companies with a foreign shareholder have a shareholder located in Czechia (9.8%) and Ukraine (6.3%). Finally, more than 5% of companies located in Slovakia with a foreign shareholder have a shareholder located in Belgium or Italy.

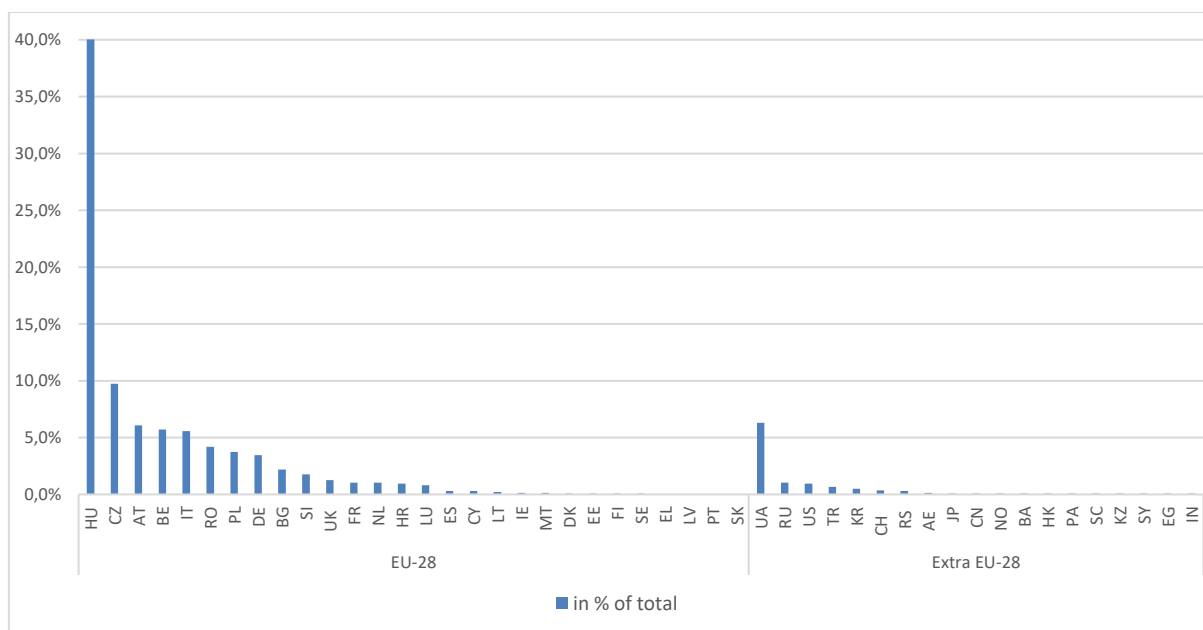
Figure 31. Location of foreign shareholders of companies active under NACE-code 4941 'Freight transport by road in Bulgaria', 100%



* The shares were calculated on the total number of companies located in Bulgaria with a foreign majority shareholder. 58.4% of the foreign shareholders are located within the EU-28 and 41.6% outside the EU-28.

Source Own elaborations based on Orbis [Data extracted on 24 October 2019]

Figure 32. Location of foreign shareholders of companies active under NACE-code 4941 'Freight transport by road in Slovakia', 100%



* The shares were calculated on the total number of companies located in Slovakia with a foreign majority shareholder. 89.3% of the foreign shareholders are located within the EU-28 and 10.7% outside the EU-28.

Source Own elaborations based on Orbis (data extracted on 24 October 2019)

A4.1.3 Letterbox companies in freight transport by road

A4.1.3.1 Definition of letterbox companies

It may be more straightforward to identify possible letterbox companies in the road transport sector, compared to other sectors, as Regulation (EC) No 1071/2009⁶⁴⁵ introduced some important requirements for all transport undertakings authorised by a Member State.

The core requirements for engagement in the occupation of road transport operator are summarised in Article 3(1) of Regulation (EC) No 1071/2009:

- have an effective and stable establishment;
- be of good repute;
- have appropriate financial standing; and
- have the requisite professional competence.

Undertakings engaged in the occupation of road transport operator should have 'an effective and stable establishment' in a Member State. In order to satisfy this requirement, Article 5 of the Regulation provides that an undertaking will, in the Member State concerned:

- a) have an establishment situated in that Member State with premises in which it keeps its core business documents, in particular its accounting documents, personnel management documents, documents containing

⁶⁴⁵ Regulation (EC) No 1071/2009 of the European Parliament and of the Council of 21 October 2009 establishing common rules concerning the conditions to be complied with to pursue the occupation of road transport operator and repealing Council Directive 96/26/EC.

data relating to driving time and rest and any other document to which the competent authority must have access in order to verify compliance with the conditions laid down in this Regulation. Member States may require that establishments on their territory also have other documents available at their premises at any time;

- b) once an authorisation is granted, have at its disposal one or more vehicles which are registered or otherwise put into circulation in conformity with the legislation of that Member State, whether those vehicles are wholly owned or, for example, held under a hire-purchase agreement or a hire or leasing contract;
- c) conduct effectively and continuously with the necessary administrative equipment its operations concerning the vehicles mentioned in point (b) and with the appropriate technical equipment and facilities at an operating centre situated in that Member State.

These key requirements of Article 5 of Regulation 1071/2009 will be significantly strengthened from 21 February 2022, when the new and modified provisions under the Mobility Package I on access to the profession of road haulage operator and on access to the international haulage market, introduced by the Mobility Package, will start applying (see below).

Of the four core requirements mentioned above, the first (having an effective and stable establishment) and the third (having an appropriate financial standing) are the most convenient to investigate more broadly and use the quantification tools. These requirements form the basis of the analysis of the occurrence of letterbox companies in Bulgaria and Slovakia (see Section A4.2).

In practice, there has been some critique of the requirements listed in Regulation 1071/2009. In an interview with members of the World Road Transport Organisation (IRU)⁶⁴⁶, it was noted that Regulation 1071/2009 does not provide a definition of a letterbox companies, but only four requirements, causing the term to be open to interpretation. ETF Road Transport considered the requirements vague⁶⁴⁷. It pointed to the third requirement of 'having an appropriate financial standing', noting that this requirement relates to the number of vehicles but makes no mention of the number of drivers.

Another study provided an example that illustrates the complexity of the Regulation⁶⁴⁸. Every Member State has to appoint a competent authority to check companies' compliance with the specified requirements. However, as competent authority that should perform this task is not defined, they differ greatly between Member States, causing confusion and insufficient information exchange between authorities.

This vagueness in requirements might lead to problems of enforcement (see discussion in section A4.2.1.4). In 2017, a proposal was launched to amend Regulation No 1071/2009 and No 1072/2009⁶⁴⁹. The main reasons were the shortcomings of the rules and their enforcement, which were seen as only partly effective in creating suitable competitive conditions in the market.

⁶⁴⁶ Visser, E., Billiet, M., and Kamberski, O. (2019, July 16). Personal communication – interview. IRU – World Road Transport Organisation.

⁶⁴⁷ ETF Road Transport. (2016). The European Commission road initiative. What it needs to include to effectively combat social dumping and unfair competition in the EU haulage market. An ETF set of concrete proposals on cabotage rules and access to occupation. Brussels: European Transport Workers' Federation.

⁶⁴⁸ Visser, E., Billiet, M., and Kamberski, O. (2019, July 16). Personal communication – interview. IRU – World Road Transport Organisation.

⁶⁴⁹ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1071/2009 and Regulation (EC) 1072/2009 with a view to adapting them to developments in the sector.

The impact assessment of the proposal states that it might generate savings for companies in the EU-28 of around EUR 2.7 to 5.2 billion in 2020-2035. It was also expected to reduce infringement of cabotage rules by up to 62% and to reduce the risk of formation of letterbox companies by around 10%, which should have a positive impact on working conditions.

The Commission came to the conclusion that the existing requirements on establishment under Regulation 1071/2009 were unevenly applied and had not been sufficient to ensure a genuine link with the Member State of establishment in order to efficiently fight letterbox companies.

The Mobility Package 1, including the revision of Regulation 1071/09, was adopted by the Parliament and the Council on 15 July 2020 and entered into force on 20 August 2020. It contains the following additional measures to address the problems of letterbox companies and the associated dishonest business and employment practices.

- **Strengthened rules on stable establishment:** Article 5 of Regulation 1071/2009 is amended by adding several additional conditions that must be fulfilled. These provisions will start applying from 21 February 2022:
 - being registered on the register of commercial companies;
 - being subject to tax on revenues and have a valid value added tax registration number;
 - on an ongoing basis have at its regular disposal, proportionate to the volume of transport operations carried out by the undertaking, an adequate number of vehicles which are put into circulation in conformity with the legislation of the Member State and drivers who are normally based at an operational centre in that Member State,
 - Member States may also require, proportionate to the size of the activity of the undertaking: the presence of duly qualified administrative personnel at the premises or the transport manager reachable during customary business hours, and operational infrastructure including an office which is open during customary business hours.
- **Strengthened rules on good repute** by making good repute dependent also on compliance with posting rules, cabotage rules, law applicable to contractual obligations and tax law.
- **Posting of drivers** rules will ensure that drivers employed in Member States with lower labor standards and lower wages will enjoy their social protection rights and remuneration in line with the terms and conditions of employment of the Member States where they actually work, and where labor standards and thus labor costs are usually higher. This will help to fight unfair competition based on cheap labor and make the use of letterbox companies not profitable any more.
- **Operators of Light Commercial Vehicles** will be subject to the rules on access to occupation, including financial standing and good repute. They will also be subject to the driving time rules and rules on posting of drivers. All this will significantly reduce a cost-based competitive advantage of such operators and will make the use of letterbox companies much more difficult.

The new legislation additionally aims at strengthening enforcement of these rules through the following provisions:

- Smart tachograph version 2 will help to control posting and cabotage by enabling to record border crossings as well as locations of loading and unloading;

- Infringements of cabotage and of posting rules may lead to a loss of good repute and further to a loss of Community licence;
- National registers of road transport undertakings will include additional data including the registration numbers of vehicles, number of people employed and the risk rating of undertaking;
- Internal Market Information System (IMI) will facilitate administrative cooperation between MS when controlling stable establishment of road transport undertaking.

In addition one of the key tasks of the European Labor Authority (ELA) is to help Member States to investigate the cases of alleged letterbox companies and other illicit business models in road transport sector.

All these additional rules and strengthened enforcement aim at making the use of letterbox companies unattractive and much easier to detect.

A4.1.3.2 Occurrence of letterbox companies in freight transport by road

Quantification of the occurrence of letterbox companies in the freight transport sector is somewhat scarce. As a result, opinions differ on its scope. Certain scholars believe the problem of letterbox companies in the transport sector to be quite minimal⁶⁵⁰. By contrast, the issue of letterbox companies in the road transport sector has been described as one of the main problems in the European road transport market and is said to be increasing in recent years⁶⁵¹. Furthermore, it is claimed that letterbox companies in the transport sector are the norm rather than the exception⁶⁵², and that the phenomenon is very widespread⁶⁵³.

An evaluation of the EU legislative framework in the transport sector analysed the available statistics from public authorities on the number of letterbox companies, defined as companies without stable and effective establishment⁶⁵⁴, detected through inspections or other law enforcement activities⁶⁵⁵.

Overall, very few Member States were able to provide data, as shown in Table 43 below. While the analysis of official statistics showed the existence of a large number of companies without stable and effective establishment (a sample which could include

⁶⁵⁰ Borkowski, P. and Bąk, M. (2018). Short and Long-Term Consequences of Further Regulation of the European Union Road Haulage Market. *Journal of Management and Financial Sciences*, 11 (33), pp. 9-23.

⁶⁵¹ Šimurková, P., and Poliak, M. (2019). Identification of letterbox companies in the road transport sector. 13th International Scientific Conference on Sustainable, Modern and Safe Transport (TRANSCOM 2019), High Tatras, Nový Smokovec – Grand Hotel Bellevue, Slovak Republic, May 29-31, 2019. *Transportation Research Precedia*, 40, pp. 1184-1191.

Thörnquist, A. (2019). Truck Drivers in the Grey Area between Employment and Self-employment: Swedish Experiences. *Nordic journal of working life studies*, 9 (S6), pp. 33-52.

⁶⁵² McGauran, K. (2016). The impact of letterbox-type practices on labour rights and public revenue. Available at: https://www.etuc.org/sites/default/files/publication/files/ces_letterbox_compagnies_gb_juin_ok.pdf. Accessed on 06 May 2019.

⁶⁵³ Tilling, C. (2019, May 28). Personal communication – interview. The European Transport Workers' Federation.

⁶⁵⁴ As per Regulation No 1071/2009, transport undertakings must demonstrate their effective and stable establishment. Article 5 specifies that an undertaking must have an office in which it keeps its core business documents and an operating centre with the appropriate technical equipment and facilities in the Member State of establishment. Once authorisation is granted, they need to have at least one vehicle at their disposal which is registered in that Member State.

⁶⁵⁵ Gibson et al., 2015.

letterbox companies), the number of letterbox companies (both domestic and foreign-owned) detected was low, at least in the countries able to provide this information.

Table 43. Estimated number of letterbox companies in the transport sector in selected Member States (2013 or a similar recent year)

Member State	Number of checks of stable and effective establishment	Number of letterbox companies detected*	Estimated actual number of letterbox companies
Denmark	All applications	1	0
Poland	2,351	30	No data
Bulgaria	5,640	35 for 2013; 49 for 2014	35 for 2013; 49 for 2014
Romania	7,110	0	0
Netherlands	N/A	15 for 2014	Less than 500
Latvia	No information	0	0

*i.e. companies without stable and effective establishment

Source: Survey of enforcement authorities

Source Gibson et al., 2015, p.38.

The analysis of further data available from Member State authorities showed several Member States with a relatively high number of total withdrawals, suspensions and declarations of unfitness of transport companies⁶⁵⁶. However, closer analysis of the monitoring data suggested that most infringements were due to reasons other than stable and effective establishment. In-depth interviews with the public authorities in several Member States showed a prevailing consensus about continuing problems with letterbox companies in the sector, with issues particularly prominent in some countries (although no respondents could provide concrete data, the problem was, for example, acknowledged in northern Germany bordering Denmark). Five national Ministries out of the 19 consulted for the study⁶⁵⁷ reported that they suspected that letterbox companies were being established on their territory (representing a mix of Eastern European countries and high-wage Western European countries: Bulgaria, Estonia, Germany, Luxembourg and Slovakia).

Reasons for establishing letterbox companies in the transport sector involve cheaper labour, the avoidance of social contributions (or paying lower social contributions), and lower taxes⁶⁵⁸. Companies will engage in the process of regime shopping to establish their subsidiary where the regime is most advantageous, which then leads to social dumping. For instance, a company in Member State A flag out to Member State B where it will establish a subsidiary⁶⁵⁹. This subsidiary is referred to as 'fake subsidiary'⁶⁶⁰, as

⁶⁵⁶ Spain (37 595 withdrawals and 12 493 suspensions in 2012); France (3 344 withdrawals between 4 December 2011 and 31 December 2012); Netherlands (1 038 withdrawals in 2012); Slovakia (1 219 withdrawals in 2012).

⁶⁵⁷ Namely the 15 Member States consulted for the study, the UK, Switzerland, Panama and the US.

⁶⁵⁸ McGauran, K. (2016). The impact of letterbox-type practices on labour rights and public revenue. Available at: https://www.etuc.org/sites/default/files/publication/files/ces_letterbox_compagnies_gb_juin_ok.pdf. Accessed on 06 May 2019.

Tilling, C. (2019, May 28). Personal communication – interview. The European Transport Workers' Federation.

⁶⁵⁹ Visser, E., Billiet, M., and Kamberski, O. (2019, July 16). Personal communication – interview. IRU – World Road Transport Organisation.

⁶⁶⁰ Tilling, C. (2019, May 28). Personal communication – interview. The European Transport Workers' Federation.

no or little economic activity is performed in Member State B. Afterwards, the subsidiary will carry out its activities in Member State A, where it will compete with other companies that still have to comply with the stricter rules of Member State A⁶⁶¹. Member State A is typically a Western European Member State whereas Member State B is situated in Eastern Europe, typically with lower wages and lower social contributions⁶⁶².

As a result, distorted situations like the following become possible: a German company sets up a subsidiary in Slovakia. The subsidiary then employs workers causing them to earn a Slovakian wage of EUR 250. However, the workers will never operate in Slovakia. Instead, they work in Germany, where the national German drivers earn a wage of EUR 1 200⁶⁶³. It is clear that this situation can lead to problematic circumstances, as the drivers will not be able to afford to live in Germany with the wage they receive.

Another example of the presence of abusive use of letterbox companies in the subcontracting chains was detected in the case of a Dutch company employing foreign workers, mainly from Romania and Lithuania, through a number of subsidiary companies. The suspicion of such companies being letterbox companies stemmed from the fact that instructions to staff were directed from the headquarters in the Netherlands. Drivers were required to open a bank account in the Netherlands to receive wages, while, following inspections, one Romanian company was found to be in a private house⁶⁶⁴. Consequently, some talked about slavery-like conditions and referred to this situation as a 'sweatshop on wheels'⁶⁶⁵.

A4.2 Focus on Bulgaria and Slovakia

This section focuses on the occurrence of letterbox companies in Bulgaria and Slovakia in the transport sector. Firstly, some facilitating factors in setting up letterbox companies in Bulgaria and Slovakia are identified and analyzed. The prevalence of letterbox companies based on factors defined in Regulation (EC) No 1071/2009 is then discussed.

A4.2.1 Facilitating factors in setting up letterbox companies

The reasons for using letterbox companies are plentiful and may vary from sector to sector and country to country. This section defines a number of risk factors for the transport sector. While no single specific factor is decisive, the combination of several factors serves to increase risk. For instance, for Bulgaria, no single specific reason is reported for the existence of letterbox companies in the transport sector, which is, rather, a combination of low corporate and income taxes, low licence fees, uncomplicated regulatory requirements to maintain a licence, low administrative costs, low technical inspection standards, and easy access to the EU market. Some of these elements are discussed in more detail below.

⁶⁶¹ Visser, E., Billiet, M., and Kamberski, O. (2019, July 16). Personal communication – interview. IRU – World Road Transport Organisation.

⁶⁶² Tilling, C. (2019, May 28). Personal communication – interview. The European Transport Workers' Federation.

⁶⁶³ Borgström, B. (2017). What is fair in the fair transport concept? Presented at Sub-theme 12, EGOS 2017, Copenhagen: Being good or looking good? Interrogating the contradictions and tensions in organizational ethics. Available at https://odoko.cbs.dk/bitstream/handle/10398/9516/borgstroem_egos2017.pdf?sequence=1

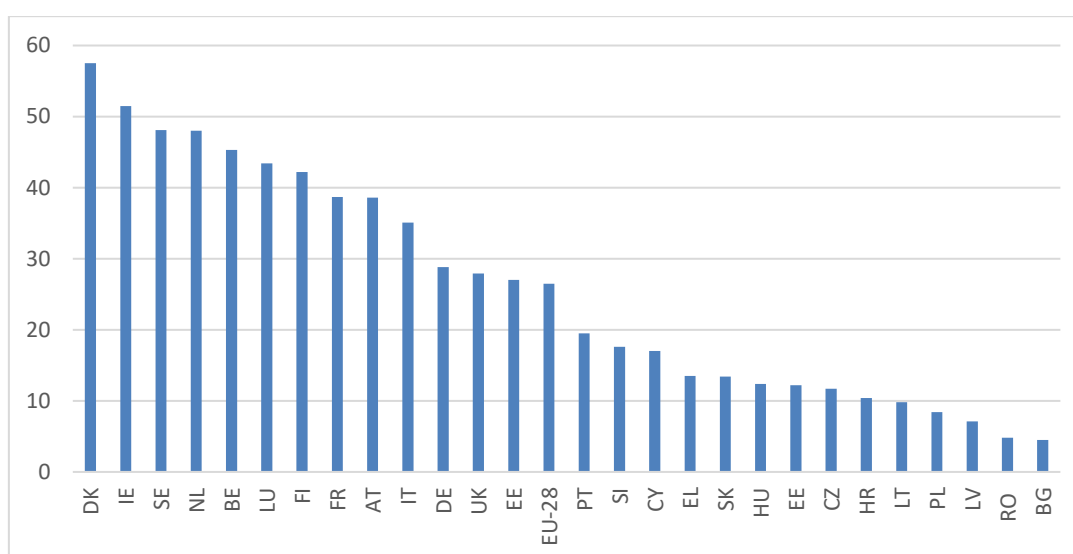
⁶⁶⁴ Hastings, T. and Cremers, J. (2017). Developing an approach for tackling letterbox companies. Available at: https://www.researchgate.net/publication/322855817_Developing_an_Approach_for_Tackling_Letterbox_Companies_-_a_learning_resource. Accessed on 23 May 2019.

⁶⁶⁵ Borgström, B. (2017). What is fair in the fair transport concept? Presented at Sub-theme 12, EGOS 2017, Copenhagen: Being good or looking good? Interrogating the contradictions and tensions in organizational ethics. Available at https://odoko.cbs.dk/bitstream/handle/10398/9516/borgstroem_egos2017.pdf?sequence=1

A4.2.1.1 Differences in wages and labour taxes

The average annual personnel costs in freight transport by road in the EU-28 in 2016 amounted to EUR 26 500. This average masks sizeable gaps between EU Member States, with the annual personnel cost per employee ranging from EUR 4 500 in Bulgaria to EUR 57 500 in Denmark (Figure 33). The figure also clearly shows the distinction between EU-15 and EU-13 Member States, with almost all of the former having an average cost per employee above the EU-28 average, and the latter all lower than that average. As noted before, the average personnel cost per employee in road haulage sector is the lowest in Bulgaria but is also quite low in Slovakia. This can be a facilitating factor for companies to establish a company in these Member States in order to acquire cheap labour. It is reported that wage gaps are often abused by subcontracting, as the only task of such subsidiaries is to provide 'cheap' drivers to the parent company⁶⁶⁶.

Figure 33. Average personnel cost per employee in the Freight transport by road, in EUR thousands, EU-28, 2016



Source Eurostat [sbs_na_1a_se_r2]

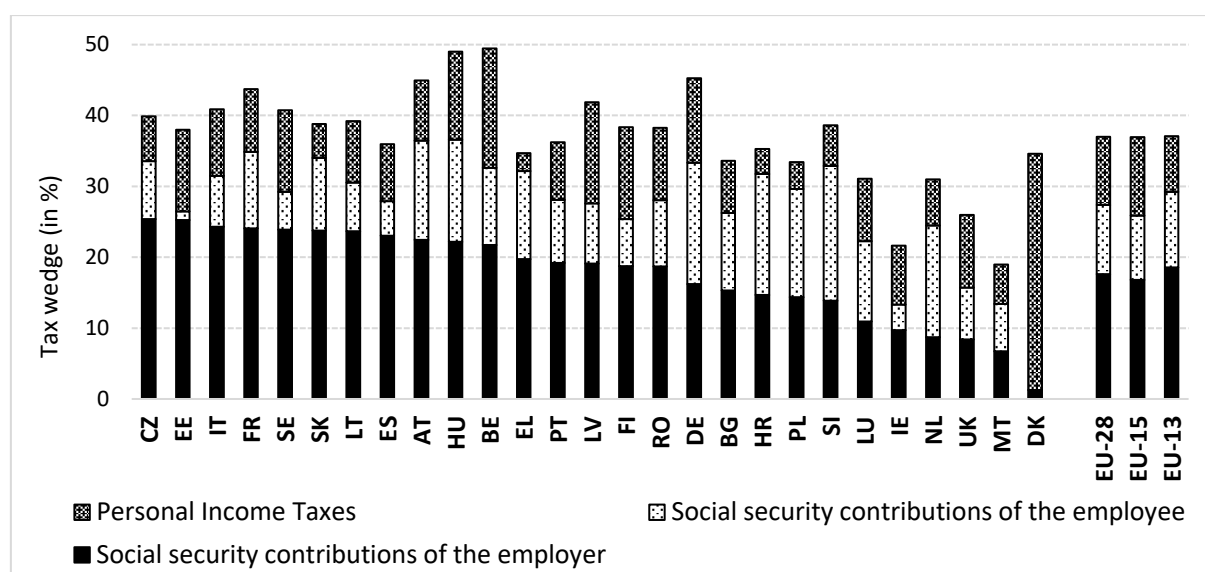
The taxation on wages is an interesting element. The tax pressure can vary greatly between Member States, which then influences the sector. Figure 34 shows the remarkable differences between Member States concerning the tax wedge in 2015. The tax wedge measures the difference between the labour costs to the employer and the corresponding net take-home pay of the employee⁶⁶⁷. In most Member States, the social security contribution of the employer comprises the greatest part of the tax wedge. The exceptions are Germany, Croatia, Poland, Slovenia, Luxembourg, and the Netherlands, where the social security contributions of the employee form the greatest part. In the UK and Denmark, the largest part of the tax wedge is formed by personal income taxes.

From a competition perspective, it is particularly interesting to look at the differences in employers' social security contributions. At first sight, these rates differ little on average between the EU-15 and the EU-13. The contributions for Bulgaria and Slovakia cannot be said to be much lower than those of Western European countries.

⁶⁶⁶ Šimurková, P., and Poliak, M. (2019). Identification of letterbox companies in the road transport sector. 13th International Scientific Conference on Sustainable, Modern and Safe Transport (TRANSCOM 2019), High Tatras, Novy Smokovec – Grand Hotel Bellevue, Slovak Republic, May 29-31, 2019. Transportation Research Precedia, 40, pp. 1184-1191.

⁶⁶⁷ OECD. (2019). Taxing Wages 2019. OECD Publishing: Paris. Available at https://doi.org/10.1787/tax_wages-2019-en

Figure 34. Tax wedge of a single person receiving 67% of the average national wage, by type of labour taxation, 2015



Source European Commission, DG ECFIN, Tax and benefits indicators database

A4.2.1.2 Ease of setting up a company

The ease of setting up a company can influence the number of letterbox companies established. It depends on the legal requirements in place (see Section 5.1, on the substantive company law requirements applicable to limited liability companies). Both Bulgaria and Slovakia follow the incorporation theory, meaning that the applicable legislation for a company is that of the place where the registered office is located, or where the company was incorporated⁶⁶⁸. This is in contrast to the real seat theory which specifies that the applicable law is the one of the country where the fundamental management decisions of the company are implemented.

Furthermore, the requirements to set up a company in Bulgaria and Slovakia are rather minimal. In Bulgaria there is no residence requirement, although there is some legal uncertainty on this point⁶⁶⁹. However, there is no requirement that the headquarters of a company should be located at the same place or even in the same country as the registered office.

In Slovakia, there is no requirement for a link between the activities of a company and its registered office⁶⁷⁰. The company only has to prove that it has some control over the premises, but this does not deter the use of letterbox companies as registered offices. The ease of setting up a company in Slovakia could be seen as a facilitating factor⁶⁷¹.

⁶⁶⁸ Malberti, C. (2017). Cross-border mobility of companies: 'Real seat' vs 'incorporation'. Euractiv. Available at <https://www.euractiv.com/section/economy-jobs/opinion/cross-border-mobility-of-companies-real-seat-vs-incorporation/>. Accessed on 11 March 2020.

⁶⁶⁹ Gerner-Beuerele, C., Mucciarelli, F. M., Schuster, E. P., & Siems, M. M. (2016). Study on the Law Applicable to Companies. Publications Office of the European Union. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1/language-en>. Accessed on 28 June 2019.

⁶⁷⁰ Ibid.

⁶⁷¹ Podnikajte. (2019). How to set up a company in Slovakia. Podnikajte.sk Available at <https://www.podnikajte.sk/corporate-services/how-to-set-up-a-company-in-slovakia>. Accessed on 22 October 2019.

Slovensko. (2019). How to set up a business enterprise in the Slovak Republic? Slovensko.sk Available at https://www.slovensko.sk/en/life-situation/life-situation/_how-to-set-up-a-business-enter/. Accessed on 22 October 2019.

For instance, several websites offer the possibility to set up a 'virtual office' online⁶⁷². See, for instance in Slovakia:

<https://www.davismorgan.sk/virtualne-sidla>

<http://www.tallerova.sk/>

Through both websites, it is possible to set up a company at Tallerova, Bratislava, an address that also appeared in the current research. Unsurprisingly, more than 970 companies are located at this address, over 200 of which have a foreign majority shareholder. This illustrates the convenience with which a letterbox company can be set up, as no economic activity is likely to take place at that address, despite the office being officially registered there.

A4.2.1.3 Different interpretations of the concepts 'habitual place of work' and 'place of business'

Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I) contains special provisions relevant for determining the governing law of employment contracts with an international element. Article 8 of the Rome I Regulation establishes rules for determining the applicable law to international employment contracts. The basic rule is that parties can choose the applicable law, subject to two sets of limitations: 1) non-derogable provisions of law of the Member State that would be applicable in the absence of choice, and 2) overriding mandatory rules of public interest (see below). In the absence of choice, subsidiary criteria are to be applied in the following hierarchical order: 1) habitual place of work, 2) place of hiring, and exceptionally 3) another law with a closer connection. Habitual place of work is defined as 'the law of the country in which or, failing that, from which the employee habitually carries out their work in performance of the contract' (Article 8(2)). Lorry drivers are very mobile, working within and across many countries. In these situations, it is not easy to determine the applicable labour law. Therefore, questions arise about the application of Article 8 of Rome I in the road transport sector. In addition, it is not always clear in which situations of road freight transport the PWD should be applied. The Mobility Package I tries to address these issues. Adopted in July 2020⁶⁷³, it clarifies the issue of whether a driver is posted or not, specifying that depends on 'the degree of connection with the territory of the host Member State'⁶⁷⁴. Therefore, as of 2 February 2022, drivers performing cabotage and certain cross-trade operations will be considered posted workers, as they have a strong connection to the host Member State. Bilateral and transit transport, on the other hand, are not considered posted work.

Furthermore, for obvious reasons, the application of the law of the workplace (*lex loci laboris*) is not suitable in cases where a person normally pursues activities in two or

Zugimpex. (2018, June). Company Formation in Slovakia. Registration in 5 steps: quick and easy. Zugimpex.com Available at https://zugimpex.com/slovakia-company.html?gclid=EAIaIQobChMI3ti0w5et5QIVleH3Ch13VQASEAAYAAEgJQf_D_BwE. Accessed on 22 October 2019.

⁶⁷² De Wispelaere, F. and Pacolet, J. (2018) Economic analysis of the road freight transport sector in Belgium within a European context: Employees and employers in 'survival mode'? Report, HIVA-KU Leuven. Available at: <https://hiva.kuleuven.be/nl/nieuws/docs/hiva%20report%20economic%20analysis%20of%20the%20road%20freight.pdf>. Accessed on 23 May 2019.

⁶⁷³ Directive 2020/1057 of the European Parliament and of the Council of 15 July 2020 laying down specific rules with respect to Directive 96/71/EC and Directive 2014/67/EU for posting drivers in the road transport sector and amending Directive 2006/22/EC as regards enforcement requirements and Regulation (EU) No 1024/2012

⁶⁷⁴ Position (EU) No 4/2020 of the Council at first reading with a view to the adoption of a Directive of the European Parliament and of the Council laying down specific rules with respect to Directive 96/71/EC and Directive 2014/67/EU for posting drivers in the road transport sector and amending Directive 2006/22/EC as regards enforcement requirements and Regulation (EU) No 1024/2012. Adopted by the Council on 7 April 2020 2020/C 149/01, available at: [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020AG0004\(01\)](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020AG0004(01)).

more Member States. For workers with such a work pattern, other connecting factors have been incorporated in special rules. These factors are laid down in Article 13 Regulation (EC) No 883/2004. The first connecting factor for determining the applicable social security law for workers normally working in two or more Member States is the notion of 'substantial part' of the worker's activities. Workers who normally work in two or more Member States and who pursue a 'substantial part' of their work in their Member State of residence are subject to the social security legislation of that State. If a substantial part is not performed in the Member State of residence, then the decisive criterion is the 'registered office or place of business' of the employer or of one of the employers.

To eliminate letterbox companies, a clarification of this term has been proposed by the Commission in Article 14(5a) of Regulation (EC) No 987/2009. This clarification has been proposed precisely to address the issue of letterbox companies. The original proposal by the Commission⁶⁷⁵ stated that only when the employer or undertaking in question carries out substantial activity in that Member State shall the employee be subject to the legislation of the Member State where the employer or undertaking's registered office or place of business is situated. Otherwise, the location of the centre of interests of activities of the undertaking shall be relevant.

The negotiations on this proposal in March 2019 led to a provisional agreement between Council and Parliament⁶⁷⁶. However, the agreement was rejected at the Committee of the Permanent Representatives of the Governments of the Member States to the European Union (Coreper) meeting on 29 March 2019, after which the Parliament refrained from voting. The legislative process on this file is thus still ongoing.

A4.2.1.4 Lack of enforcement

The lack of enforcement in combating letterbox companies seems to be a general problem, not only evident in the road transport sector. While unclear rules make enforcement difficult⁶⁷⁷, some believe that that the rules are not the problem per se, but rather the enforcement itself⁶⁷⁸. Some note that 'the problem of the European road transport is not in the lack of legislation but in the lack of enforcement by authorities'⁶⁷⁹. The same message came up in an interview with the IRU⁶⁸⁰, according to which, new rules and regulations are not the answer to the occurrence of letterbox companies, but,

⁶⁷⁵ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 883/2004 on the coordination of social security systems and regulation (EC) No 987/2009 laying down the procedure for implementing Regulation (EC) No 883/2004, available at: <https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/COM-2016-815-F1-EN-MAIN-PART-1.PDF>

⁶⁷⁶ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 883/2004 on the coordination of social security systems and regulation (EC) No 987/2009 laying down the procedure for implementing Regulation (EC) No 883/2004 - Analysis of the final compromise text with a view to agreement, available at: <https://data.consilium.europa.eu/doc/document/ST-7698-2019-ADD-1-REV-1/en/pdf>

⁶⁷⁷ ETF Road Transport. (2016). The European Commission road initiative. What it needs to include to effectively combat social dumping and unfair competition in the EU haulage market. An ETF set of concrete proposals on cabotage rules and access to occupation. Brussels: European Transport Workers' Federation.

⁶⁷⁸ McGauran, K. (2016). The impact of letterbox-type practices on labour rights and public revenue. Available at: https://www.etuc.org/sites/default/files/publication/files/ces_letterbox_compagnies_gb_juin_ok.pdf. Accessed on 06 May 2019.

⁶⁷⁹ Šimurková, P., and Poliak, M. (2019:1190). Identification of letterbox companies in the road transport sector. 13th International Scientific Conference on Sustainable, Modern and Safe Transport (TRANSCOM 2019), High Tatras, Nový Smokovec – Grand Hotel Bellevue, Slovak Republic, May 29-31, 2019. Transportation Research Precedia, 40, pp. 1184-1191.

⁶⁸⁰ Visser, E., Billiet, M., and Kamberski, O. (2019, July 16). Personnel communication – interview. IRU – World Road Transport Organisation.

rather, their correct application and enforcement. There seems to be a clear gap between the legal aspirations and the practical possibility of enforcement⁶⁸¹.

Several reasons for this lack of enforcement can be found in the literature. First, the lack of human and financial resources in the enforcement and inspection bodies, as well as, secondly, issues with the road transport sector itself⁶⁸², where the hyper-mobility of the sector complicates enforcement (e.g., difficulties in stopping trucks on the highway, linguistic problems). An additional difficulty is that of uneven enforcement⁶⁸³. For instance, a transport company established itself in Member State A (typically a low-wage country from where it also recruits its drivers), while it operates in Member State B (a high-wage country). The Member State of establishment (Member State A) is not highly affected by the occurrence of letterbox companies, reducing its need to take action. The Member States where the company is truly active (Member State B) bear the impact of letterbox companies through unfair competition and social dumping, as drivers are not paid according to the rules and regulation of this Member State, but to the ones from the lower wage country where the drivers were recruited. However, it is challenging for this Member State to take action, as the letterbox company in question is established outside its jurisdiction. This situation clearly shows the need for better cross-border cooperation between Member States to tackle the issue of letterbox companies in the road transport sector.

The importance of enforcement in confronting letterbox companies in the road transport sector should not be underestimated. Some believe that a correlation exists between a Member State's enforcement efforts and the amount of letterbox companies present⁶⁸⁴. However, the process of enforcement is hindered in different ways. Regulation 1071/2009 sets out that competent authorities need to perform checks on certain requirements. However, these checks are not conducted properly in many Member States, or corruption may ensue⁶⁸⁵. Nevertheless, Regulation 1071/2009 and 1072/2009 were amended as part of the Mobility Package I to be adapted to developments in the sector, with a specific focus on the shortcomings of the rules and their enforcement (see Section A4.1.3.1).

Table 44 presents some of the examples given by the Bulgarian expert on how certain requirements in the transport sector can be (easily) circumvented, making it possible to establish a letterbox company.

Table 44. Examples of enforcement problems in the Bulgarian road transport sector

Requirement	Ways in which the requirement is/can be circumvented
Requirement of establishment (Article 5 Regulation 1071/2009)	Present a contract with an intermediary or accounting company where they supposedly 'rent premises'
	Present a contract with an operating centre, like a service centre or garage

⁶⁸¹ Iannuzzi, F. E., and Sacchetto, D. (2019). Italian Labour Inspectors Facing Posted Workers Phenomena. In J. Arnholtz and N. Lillie (Red.). Posted work in the European Union. The political economy of free movement (pp. 109-127). New York: Taylor & Francis.

⁶⁸² Ibid.

⁶⁸³ ETF Road Transport. (2016). The European Commission road initiative. What it needs to include to effectively combat social dumping and unfair competition in the EU haulage market. An ETF set of concrete proposals on cabotage rules and access to occupation. Brussels: European Transport Workers' Federation.

⁶⁸⁴ Tilling, C. (2019, May 28). Personal communication – interview. The European Transport Workers' Federation.

⁶⁸⁵ Ibid.

Requirement	Ways in which the requirement is/can be circumvented
Requirement of sufficient parking space (Article 3(2) Regulation 1071/2009 allows Member States to impose additional requirements*)	Present a contract of empty fields or without any parking facilities, because there are no specific requirements on the parking space itself. Upon an inspector's visit, the argument is put forward that 'all trucks are on the move at the moment'
Requirement for own technical centre can be substituted by a contract for technical support with an individual or company (Ordinance 11 of 31/10/2002 on international freight and passenger transport)	No rules on the proximity of the centre, so a contract with any provider is sufficient.

* Both Bulgaria and Slovakia added the requirement of sufficient parking space (Šimurková & Poliak, 2019).

Source National expert of Bulgaria

These common loopholes show that it is easy to circumvent the requirements set out in Regulation 1071/2009. The Bulgarian expert mentioned that while a small number of companies may engage in behaviour that requires enforcement actions from regulatory authorities, for the majority of letterbox companies in the transport sector, the requirements of Regulation 1071/2009 allow them to register and function in a legitimate way without the possibility of regulatory enforcement of actual establishment.

The Bulgarian expert also indicated certain facilitating factors that impede adequate enforcement of the requirements. Firstly, there is a lack of sufficient resources. Although there is a great influx of letterbox companies (especially in the regions of Blagoevgrad and Kyustendil, both adjacent to North Macedonia), the staff of the regulatory body have remained constant. As a result, inspections are only possible every five years or when a red flag comes up concerning a particular company. Secondly, there is no database with data on technical inspections, transport licences, etc. at EU level, and companies can take advantage of this. Finally, corruption may play a role, such as the annual service checks at the technical inspection point, which are not controlled by the Bulgarian government. Over the past five years, the entire Executive Agency Automobile Administration staff of inspectors (responsible for enforcing licensing and permits for road transport operators) in the province of Blagoevgrad have been arrested on corruption charges on two occasions.

Overall, enforcement is one of the main problems in respect of letterbox companies in the road freight transport sector. Possible solutions to increase and improve enforcement in all Member States include better communication between Member States, the development of a database at EU level concerning transport information, and the use of electronic documents, which are harder to falsify and easier to compare between Member States⁶⁸⁶.

Finally, recent legislation in Slovakia is relevant to letterbox companies. The 'anti-letterbox Act' (Act No. 315/2016) came into force on 1 February 2017 and aims to combat such artificial arrangements that receive public funds, do business with public authorities, or enter into contracts with public authorities⁶⁸⁷. For certain entities, new

⁶⁸⁶ Tilling, C. (2019, May 28). Personal communication – interview. The European Transport Workers' Federation

⁶⁸⁷ Hekelová, S. and Lučivjanský, M. (2017). Slovakia: Disclose Your Beneficial Owner - Or Forget About Doing Business With The State. Available at <http://www.mondaq.com/x/596446/Government+Contracts+PPP/Disclose+Your+Beneficial+Owner+or+Forget+about+Doing+Business+with+the+State>. Accessed on 21 October, 2019.

Hodoň, A. and Labašová, D. (2017). New legislation on fighting corruption in Slovakia ("Anti-letterbox Act") increases administrative burden for business dealing with the state. Available at

rules were set up, including mandatory registration of identification information about the ultimate beneficial owner by an authorised person (an attorney, notary, bank, auditor or tax advisor with a registered seat in Slovakia)⁶⁸⁸. The main intention of this act is to tackle money laundering by increasing transparency⁶⁸⁹. It may be of less relevance for this case study, as money laundering is often not the goal of letterbox companies in the transport sector. However, it remains interesting to see whether this Act will have any impact in reality⁶⁹⁰, which, again, depends heavily on its enforcement.

A4.2.2 Prevalence of letterbox companies based on factors defined in Regulation 1071/2009

Both Member States provided several characteristics that make it possible to identify such undertakings. The Slovakian experts mentioned the inability to find someone at the postal address of the company and the absence of real activity at this address. In the interviews with Bulgarian stakeholders, several characteristics emerged: no physical presence in the country of registration, no presence of beneficial owners or directors at the address of registration, avoidance of tax payment, no full-time staff, not complying with regulatory license requirements, and multiple other companies established at the same address. According to the Bulgarian national expert, approximately 20% of all licensed road transport operators are letterbox companies. The Slovakian experts stated that the phenomenon in the transport sector exists but is not widespread.

This section examines the risk of the presence of letterbox companies in Slovakia and Bulgaria by looking at the address, ownership structure, and financial situation of the road haulage companies.

A4.2.2.1 Address

One of the requirements in Regulation 1071/2009 for road transport operators is having 'an effective and stable establishment', which is further specified in Article 5 of the Regulation. One possible indicator to assess this requirement is the number of transport companies located at the same address. A general analysis concerning the address variable was carried out for Slovakia among others (see Section 3.2.3 and Annex A3.4.3)⁶⁹¹. This section focuses specifically on the address variable for Bulgarian and Slovakian companies active in the transport sector.

Firstly, an analysis of frequent addresses of companies with a foreign majority shareholder in the transport sector was conducted. Table 45 shows the top three addresses for companies under NACE-code 4941 with a foreign majority shareholder, in both Bulgaria and Slovakia. However, it can be seen that these addresses are not only popular for transport companies with a foreign shareholder. At the address of Karpatske Namestie in Slovakia, more than 2 100 companies are located. Some of these addresses also occur in other research on letterbox companies. The address of Tallerova 4

<https://www.kinstellar.com/insights/detail/462/new-legislation-on-fighting-corruption-in-slovakia-anti-letterbox-act-increases-administrative-burden-for-business-dealing-with-the-state>. Accessed on 21 October 2019.

⁶⁸⁸ Hekelová, S. and Lučivjanský, M. (2017). Slovakia: Disclose Your Beneficial Owner - Or Forget About Doing Business With The State. Available at <http://www.mondaq.com/x/596446/Government+Contracts+Procurement+PPP/Disclose+Your+Beneficial+Owner+or+Forget+about+Doing+Business+with+the+State>. Accessed on 21 October, 2019.

⁶⁸⁹ Wessing, T. (2017, June 21). World-wide rarity: Anti-letterbox companies act in Slovakia. CEE legal matters. Available at <https://ceelegalmatters.com/slovakia/6605-world-wide-rarity-anti-letterbox-companies-act-in-slovakia>. Accessed on 22 October, 2019.

⁶⁹⁰ Hekelová, S. and Lučivjanský, M. (2017). Slovakia: Disclose Your Beneficial Owner - Or Forget About Doing Business With The State. Available at <http://www.mondaq.com/x/596446/Government+Contracts+Procurement+PPP/Disclose+Your+Beneficial+Owner+or+Forget+about+Doing+Business+with+the+State>. Accessed on 21 October, 2019.

⁶⁹¹ The numbers can differ as the Orbis data was downloaded at different times.

appeared in two other research⁶⁹² and the Hranicna address also came up in one of them⁶⁹³. However, the latter stated that the numbers from Orbis might be an underestimation, as a comparison with the Slovakian business register revealed even higher numbers of companies located at the same address.

The Hranicna address was included in the Belgian transport union's black book⁶⁹⁴, following a visit to the physical location. The BTB found that at least 110 companies had their offices there, of which around 20 transport companies were of Belgian origin. The BTB also visited other addresses of transport companies, finding several strange situations, e.g., being unable to find the address, the office hidden within the offices of another company, or a literal wall letterbox⁶⁹⁵. It seems clear that many of these companies do not meet the requirement set out in Regulation 1071/2009 (see Section A4.1.3.1).

In 2019, the BTB published a new version of the black book⁶⁹⁶. Many companies that were scrutinised in their previous black book appeared to have relocated. This seems to be a general trend, as frequent changes of address could be a way to evade inspections. One company had had five different addresses in just over 10 years. Companies are thus not only well hidden, but even non-existent, causing the term 'phantom company' to come up. These black books only cover Belgian hauliers, but it is unlikely that these situations are unique to Belgian companies⁶⁹⁷.

Companies are often concentrated in certain regions – in Slovakia, that is its capital, Bratislava⁶⁹⁸. Table 45 confirms that the top three addresses are all located in Bratislava.

The second last column of Table 45 (B/A) shows whether a certain address is particularly attractive for companies with a foreign majority shareholder. This is the case for the Hranicna address in Slovakia, as almost 44% of companies located there are foreign-owned. Additionally, the last column displays whether a certain address is common for transport companies. In Bulgaria, the address of Oktomvri is indeed popular for transport companies, as more than half of the companies located at this address are active under NACE-code 4941 'Freight transport by road'. In contrast, companies located at the Slovakian address at Karpatske Namestie are generally not active in this sector

⁶⁹² De Wispelaere, F. and Pacolet, J. (2018) Economic analysis of the road freight transport sector in Belgium within a European context: Employees and employers in 'survival mode'? Report, HIVA-KU Leuven. Available at: <https://hiva.kuleuven.be/nl/nieuws/docs/hiva%20report%20economic%20analysis%20of%20the%20road%20fr eight.pdf>. Accessed on 23 May 2019.

Šimurková, P., and Poliak, M. (2019). Identification of letterbox companies in the road transport sector. 13th International Scientific Conference on Sustainable, Modern and Safe Transport (TRANSCOM 2019), High Tatras, Nový Smokovec – Grand Hotel Bellevue, Slovak Republic, May 29-31, 2019. Transportation Research Precedia, 40, pp. 1184-1191.

⁶⁹³ Ibid.

⁶⁹⁴ Belgische Transport Bond (2017). The road to Slovakia – Social dumping: this is how it works. Available at: https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek-2017-ENG-DIGITAAL.pdf. Accessed on 4 July 2019.

⁶⁹⁵ Ibid.

⁶⁹⁶ Belgische Transport Bond. (2019). The Road to Slovakia is still busy. The ABC of social dumping and how nothing has changed...The BTB continues to investigate. Available at https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek_2019_EN_WEB.pdf. Accessed on 24 October 2019.

⁶⁹⁷ Ibid. Belgische Transport Bond (2017). The road to Slovakia – Social dumping: this is how it works. Available at: https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek-2017-ENG-DIGITAAL.pdf. Accessed on 4 July 2019.

⁶⁹⁸ Šimurková, P., and Poliak, M. (2019). Identification of letterbox companies in the road transport sector. 13th International Scientific Conference on Sustainable, Modern and Safe Transport (TRANSCOM 2019), High Tatras, Nový Smokovec – Grand Hotel Bellevue, Slovak Republic, May 29-31, 2019. Transportation Research Precedia, 40, pp. 1184-1191.

(only 2.9% of the 2 174 companies located there operate as a road freight transport company).

Table 45. Road freight transport companies located at the same address, Bulgaria and Slovakia

	Address	Total companies		Companies active under NACE-code 4941		Share of companies with a foreign majority shareholder of total number of companies (B/A)	Share of companies active under NACE-code 4941 of total number of companies (C/A)
		registered (A)	with a foreign majority shareholder (B)	registered (C)	with a foreign majority shareholder		
Bulgaria	Tsar Boris III, 11, Petrich	866	100	343	28	11.5%	39.6%
	28 Oktomvri 5, Petrich	456	32	240	12	7.0%	52.6%
	Ivan Vazov 21, Razgrad	67	11	19	7	16.4%	28.4%
Slovakia	Tallerova 4, Bratislava	971	229	116	22	23.6%	11.9%
	Karpatske Namestie 10, Bratislava	2 174	448	64	21	20.6%	2.9%
	Hranicna 18, Bratislava	144	63	21	18	43.8%	14.6%

Source Own elaborations based on Orbis (data extracted on 24 October 2019)

A4.2.2.2 Ownership structure

A typical element present in the road transport sector is the existence of complex transport chains. These often consist of many layers of subcontractors that change over time⁶⁹⁹. Due to these complex subcontracting chains, the road transport sector is

⁶⁹⁹ Borgström, B. (2017). What is fair in the fair transport concept? Presented at Sub-theme 12, EGOS 2017, Copenhagen: Being good or looking good? Interrogating the contradictions and tensions in organizational ethics. Available at https://odoko.cbs.dk/bitstream/handle/10398/9516/borgstroem_egos2017.pdf?sequence=1

characterised by hyper-fragmentation of the production relation⁷⁰⁰. These chains are constantly changing, as companies often have a wide network of suppliers for different service provisions⁷⁰¹. The most obvious reason for the existence of these complex chains is the reduction of costs.

For letterbox companies in particular, setting up a long transport chain or large network is attractive as it makes it harder for inspectors to find the company. Slovakia is particularly attractive to prolong the chain of subsidiaries used in the context of letterbox companies⁷⁰². An illustrative example is useful here: a Belgian company can set up a fake subsidiary in Romania. This subsidiary then opens a service centre in Slovakia that recruits drivers in Romania, who will eventually only work in Belgium. As a result, the Slovakian social security rules will apply to the drivers, although they will only work in Belgium.

The longer the chain, the more difficult it becomes to determine where the social security is actually based⁷⁰³. Where more than two Member States are involved, the situation becomes particularly complex. There is a lack of inspection and enforcement due to the different interests of the Member States involved, which further facilitates the occurrence of letterbox companies.

A real-life example is provided by analysing the ownership structure of Jost Group SA. On its website, Jost Group defines itself as a leading transport and logistics company in Europe⁷⁰⁴. It claims that 'as a fully integrated transport and logistics provider, Jost Group is able to make your logistics network more cost-efficient, whatever your business sector'⁷⁰⁵. In 2017, Jost Group was accused of social fraud, social dumping and human trafficking⁷⁰⁶. The CEO was accused of employing truck drivers from Eastern Europe who worked in Belgium, but without the Belgium terms of employment⁷⁰⁷. The federal public prosecutor's attempt to confiscate 300 trucks was stopped by the intervention of a judge⁷⁰⁸. Four people were held in prison for several days on suspicion of human trafficking and social dumping⁷⁰⁹. Additionally, its two subsidiaries located in Slovakia

⁷⁰⁰ Iannuzzi, F. E., and Sacchetto, D. (2019, forthcoming). Italian Labour Inspectors Facing Posted Workers Phenomena. In J. Arnholtz and N. Lillie (Red.). *Posted work in the European Union. The political economy of free movement* (pp. 109-127). New York: Taylor & Francis.

⁷⁰¹ Borgström, B. (2017). What is fair in the fair transport concept? Presented at Sub-theme 12, EGOS 2017, Copenhagen: Being good or looking good? Interrogating the contradictions and tensions in organizational ethics. Available at https://odoko.cbs.dk/bitstream/handle/10398/9516/borgstroem_egos2017.pdf?sequence=1

⁷⁰² Tilling, C. (2019, May 28). Personal communication – interview. The European Transport Workers' Federation.

⁷⁰³ Ibid.

⁷⁰⁴ Jost Group. (2019). Identity & value-addition. Jost Group. Available at <https://www.jostgroup.com/jost-home/>. Accessed on 23 October 2019.

⁷⁰⁵ Ibid.

⁷⁰⁶ Broens, B. (2019, March 19). Dossier Jost Group: Luikse rechter fluit federaal parket terug (Jost Group file: Liège judge whistle federal prosecutor back). *De Tijd*. Available at <https://www.tijd.be/ondernemen/transport/dossier-jost-group-luikse-rechter-fluit-federaal-parket-terug/10108867.html>. Accessed on 23 October 2019.

⁷⁰⁷ Van Raemdonck, H. (2019, February 20). Jost Group threatened to have 300 trucks seized for social fraud. *News mobility news*. Available at <https://newmobility.news/2019/02/20/jost-group-accused-of-social-fraud-and-human-trafficking/>. Accessed on 23 October 2019.

⁷⁰⁸ Ibid.

⁷⁰⁹ Broens, B. (2019, March 19). Dossier Jost Group: Luikse rechter fluit federaal parket terug (Jost Group file: Liège judge whistle federal prosecutor back). *De Tijd*. Available at <https://www.tijd.be/ondernemen/transport/dossier-jost-group-luikse-rechter-fluit-federaal-parket-terug/10108867.html>. Accessed on 23 October 2019.

also appeared in the black book by the Belgian transport union on social dumping⁷¹⁰. However, the investigation into the Jost Group has yet to be concluded.

Table 46 shows the ownership structure of Jost Group SA, together with the location, operating revenue (in EUR million) and the number of employees of each subsidiary. In total, there are 28 subsidiaries, with some being third in line. For instance, Kuijpers cargo service GMBH & CO. KG, in Germany is a subsidiary of a subsidiary of a subsidiary of Jost Group SA. Furthermore, the subsidiaries are based in eight different Member States - Luxembourg, Bulgaria, the Netherlands, Germany, Slovakia, Romania, Belgium, and Italy. The number of subsidiaries in each of these Member States is shown in Figure 35. Considering that it is difficult to trace the correct social security when more than two Member States are involved, eight Member States implies considerable complexity indeed⁷¹¹.

In the absence of a legal judgment on the company, no assumptions can be made or conclusions drawn, other than that complex ownership structure is a red flag.

Table 46. Ownership structure of Jost Group SA

Level of subsidiary			Location	Operating revenue in EUR million	Number of employees
0		Jost Group SA	LU	355	2,717
1	↳	Jost Management SA	LU	n.a.	115
2	↳	Jost SA	LU	9	95
3	↳	Kangaroo - Trans EEOC	BG	15	308
4	↳	Kuijpers logistieke diensten B.V.	NL	n.a.	94
4.1		↳ Kuijpers carco service B.V.	NL	n.a.	94
4.2		↳ Kuijpers invest B.V.	NL	n.a.	1
4.3		↳ Kuijpers warehousing & logistics B.V.	NL	n.a.	25
5	↳	Kuijpers logistieke diensten international B.V.	NL	n.a.	n.a.
5.1		↳ Kuijpers cargo service GMBH & CO. KG	DE	n.a.	51
5.2		↳ Kuijpers cargo service verwaltungs-GMBH	DE	n.a.	1
5.2.1		↳ Kuijpers cargo service GMBH & CO. KG	DE	n.a.	51

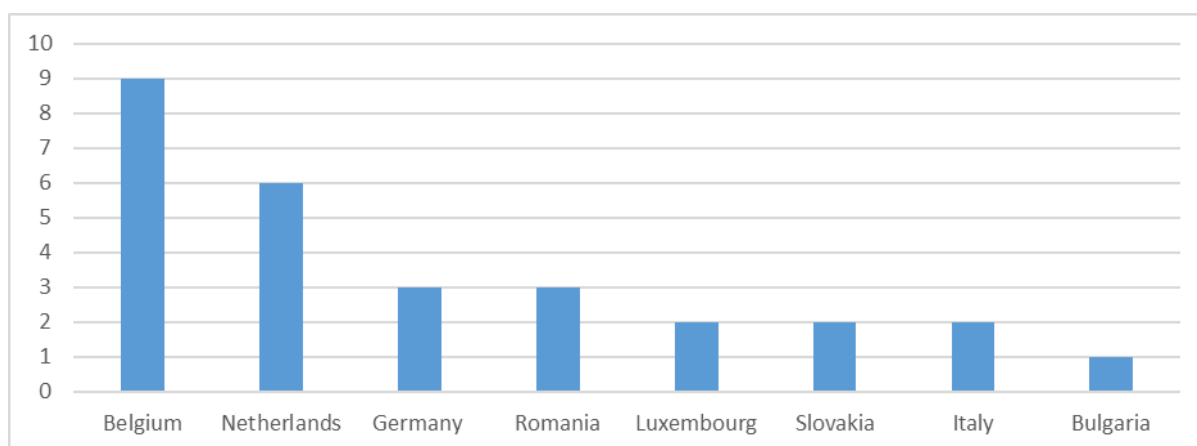
⁷¹⁰ Belgische Transport Bond (2017). The road to Slovakia – Social dumping: this is how it works. Available at: https://www.btb-abvv.be/images/WegvervoerEnLogistiek/campagne/sociale_dumping/Engels/Zwartboek-2017-ENG-DIGITAAL.pdf. Accessed on 4 July 2019.

⁷¹¹ Tilling, C. (2019, May 28). Personal communication – interview. The European Transport Workers' Federation.

Level of subsidiary			Location	Operating revenue in EUR million	Number of employees
6	↳	Kuijpers vastgoed B.V.	NL	n.a.	80
7	↳	SK Line, S.R.O.	SK	0	n.a.
8	↳	Trans - Union, S.R.O.	SK	6	15
9	↳	Tempo premium team SRL	RO	1	84
10	↳	Skiptrans SRL	RO	62	751
11	↳	Charlier logistics	BE	6	54
12	↳	De Bock gebroeders transport	BE	40	148
13	↳	Figem SA	BE	n.a.	n.a.
14	↳	Gema - Ancienne maison Henri Gentges	BE	n.a.	3
15	↳	Jost & CIE	BE	136	321
15.1	↳	Jost Italia	IT	n.a.	n.a.
15.2	↳	Maes international S.R.L.	RO	0	1
15.3	↳	Jost Italia SRL	IT	3	1
16	↳	Jost logistics	BE	15	83
17	↳	Supertransport	BE	60	258
18	↳	T.T.S. Multimodal Belgium	BE	15	128
19	↳	Transport et travaux s'Heeren	BE	52	38

Source Own elaborations based on Orbis (data extracted on 24 October 2019)

Figure 35. Location of subsidiaries of Jost Group SA



Source Own elaborations based on Orbis (data extracted on 24 October 2019)

A4.2.2.3 Financial situation

Regulation 1071/2009 stipulates that road transport companies should have 'appropriate financial standing'. This requirement is explained in more detail in Article 7 of the Regulation. An undertaking should at all times be able to meet its financial obligations in the course of the annual accounting year⁷¹². To this end, the undertaking should demonstrate, on the basis of annual accounts certified by an auditor or a duly accredited person, that, every year, it has capital and reserves at its disposal totaling at least EUR 9 000 when only one vehicle is used and EUR 5 000 for each additional vehicle⁷¹³.

In order to check this requirement, data was downloaded in Orbis for companies with a foreign shareholder (foreign) and companies without a foreign shareholder (domestic). A comparison between the capital of these companies in Bulgaria and Slovakia is provided in Table 47. In both Member States, the average capital for foreign-owned road transport companies is significantly higher than for domestic companies. In Bulgaria, this average is 18 times higher for foreign-owned companies.

Interestingly, in both Member States and for both types of companies, the share of companies with a capital lower than EUR 9 000 is over 50%. In Bulgaria, a higher share of domestic companies have capital lower than EUR 9 000, whereas in Slovakia, companies with a foreign shareholder more often do not have capital higher than EUR 9 000.

However, it should not be concluded that all the companies with capital lower than EUR 9 000 are letterbox companies, as the reserves should also be added to reach this threshold. Nevertheless, it is notable that 256 foreign-owned Bulgarian companies and 919 foreign-owned Slovakian companies have capital at their disposal of less than EUR 9 000. For Bulgaria, this is 78% of all foreign-owned transport companies (n=328), and for Slovakia this amounts to 64.5% of all foreign-owned transport companies (n=1 342).

Table 47. Capital of companies active under NACE-code 4941 'Freight transport by Road', in EUR, in Bulgaria and Slovakia

	Average capital in EUR thousands	Capital lower than EUR 9 000		Capital higher than or equal to EUR 9 000	
		Number	Row %	Number	Row %
BG domestic (n = 15 744)	6	14 554	92%	1 190	8%
BG foreign (n = 328)	108	256	78%	72	22%
SK domestic	21	4 541	64%	2 560	36%

⁷¹² De Wispelaere F. and Pacolet J. (2018) Economic analysis of the road freight transport sector in Belgium within a European context: Employees and employers in 'survival mode'? Report, HIVA-KU Leuven. Available at: <https://hiva.kuleuven.be/nl/nieuws/docs/hiva%20report%20economic%20analysis%20of%20the%20road%20fr eight.pdf>. Accessed on 23 May 2019.

⁷¹³ These amounts are not corrected for purchasing power.

		Capital lower than EUR 9 000		Capital higher than or equal to EUR 9 000	
	Average capital in EUR thousands	Number	Row %	Number	Row %
(n = 7 101)					
SK foreign (n = 1 342)	45	919	68%	423	32%

* The number of companies might differ from earlier quoted numbers, as certain companies did not have information about capital available.

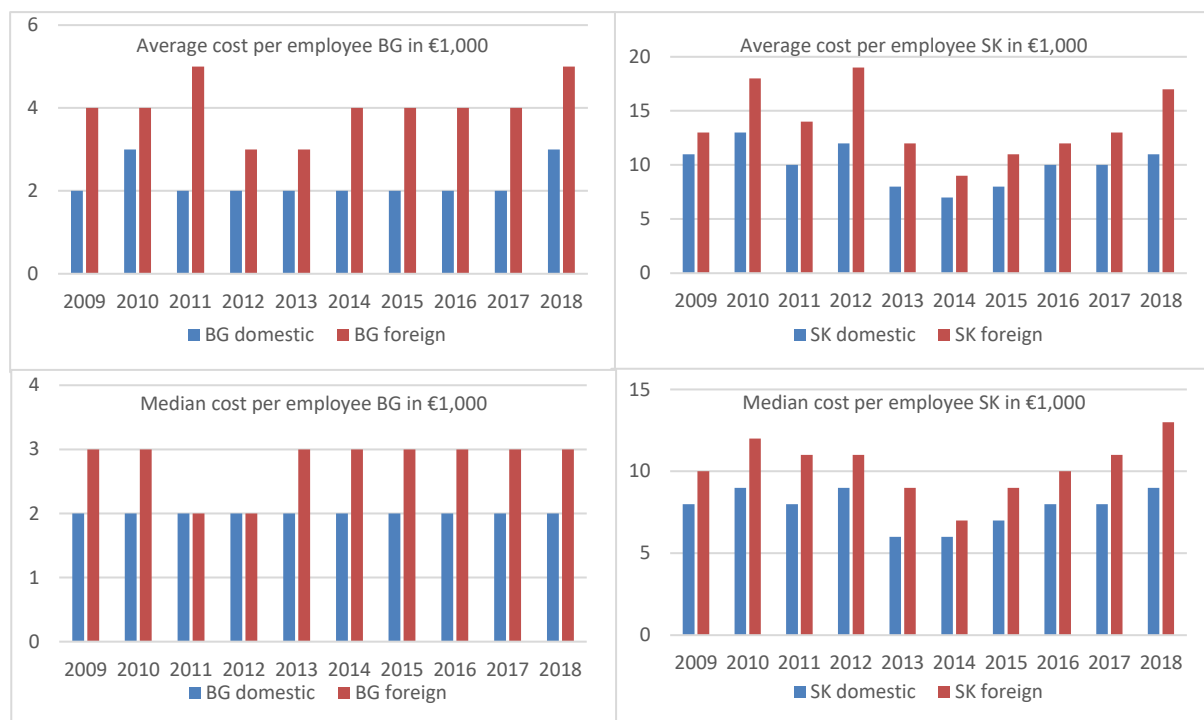
Source Own elaborations based on Orbis (data extracted on 24 October 2019)

As discussed in this case study, wages and the taxation on wages can be a facilitating factor in setting up letterbox companies. It was thus useful to look at another element of the financial situation of companies – the average cost per employee. Based on Orbis data, the average labour cost for foreign-owned Slovakian companies amounted to EUR 14 471, while this cost only amounted to EUR 10 869 for domestic Slovakian transport companies. In Bulgaria, the same order can be detected, as foreign-owned companies reported a higher average labour cost (EUR 4 182) than domestic transport companies (EUR 2 496).

The comparison between domestic and foreign-owned road transport companies is also shown in Figure 36, both in terms of average and median labour costs. Over the years in both Member States, the average labour cost for foreign-owned companies has been consistently higher than for domestic companies. Although the median value shows that the cost per employee is less distinct between foreign and domestic companies than the average, it is still higher for foreign-owned companies.

This finding adds nuance to the idea that all foreign-owned companies are fraudulent letterbox companies. However, taking into account that most of the employees might be active outside of Slovakia and Bulgaria, the average labour cost might nevertheless be too low. For instance, when the employee of a foreign-owned company in Bulgaria is mostly active in Belgium, the difference remains notable, as the average cost per employee in Belgium amounts to EUR 45 000. Thus, the average cost per employee of a foreign-owned company should not be compared to that of a domestic company, but to the cost per employee of the Member State where the employees are actually active.

Figure 36. Average and median cost per employee in Bulgaria and Slovakia, comparison between domestic and foreign companies, in EUR thousands, 2009-2018



* Domestic stands for companies located in Bulgaria or Slovakia that do not have a foreign majority shareholder anywhere in the world. Foreign stands for companies located in Bulgaria or Slovakia with a foreign majority shareholder.

Source Own elaborations based on Orbis (data extracted on 24 October 2019)

A4.2.2.4 Conclusion

This section analysed several factors that could indicate the prevalence of letterbox companies in the transport sector in Bulgaria and Slovakia. More specifically, Regulation 1071/2009 sets out some requirements, which, when not met, could be an indicator of an artificial undertaking.

There are certain Bulgarian and Slovakian addresses where many (transport) companies are located, which makes the requirement of an effective and stable establishment doubtful. The ownership structure can be an indication of a letterbox company when the number of subsidiaries is high, and the chain is long. Finally, the financial situation of transport companies was analysed and found that a high share of companies in Bulgaria and Slovakia might not meet the requirement of an appropriate financial standing.

However, it is not possible to provide the reader with a figure for the number of letterbox companies in the Bulgarian and Slovakian transport sector, as all indicators should be looked at together, and even then, only an inspection can identify the existence of a true letterbox company. This section simply sketches out the transport sector in Bulgaria and Slovakia, and possible indicators to identify these artificial corporate structures.

Annex 5 Case study on taxation in Denmark and the Netherlands

A5.1 Denmark and dividend withholding taxes

The case study relating to Denmark is inspired by a recent ruling of the ECJ (C-116/16, *T Danmark* and C-117/16, *Y Danmark*) regarding the application of the Parent-Subsidiary Directive in the context of conduit companies.

The case study shows that the tax issues posed by the use of letterbox companies in the context of taxation depend not only on the laws of one state but are also facilitated by the interplay of the tax rules of the source state of the income (in this case Denmark), the tax and corporate law rules of the state of the LBC (in this case study Luxembourg and Cyprus respectively) and the tax treaty concluded between the different states involved.

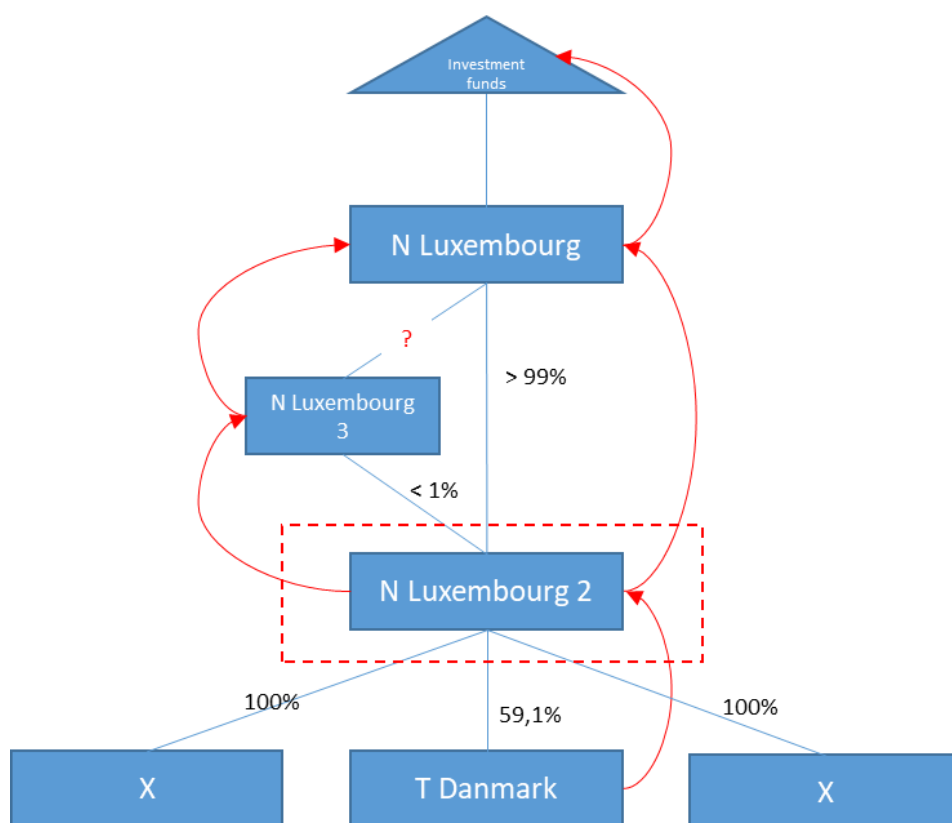
A5.1.1 Factual situation

A5.1.1.1 Case C-116/16 (*T Danmark*)

T Danmark concerned the indirect investment of a number of investment funds in a Danish company with real economic activity (*T Danmark*). Rather than making the investment directly, it was made through a holding structure involving Luxembourg companies (*N Luxembourg* and *N Luxembourg 2*). *N Luxembourg 2* was argued to function as a letterbox company, having no economic or commercial activity in its country of registration (Luxembourg) other than the activities relating to the shareholding, and functioning as an “empty shell” (due to the lack of any physical premises or staff in that country)⁷¹⁴ that was used to obtain tax benefits in a cross-border context.

That structure made it possible to avoid withholding tax on the dividends distributed by *T Danmark* (and further distributed onto the investment funds and their ultimate investors). The case concerned dividends distributed in 2011 and 2012.

⁷¹⁴ See § 31 of the Judgment of the referring Court.



A5.1.1.2 Case C-117/16 (Y Denmark)

Y Denmark concerned the reorganization of the EU activities of a US Company (Y USA) initially held by a Danish mixed holding company (Y Denmark) with economic activities (sales and support). The reorganization was carried out as a result of the 2004 American Jobs Creation Act favouring the repatriation of dividends of foreign subsidiaries to be reinvested in R&D in the US.⁷¹⁵ A Cypriot holding company (Y Cyprus) was interposed in this transaction.

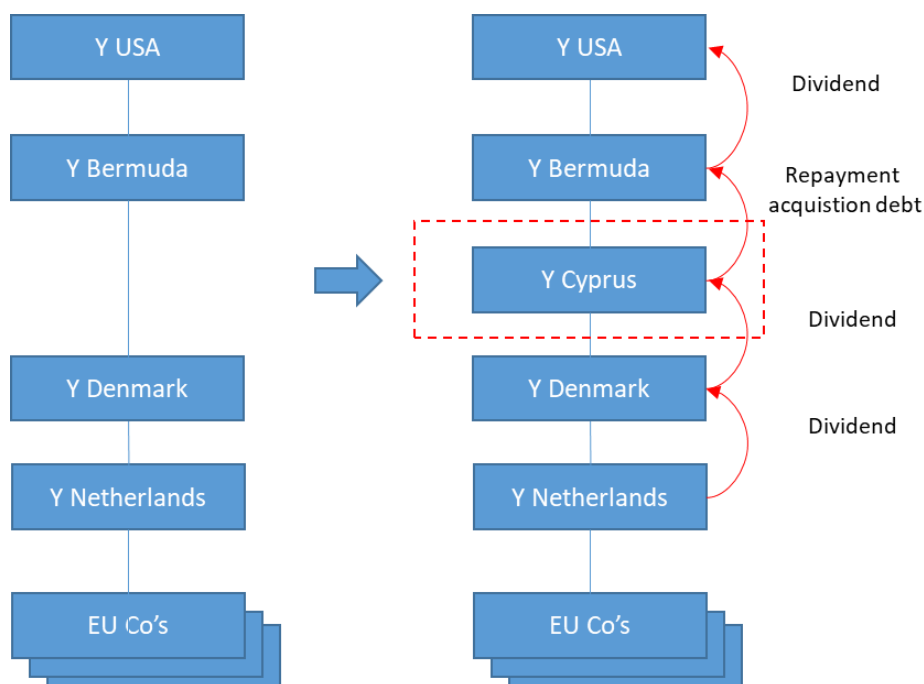
Y Cyprus was argued to function as a letterbox company since it does not have any economic or commercial activity in its country of registration (Cyprus) other than the activities relating to the shareholding and certain group financing activities⁷¹⁶, does not have physical premises or staff in that country⁷¹⁷ and is used to obtain tax benefits in a cross-border context.

The Y Cyprus interposition made it possible to upstream the dividends from the European subsidiaries free from withholding tax and to subsequently distribute these dividends as a (tax-free) repayment of the debt from the acquisition of the shares in Y Denmark by Y Cyprus from Y Bermuda. The case concerned dividends distributed in 2005 and 2006.

⁷¹⁵ See ECJ, 26 February 2019, C-117/16, *Y Denmark*, § 51.

⁷¹⁶ See ECJ, 26 February 2019, C-117/16, *Y Denmark*, § 53.

⁷¹⁷ See § 23 of the judgment of the referring court: Y Cyprus has no employees and is located in Cyprus on the address of a management company. The board of Y Cyprus consists of 3 Cypriot nationals and two American residents who are residents of the US and the Netherlands.



A5.1.2 Danish domestic tax law

A5.1.2.1 Preferential intermediary holding regime

Pursuant to a 1998 amendment of Danish domestic law, withholding tax on dividends to foreign parent companies holding at least 25% of the shares of the distributing company was abolished. This change made Denmark an attractive location for setting up intermediary holding companies for non-EU parent companies with activities in the EU. Dividends from European subsidiaries could be distributed to the Danish holding company free from tax under the EU Parent-Subsidiary Directive and could – as a result of the 1998 law – be redistributed by the Danish holding company to its non-EU parent company without attracting any dividend withholding tax.⁷¹⁸

In 2001 the Danish rules were however modified, under pressure of the EU Code of Conduct on Business Taxation. As a result of that modification, the domestic withholding tax exemption would only apply in case the dividends would benefit from exemption under the Parent-Subsidiary Directive or from an exemption or reduced rate under a tax treaty concluded by Denmark.⁷¹⁹

A5.1.2.2 Absence of GAAR until 2015

One of the specific features of Danish domestic tax law at the time of the cases at hand was the absence of a specific domestic general anti-abuse rule (GAAR) which could allow the Danish tax authorities to disregard tax-driven constructions. Jurisprudence however developed a “principle of reality”, under which certain fictional artificial transactions could be disregarded (*substance over form approach*)⁷²⁰ and a principle of “rightful income recipient”, under which it was possible in certain cases to consider a different

⁷¹⁸ See H. S. HANSEN, Det store hykleri – om ‘beneficial owner’ sagerne’, *Tidsskrift for Skatter og Afgifter* 2011, 537 et seq. (English translation, accessed from: https://www.plesner.com/~media/plesnerdocuments/artikler/2016_07_27_the%20great%20hypocrisy%20-%20the%20beneficial%20owner_%20cases_new_edition.ashx, p. 4).

⁷¹⁹ *Ibid*, p 5; ECJ, 26 February 2019, C-116/16 and C-117/16, *T Denmark*, § 19.

⁷²⁰ See ECJ, 26 February 2019, C-116/16 and C-117/16, *T Denmark*, § 31.

taxpayer than the taxpayer that has been formally designated as recipient of the income as the *real* recipient of the income.⁷²¹

In the present cases these principles could not however be used to set aside the respective arrangements.⁷²²

The absence of a GAAR in order to tackle such transactions led to numerous cases, of which the present cases are only two, where taxpayers relied on the benefits of EU Directives or tax treaties in order to reduce or eliminate Danish withholding taxes. As noted above, letterbox companies were used in order to claim tax benefits in relation to different cross-border transactions and payments.

A5.1.3 Tax treaty law

A5.1.3.1 Tax treaty Denmark-Luxembourg

Art. 10(1) and (2) of the 1980 tax treaty between Denmark and Luxembourg provides:

'1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed:

(a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;

(b) 15 per cent of the gross amount of the dividends in all other cases.'

A5.1.3.2 Tax treaty Denmark-Cyprus

At the time of the relevant case, article 10(1) and (2) of the 1981 tax treaty between Denmark and Cyprus provided:⁷²³

1 *'1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.*

2 *2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed:*

⁷²¹ *Ibid.*, § 33; This might for example allow to disregard the formal shareholder as rightful income recipient where the latter acts as a nominee or a dummy shareholder for the real owner, see H. S. HANSEN, L. E. CHRISTENSEN and A. E. PEDERSEN, Danish "Beneficial Owner" Cases – A Status Report", *Bull.Int. Tax.* 2013, 194.

⁷²² *Ibid.*, § 32 and § 63.

⁷²³ Note that this tax treaty was replaced by a new treaty in 2010, now providing for a 0% withholding tax rate on dividends under certain conditions.

- 3 (a) 10 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;
- 4 (b) 15 per cent of the gross amount of the dividends in all other cases.'

A5.1.4 Domestic law in the state of the conduit company

A5.1.4.1 Luxembourg law

a) Tax residency rules (place of effective management)

An entity is tax resident in Luxembourg when it has its registered office or its central administration in Luxembourg.⁷²⁴ The registered office is simply the location indicated as such in the articles of association of the company. The notion of 'central administration' is derived from Luxembourg company law and is referred to as the place the most important and strategic decisions are taken with respect to the entity and its activities, where the shareholders and board meetings are held, where the daily management is carried out and where the accounts and registers are maintained (also referred to as the 'place of management').⁷²⁵

In the *T Danmark* case, N Luxembourg 2 was considered a Luxembourg tax resident⁷²⁶, even though the ECJ stated that it can be established that a company acts as a conduit company if its sole activity consists in the receipt of dividends and their transmission to the beneficial owner or other conduit companies (see also Section 4.2.3.2 for more details about the notion of conduit company).⁷²⁷ As noted, N Luxembourg 2 was argued to qualify as a letterbox company since it does not carry out any business (other than the holding of the shares) in Luxembourg, does not have physical premises or staff there and is used as part of a scheme to reduce the tax burden in a cross-border setting. Nevertheless, N Luxembourg 2 is regarded as a resident of Luxembourg, granting it entitlement to the benefits of the tax treaties concluded by Luxembourg (as well as resulting in an exemption from withholding tax as discussed under 5.1.2). Indeed, the place of effective management criterion is also in line with most tax treaties (article 4 of the OECD Model Income Tax Convention), so that a company is also tax resident of Luxembourg for purposes of the tax treaties concluded by Luxembourg if it is effectively managed from Luxembourg⁷²⁸.

b) Withholding tax rules

Luxembourg does not levy withholding tax on outbound dividend payments to non-resident companies subject to income tax with a shareholding of at least 10% or with an acquisition value of at least 1.2 million EUR in the distributing company. The exemption applies to dividends paid to both EU companies that can benefit from the

⁷²⁴ Art. 159(1) Loi concernant l'impôt sur le revenu ('LIR')

⁷²⁵ P. BERNA, P. MISCHO, F. VAN KUIJK, *Luxembourg in IFA Cahiers 2014 - Volume 99B: Qualification of taxable entities and treaty protection*, 515.

⁷²⁶ ECJ, 26 February 2019, C-116/16 and C-117/16, *T Denmark*, § 40.

⁷²⁷ ECJ, 26 February 2019, C-116/16 and C-117/16, *T Denmark*, § 104.

⁷²⁸ Note that in practice, it is often difficult for the tax authorities to contest the tax residence (place of effective management) of a holding company if it is formally managed from Luxembourg (eg. meetings of the board and shareholders, bookkeeping, and bank accounts in Luxembourg). That is illustrated by a recent Belgian court case, which confirmed the Luxembourg tax residency of a holding company of which all shareholders were residents in Belgium, of which the sole assets consisted in shares of two Belgian companies and which did not have any employees in Luxembourg (Court of Appeal Brussels 23 November 2017, 2014/AF/271).

Parent-Subsidiary Directive and companies' resident in a tax treaty state.⁷²⁹ Furthermore, Luxembourg as a general rule does not levy withholding tax on interest paid to non-resident companies.⁷³⁰

A5.1.4.2 Cypriot law

a) Tax residency rules (place of effective management)

An entity is tax resident in Cyprus when its management and control is exercised in Cyprus, regardless of its place of incorporation.⁷³¹ As stated above, this is in line with most tax treaties (article 4 of the OECD Model Tax Convention) and means that a company effectively managed from Cyprus is also a resident of Cyprus under the tax treaties concluded by Cyprus. As noted, Y Cyprus was argued to qualify as a letterbox company since it does not carry out any business (other than the holding of the shares and certain group financing activities) in Cyprus, does not have physical premises or staff there and is used as part of a scheme to reduce the tax burden in a cross-border setting. Nevertheless, Y Cyprus is regarded as a resident of Cyprus, granting it entitlement to the benefits of the tax treaties concluded by Cyprus (and resulting in a withholding tax exemption on its outgoing dividend and interest payments as discussed under 5.2.2).

b) Withholding tax rules

Cyprus does not levy withholding tax on dividends or interest distributed to non-residents.⁷³² The interposition of a Cypriot holding company in *Y Denmark* thus prevented that dividends distributed to the parent company (Y Bermuda) would be subject to withholding tax in Denmark following the 2001 legislative change referred to in 3.1 above. As Denmark has concluded a tax treaty with Cyprus, diverting the dividends to a Cypriot holding company still resulted in an exemption from withholding tax. The Cypriot withholding tax exemption for outbound dividends would subsequently allow for the tax-free redistribution of the dividends to Y Bermuda.

A5.1.5 Impact of the decision

The ECJ decision addressed here can be considered a landmark case that may have a profound effect on the application of EU law in situations of abuse (and, more specifically, also on the interpretation of the beneficial ownership criterion in the context of EU law). Of particular importance is the Court's finding that a specific (domestic or tax treaty-based) anti-abuse provision is not necessary to challenge such situations of abuse: tax authorities can deny benefits (of for instance EU Directives) by relying on the general principle that EU law cannot be relied on for abuse of fraudulent purposes. The extent of that possibility, however, may need further clarification. It is, for instance, not yet clear whether that general 'anti-abuse' principle of EU law can also be used to deny tax treaty benefits in situations that can be regarded as abusive (e.g., certain conduit structures).

In addition, the Court's interpretation of the beneficial ownership requirement (and particularly the intertwinement of that interpretation with the general anti-abuse principle of EU law, referred to above) could give rise to some discussion. While it is

⁷²⁹ Art. 147 LIR, see R. OFFERMANS, Luxembourg – Corporate Taxation, *IBFD Country Tax Guides*, 6.3.1. (last accessed 17 October 2019); See also Opinion AG KOKOTT, 1 March 2018, C-116/16 and C-117/16, *T Denmark*, § 71.

⁷³⁰ Unless in certain cases dividend withholding tax is levied on interest on profit-sharing bonds., see R. OFFERMANS, Luxembourg – Corporate Taxation, *IBFD Country Tax Guides*, 6.3.2. (last accessed 17 October 2019).

⁷³¹ A. TALLOTIS, Cyprus – Corporate Taxation, *IBFD Country Tax Guides*, 1.2.1. (last accessed 17 October 2019).

⁷³² A. TALLOTIS, Cyprus – Corporate Taxation, *IBFD Country Tax Guides*, 6.3. (last accessed 17 October 2019).

true that the beneficial ownership criterion is intended to counter (certain specific types of) abuse, the extent to which the Court considers that criterion to be relevant for the application of the general anti-abuse principle (and vice versa) is not fully clear from the decision. This is of particular relevance as the Court also seems to take account of the beneficial ownership criterion in relation to the Parent-Subsidiary Directive (Directive 90/435) even though that Directive does not contain an explicit reference to beneficial ownership⁷³³.

Finally, an important question in the context of letterbox companies which may need further clarification is whether the case law referred to here has lowered the threshold for assessing abuse. If that were the case, it may be possible for tax authorities to deny certain tax benefits where arrangements or transactions are mainly motivated by tax purposes, even in cases where the letterbox company is not 'wholly artificial' (i.e., has a certain degree of substance). As discussed in section 4.3.3, there is discussion on whether the ECJ has indeed changed its approach. Future case law will need to offer clarification on this point.

A5.1.6 Changes to domestic law challenging the use of the present structures

As a result of the amended Parent-Subsidiary Directive, all EU Member States had to introduce a GAAR under which taxpayers cannot obtain the benefits of an EU Directive or tax treaty if obtaining such benefit was one of the main purposes of the arrangement. Article 6 of the Anti-Tax Avoidance Directive (ATAD) has extended the application of this GAAR to the domestic corporate tax law of the member states. The new GAAR needed to be implemented by all member states with application as from 1 January 2019.⁷³⁴ Under Article 6 of ATAD:

For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

Both changes could potentially drastically increase the possibility of the tax administrations of the EU member states (such as Denmark in the present cases) to challenge the use of mainly tax-driven conduit companies⁷³⁵.

For prior years however, the judgment of the ECJ in respect of the present cases will be relevant for challenging these structures, as it allows the tax authorities to deny the withholding tax exemption under the Parent-Subsidiary Directive and other EU corporate tax Directives in abusive situations under a general EU law principle of anti-abuse, even in the absence of a domestic GAAR (see section 6 above).

A5.1.7 Changes to tax treaty law challenging the use of these structures

In case the EU Parent-Subsidiary Directive cannot be relied on (see section 6 above), a second question is whether the respective structures could then still rely on withholding tax exemptions or reduced rates under the tax treaties.

⁷³³ ECJ, 26 February 2019, C-116/16 and C-117/16, *T Denmark*, § 100-105.

⁷³⁴ Denmark implemented both rules in 2015 and 2018 respectively.

⁷³⁵ It is indeed up to the Member State to exercise this right.

This question gives rise to a number of legal issues, notably whether the anti-abuse principle, as a general principle of EU Law (as recognized the ECJ in *T Danmark* and *Y Danmark*) can also be used to set aside the use of conduits in the context of tax treaties.

Secondly and depending on the answer to the above question, the question arises whether the changes to the OECD Commentaries (namely the change to the Commentaries in 2003 as a result of the reports of the OECD regarding conduit companies) could be used when interpreting the notion of “beneficial ownership” in tax treaties concluded prior to that date. Whether new OECD Commentaries can be used to interpret existing treaties (dynamic interpretation) is a difficult issue that is still the subject of discussion.

A5.1.7.1 Implications of the Multilateral Instrument (MLI)⁷³⁶

Inspired by BEPS Action 6, Article 7 of the MLI provides for measures to counter the use of tax treaties in abusive circumstances. As such parties to the MLI can choose to implement in their tax treaties either:

- a principal purpose test, allowing to deny treaty benefits to arrangements or transactions where the principle purpose or one of the principle purposes was obtaining the treaty benefits unless it is established that the granting of the benefit is in line with the object and purpose of the tax treaty. This test could be supplemented by a simplified limitation on benefits test (‘LOB’), allowing to deny treaty benefits for example to companies without real economic activity (‘active trade or business’);
- a detailed LOB, supplemented with anti-conduit financing rules.

Denmark has chosen to apply the PPT and in some cases also the simplified LOB. Luxembourg has chosen to apply the PPT⁷³⁷. Cyprus will apply the PPT as the country has ratified it in January 2020.

The PPT (or detailed LOB) supplements the anti-abuse framework in a tax treaty context. Aside from the question regarding the possible application of the ATAD GAAR or the general EU law principle of anti-abuse in a tax treaty context, the PPT or LOB in the future will arguably provide a distinct and clear basis to set aside the use of tax treaty benefits by conduit companies.

A5.2 The Netherlands and royalties in relation to digital activities

The second case study concerns the difficulties in applying the traditional rules of international taxation (notably the permanent establishment criterion) in relation to digital activities as well as the use of companies established in the Netherlands in order to achieve a favourable tax treatment of income from intellectual property. The case illustrates that the use of letterbox companies in the specific scenario of business income from digital activities allows for profits to remain almost entirely untaxed in certain situations.

Note that the issue of digital activities is not as such a characteristic of letterbox companies and that the case is not based on digital technologies being used as part of an attempt to set up a letterbox company. It is of course true that the use of such technologies may make it difficult to apply the criteria that are currently used in company law and tax law to determine a company’s place of residence. For instance, the use of digital technology such as video-conferences instead of physical meetings complicates the application of traditional criteria such as the “place of effective management”. Similarly, if a company conducts most (or all) of its activities digitally

⁷³⁶ Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

⁷³⁷ With the sole exception of the tax treaty with Senegal, for which it used the option not to implement the PPT in the tax treaty due to a similar rule already being provided for in the treaty.

(e.g., online), the place of business may be difficult to determine. Such technological evolutions have made the territorial connection between a company and its country of registration less relevant, as a result of which the existing traditional concepts relating to corporate residence risk becoming outdated (see Section 5.1.1.4 for more details on technological developments). That evolution may also have an impact on the understanding of what constitutes a letterbox company since that understanding is currently determined, by a lack of business activities in the company's state of registration. Those issues have, however, not been incorporated as such in the case study as there is currently no evidence that these technological issues are used in practice as part of tax avoidance structures involving letterbox companies.⁷³⁸ Instead, such structures are often based on mismatches or discrepancies between domestic laws and a lack of coordination at the international level, as is the case in the present case study. Nevertheless, digital activities are an integral part of this case study, as current international tax rules are difficult to apply to those activities. As a result, a country where such activities are performed may be unable to tax the profits generated from them. The case study shows that digital activities thus reveal a weakness in the current rules on international taxation and by making use of that weakness as part of a structure that also involves letterbox companies, multinational enterprises (especially digital ones) may be able to achieve a situation in which business profits remain almost entirely free from tax.

A5.2.1 Factual situation

The A-Co group is a group of companies that have developed and operate a software application that allows for peer-to-peer ridesharing. Users of the service install a smartphone application which gives access to the software platform. Using that platform, passengers can order a ride to their destination of choice and are quoted a fare. Drivers act as independent contractors and use their own car to provide the services.

The structure of the A-Co group is as follows. A-Co Tech Inc. is a Delaware corporation with a number of US and non-US subsidiaries. One of those subsidiaries is A-Co CV, an entity set up in the Netherlands but headquartered in Bermuda. A-Co CV does not have any employees and due to its hybrid status it is neither taxable in Bermuda (due to the absence of corporate income taxes in that country), nor in the Netherlands or the US (see below, section 4).

A-Co CV and A-Co Tech Inc. have concluded an agreement on the use of intellectual property ('I.P.') of A-Co Tech Inc. Under that agreement, A-Co CV paid a one-time fee of 1 million USD and agreed to pay 1,5% of its future net revenue in exchange for the right to use the I.P. of A-Co Tech Inc. (including its brand name, logo, and software I.P.) outside the United States.

Local subsidiaries of the A-Co group are responsible for marketing and other supporting services in the different market jurisdictions where the ride-sharing services are offered. A-Co CV holds the shares in those local subsidiaries through a holding company in the Netherlands (which is disregarded for purposes of the present case study).

A-Co CV can be regarded as a letterbox company: it does not carry out any business in the Netherlands, other than the activities relating to the I.P. In addition, it does not have physical premises or staff in the Netherlands and it is used specifically to obtain tax benefits in a cross-border setting, as will be pointed out below.

⁷³⁸ On the contrary, for tax purposes, in many cases (and arguably, in many LBC cases) companies expressly resort to physical board meetings taking place in a certain country (rather than digital meetings) in order to be able to more easily demonstrate tax residency in that country (effective management from that respective country) and in order to be able to fend off foreign tax administrations challenging that tax residency. Reference in that respect can be made for example to the case cited under note 15.

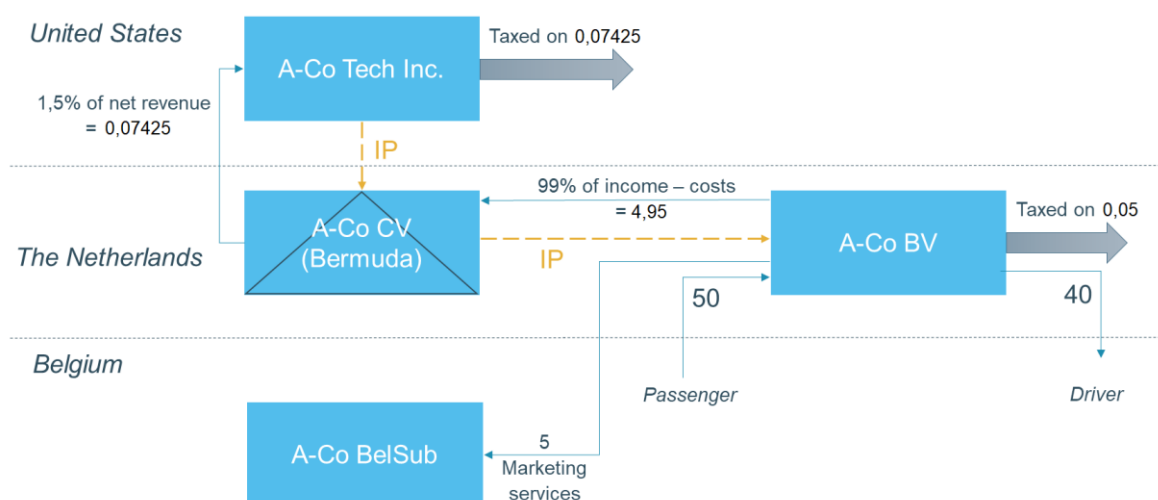
A-Co CV also holds the shares in A-Co BV, a company resident in the Netherlands, which processes the payments for the ride-sharing services. When a ride has been ordered, the passenger pays the fare to A-Co BV through the platform. The company pays 80% of the fare to the driver and keeps 20% as a commission. A-Co BV pays a fee to the local subsidiaries for its (marketing and other) services. That fee is determined on a cost plus basis (costs of the local subsidiaries plus a mark-up).

A-Co CV and A-Co BV have concluded an I.P.-licensing agreement, under which A-Co BV pays a royalty to A-Co CV for the use of the A-Co I.P. That royalty payment is set at 99% of A-Co BV's income (i.e. the commissions) minus costs. Assuming that a Belgian individual makes use of the A-Co application by paying a fee of 50 Euros, the structure and payment flow could be summarized as follows:

Party to the transaction	Amount paid/received	Taxable
Belgium customer	Pays 50 Euro fare to A-co BV	n/a
A-Co BV (NL)	Pays 80% of the fare to driver (40 Euros) and a fee for local services to its subsidiary A-Co BelSub in Belgium (5 Euro) The net income of A-Co BV is thus 5 Euro (i.e., the gross income of 50 Euros – the 40 Euro payment to the driver – the 5 Euro payment to A-Co BelSub)	40 Euros is taxable in Belgium for the driver 5 Euro Fee is taxable in Belgium
A-Co BV (NL)	Pays 99% of its net income of 5 Euro to its holding company, (A-CO CV in the NL) = 4.95 Euros	0.05 Euros is taxable on A-Co BV in the NL
A-CO CV (NL)	Pays 1.5% net revenue to A-Co Tech Inc. (USA)	A-CO CV is neither taxable in the NL nor in Bermuda

Country of Taxation	Company	Liable for CIT
Belgium	A-Co BelSub	5 Euros for Marketing services
The Netherlands	A-Co BV	0.05 Euros (net income, after payment of 99% fee)
Bermuda	Hybird-A-Co CV	Nil

US	A-Co Tech	Fee of 0.07425 (1.5% of net revenue)
Total Liable to corporation tax		5.12425
Non-Taxable corporation income		4.87575



The Belgian passenger pays a fare of 50 Euros, 20% of which is booked by A-Co BV in the Netherlands as a commission. That company then remunerates the local subsidiary (A-Co BelSub) in Belgium with 5 Euros for its supporting services and, under the licensing agreement with A-Co BV, pays 99% of its net income to A-Co CV, while paying in tax in the Netherlands on 0.05 Euros (its net income). The Bermudan-Netherlands hybrid, A-Co CV, receives 4.95 Euros for the transaction but does not pay tax on it. The US entity, A-Co Tech inc, is then taxed in the US on 1.5% of the net revenue of the transaction which amounts to 0.07425 Euros.

A5.2.2 Absence of taxable presence in the market jurisdiction

The first tax-related issue in this case study is the impossibility for the market jurisdiction (Belgium in the example) to tax profits generated from the ride-sharing services (other than the profits of A-Co BelSub). Even though the actual economic activities are to a considerable extent carried out on the territory of the market jurisdiction (i.e., in the example: the application is used in Belgium, the ride is completed in Belgium, the data that is used to perform and optimize the service is collected in Belgium, etc.), that jurisdiction is unable to tax the actual profits generated by those activities.

The reason can be found in the international tax rules that determine which state is entitled to tax business profits in cross-border situations. In this respect, tax treaties generally follow the approach of the OECD Model Convention. Article 7 of that convention contains the following provision: "Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the

enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment [...] may be taxed in that other State”.

Consequently, the general rule is that business profits of an enterprise can only be taxed in the home state of the enterprise. The exception to that rule is the situation where that enterprise has a permanent establishment ('PE') in the other state. Applied to the case at hand, Belgium would only be able to tax (part of) the profits of A-Co BV if that company had a PE in Belgium.

The term 'permanent establishment' is defined in article 5 of the OECD Model Convention, which draws a distinction between two types of PEs: a fixed place of business and an agency PE.

Article 5(1) contains the following description of the first type:

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

a) a place of management;

b) a branch;

c) an office;

d) a factory;

e) a workshop, and

f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

In order for there to be a PE in accordance with this definition, three conditions must therefore be met: (1) there must be a physical presence which is at the disposal of the enterprise, (2) that presence must be fixed, i.e. characterised by a certain permanence in time and space and (3) the business of the enterprise must be carried on through that presence.

If there is no such fixed place of business, it is still possible that a PE exists if the conditions of the agency PE are met. That concept is defined in article 5(5) of the OECD Model:

"[...] where a person [who is not an independent agent acting in the ordinary course of his business] is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are

a) in the name of the enterprise, or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise [...]"

In the case at hand, A-Co BV does not have a fixed place of business in Belgium as it does not have any physical presence at its disposal through which its business is carried on. In addition, A-Co contracts directly with the Belgian passengers through the digital platform. As a result, there are no dependent agents of A-Co BV acting in Belgium and concluding contracts (or playing the principal role leading to the conclusion of contracts). Consequently, A-Co BV does not have a PE in Belgium, as a result of which Belgium is

unable to tax the profits of that enterprise. Only the Netherlands, as the enterprise's home state, is able to tax those profits.

A5.2.3 Royalty payments

As noted under section 3, only the Netherlands has the authority to tax the profits of A-Co BV. In the case at hand, however, the tax burden in the Netherlands is reduced to a significant extent due to the I.P. licensing agreement with A-Co CV. As noted, A-Co BV is required to pay 99% of its income as a royalty to A-Co CV, leaving only a minimal amount of taxable income in the Netherlands. Provided that the amount of that payment is compatible with the transfer pricing rules applicable in the Netherlands (i.e. if they can be considered to correspond to the arm's length standard), the Dutch tax authorities are in principle unable to challenge that payment. The royalty payment from A-Co BV to A-Co CV is further exempt from withholding taxes (WHT) under Dutch domestic law. The Netherlands does not impose a WHT on royalties.

A-Co CV's income (the royalty payment) is not subject to corporate income tax in any of the states involved. This is because the structure gives rise to a 'hybrid mismatch' due to the differences as regards the classification of legal entities under the domestic laws of the states involved (in the case at hand the Netherlands and the US). Such mismatches occur where the state where an entity is established considers it to be transparent for tax purposes, while the state where the participants reside classify the entity as non-transparent for tax purposes.

In the case at hand, A-Co CV is regarded as a transparent entity for purposes of domestic tax law in the Netherlands, which entails that its income is not subject to corporate income tax in the Netherlands (instead, that income is - according to domestic law in the Netherlands - taxable at the level of the CV's participants but as those participants are non-residents, they are not taxable in the Netherlands). Conversely, the United States classify the CV as a non-transparent entity, meaning that from the perspective of US tax law, the CV's income is taxable at the level of the entity itself rather than at the level of the participants. Consequently, that income is not taxable in the United States either (apart from the portion paid to A-Co Tech Inc., i.e., 1.5% of A-Co CV's net revenue). That 'mismatch' in the classification of the entity results in the entity's income not being taxable in either state. Finally, no corporate income tax applies in Bermuda.

As noted, A-Co CV can be regarded as a letterbox company, given its lack of business activities in its state of registration (the Netherlands), the lack of physical premises and staff and its purpose as part of a scheme to reduce the tax burden of the multinational group in the cross-border context described above.

A5.2.4 Potential solutions

A5.2.4.1 Changes to tax treaties to address the PE-issue

The first issue, the inability of the market jurisdiction to tax the profits generated from digital activities carried on in its territory, has given rise to a number of different proposals but currently there is no consensus on the most proper and feasible way to address it. Broadly speaking, a distinction can be made between a number of proposals that seek to address the issue in the short term, and other proposals of a more fundamental nature that are intended to constitute a long-term solution.

At the level of the OECD, BEPS Action 1 has resulted in a 2015 final report in which two short-term solutions were proposed⁷³⁹. The first, an 'equalisation levy', is a levy at source on gross income from digital activities intended to achieve a level playing field between domestic and foreign enterprises of the market jurisdiction. That is to say, due

⁷³⁹ OECD (2015), *Addressing the Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD publishing, Paris.

to the absence of a taxable presence in the market jurisdiction, that jurisdiction is unable to tax the profits of foreign enterprises carrying on digital activities while domestic enterprises are taxable in that jurisdiction. The report does not indicate on what basis the levy would apply. One possibility mentioned in the report is that the levy could be imposed on data and other contributions gathered from in-country customers and users⁷⁴⁰, but no detailed proposal is given. The report also emphasizes that such a levy may raise substantial questions in relation to EU law and trade agreements⁷⁴¹.

A second short-term solution proposed in the 2015 report is a withholding tax on digital transactions. Such a tax could be applied for example, on a gross basis to transactions for goods or services ordered online⁷⁴². In this regard as well, the report is careful to note potential difficulties with EU law and WTO law⁷⁴³.

As a long-term solution, the 2015 report suggested to use 'significant economic presence' as a criterion for tax jurisdiction in relation to business profits. The underlying idea would be that a non-resident enterprise should be taxable in a country when it has a significant economic presence there on the basis of factors that evidence a purposeful and sustained interaction with the economy of that country via technology and other automated tools⁷⁴⁴. In order to determine whether a non-resident enterprise has a significant economic presence, the report proposes a number of criteria, e.g. the presence of local factors such as a local domain name or local payment options, the income generated from users in the country, the number of users in that country, etc.⁷⁴⁵

Provided that there is a significant economic presence, it is necessary to determine the amount of profits that can be attributed to that 'digital PE'. On that point, the 2015 report does not contain any specific proposals, but indicates that it should be assessed whether the current rules only need modification or new allocation rules should be developed⁷⁴⁶.

In a subsequent interim report of 2018, the OECD stated that there was no consensus on the merit or the need for short-term measures and therefore the 2018 report did not make a recommendation for their introduction⁷⁴⁷. That report, however, did give some suggestions to states that considered the unilateral introduction of such short-term measures⁷⁴⁸. The 2018 report did not address long-term solutions.

In 2019, the OECD has made considerable progress in developing a possible long-term solution. All the ideas presented by the OECD during this year start from the premise that more taxing rights should be allocated to the countries where consumers or end-users are located.

In February 2019, the OECD issued a public consultation document where three possible long-term solutions were proposed: (i) a 'significant economic presence', (ii) the 'user participation proposal' and (iii) the 'marketing intangibles proposal'.

⁷⁴⁰ OECD (2015), *Addressing the Challenges of the Digital Economy, Action 1 – 2015 Final Report*, no. 305.

⁷⁴¹ OECD (2015), *Addressing the Challenges of the Digital Economy, Action 1 – 2015 Final Report*, no. 306.

⁷⁴² OECD (2015), *Addressing the Challenges of the Digital Economy, Action 1 – 2015 Final Report*, no. 294.

⁷⁴³ OECD (2015), *Addressing the Challenges of the Digital Economy, Action 1 – 2015 Final Report*, no. 298-300.

⁷⁴⁴ OECD (2015), *Addressing the Challenges of the Digital Economy, Action 1 – 2015 Final Report*, no. 277.

⁷⁴⁵ OECD (2015), *Addressing the Challenges of the Digital Economy, Action 1 – 2015 Final Report*, no. 278-283.

⁷⁴⁶ OECD (2015), *Addressing the Challenges of the Digital Economy, Action 1 – 2015 Final Report*, no. 284-291.

⁷⁴⁷ OECD (2018), *Tax Challenges Arising From Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, 178, no. 404.

⁷⁴⁸ OECD (2018), *Tax Challenges Arising From Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, no. 412-463.

The first proposal had already been developed to a certain extent in the 2015 report (see above). In the February 2019 public consultation document the OECD did not further substantially develop this concept. It merely stated that revenue generated on a sustained basis in a country would serve as the basic factor for determining whether a non-resident enterprise has sufficient economic ties with that country. In addition, the OECD proposed to explore whether the allocation of profit to a significant economic presence could be based on a fractional apportionment method.⁷⁴⁹

The user participation proposal and the marketing intangibles proposal are entirely new proposals. The user participation proposal relies on the idea that the added value for some enterprises is created by the active participation of their users. Therefore, this proposal aims at allocating a portion of the profits of an enterprise in the country where users are located.⁷⁵⁰ On the other hand, the marketing intangibles proposal relies on the idea that an enterprise is able to develop marketing intangibles (e.g. brand name or clientele) in a country without the need for physical presence in that country. Consequently, this method would allow countries where marketing intangibles have been developed to tax a non-resident enterprise where this previously was not the case.⁷⁵¹

In May 2019, the OECD further issued a programme of work to develop a consensus solution to the tax challenges arising from the digital economy (the 'Programme of Work'). This document focussed on the development of new profit allocation rules between countries, having in mind the ideas already presented in the February 2019 public consultation document. The proposed profit allocation methods were the following (i) the 'modified residual profit split method', (ii) the 'fractional apportionment method' and (iii) 'distribution-based approaches'.

The modified residual profit split method and the fractional apportionment method work in a similar way. In both methods, an amount of group profit (or business line) would be divided amongst different countries where consumers/users are located using an allocation key (or formula). The major difference between the two methods is that with the modified residual profit split method, the group profit that would need to be split is only the non-routine profit whereas for the fractional apportionment method, the total group (or business line) profit would need to be split.⁷⁵²

Distribution-based methods are designed to address profits arising from routine activities associated with marketing and distribution. The idea is here to explore the possibility of more simplified methods to allocate profits related to those activities.⁷⁵³

The Programme of Work did not provide details on how it would need to be determined whether a market jurisdiction has taxing rights or not. It merely stated that this could be done by (i) either adjusting the existing PE rule or (ii) by creating entirely new rules that would co-exist with the existing PE rule.⁷⁵⁴

Finally, **in October 2019**, the OECD issued another public consultation document introducing a 'unified approach' in resolving the challenges posed by the digital

⁷⁴⁹ OECD, Addressing the Tax Challenges of the Digitalization of the Economy: Public Consultation Document (2019), 16.

⁷⁵⁰ OECD, Addressing the Tax Challenges of the Digitalization of the Economy: Public Consultation Document (2019), 9.

⁷⁵¹ OECD, Addressing the Tax Challenges of the Digitalization of the Economy: Public Consultation Document (2019), 10-12.

⁷⁵² OECD (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Inclusive Framework on BEPS*, OECD, Paris, 12-15.

⁷⁵³ OECD (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Inclusive Framework on BEPS*, OECD, Paris, 15.

⁷⁵⁴ OECD (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Inclusive Framework on BEPS*, OECD, Paris, 18-19.

economy. The OECD developed a more precise framework in this document that it hopes to build upon after agreement of the G20.

The new rules should be applicable to consumer-facing businesses covering both digital and non-digital businesses. The scope is therefore broader than merely the digitalized economy. For the businesses in scope, the OECD strives to design a profit allocation system between market jurisdictions that would be more practical to apply and to administer.⁷⁵⁵ The general idea is to allocate non-routine group (or business line) profits to market jurisdictions based on a defined allocation key (e.g. sales).⁷⁵⁶ The routine and non-routine profits would be split based on a fixed percentage that still needs to be determined.⁷⁵⁷ In addition, the new rules also provide for profit allocation rules related to marketing and distribution functions and other functions that go beyond marketing and distribution. The profits related to the marketing and distribution function would possibly be based upon a fixed remuneration whereas the profits related to other functions would still be based upon the arm's length principle.⁷⁵⁸

At the level of the EU, there have also been a number of proposals. In 2018, a concrete proposal for the introduction of a digital services tax ('DST') was introduced as a short-term solution⁷⁵⁹. According to that proposal, the DST would be a 3% source tax on gross income generated in the EU from digital advertising, digital platforms and the transmission of data collected about users and generated from users' activities on digital interfaces. Specific rules were suggested to determine when this income is generated in the EU⁷⁶⁰. The DST would only apply to entities with a total amount of worldwide revenues exceeding EUR 750 000 000 and a total amount of revenues from digital activities in scope exceeding EUR 50 000 000.

However, no consensus was reached on that proposal, and it has for the time being not been developed further. An attempt to reach consensus was made by Germany and France who proposed a simplified DST in December 2018. The Franco-German proposal would limit the applicability of the DST to only revenues from advertising and would be called the 'digital advertising tax' ('DAT').⁷⁶¹ However, to date, no consensus has been reached either on this proposal.

As a long-term solution, there has been a proposal at the EU level to implement the concept of 'significant digital presence' ('SDP') as a criterion for allocating taxing rights in relation to corporate income from digital activities⁷⁶². According to that proposal, a SDP would be present when a non-resident enterprise performs digital services and (i) the proportion of the total revenue obtained in a tax period and resulting from the supply of those digital services to users located in that Member State in that period exceeds EUR 7M or (ii) the number of users of one or more digital services who are located in

⁷⁵⁵ OECD, Public consultation document, "Secretariat Proposal for a "Unified Approach" under Pilla One", 9 October 2019 – 12 November 2019, 8-9.

⁷⁵⁶ OECD, Public consultation document, "Secretariat Proposal for a "Unified Approach" under Pilla One", 9 October 2019 – 12 November 2019, 7-8.

⁷⁵⁷ OECD, Public consultation document, "Secretariat Proposal for a "Unified Approach" under Pilla One", 9 October 2019 – 12 November 2019, 16-19.

⁷⁵⁸ OECD, Public consultation document, "Secretariat Proposal for a "Unified Approach" under Pilla One", 9 October 2019 – 12 November 2019, 9

⁷⁵⁹ Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM(2018) 148 final.

⁷⁶⁰ Article 5, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services.

⁷⁶¹ Franco-German joint declaration on the taxation of digital companies and minimum taxation: <https://www.consilium.europa.eu/media/37276/fr-de-joint-declaration-on-the-taxation-of-digital-companies-final.pdf>

⁷⁶² Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM/2018/0147 final.

that Member State in that period exceeds 100.000 or (iii) the number of business contracts for the supply of any such digital service that are concluded in that period by users located in that Member State exceeds 3.000.⁷⁶³

Regarding the profits to be attributed, the proposal states that the profits that need to be attributed to the SDP are those that the SDP would have earned if it had been a separate and independent enterprise performing the same or similar activities. The proposal attempts to identify economically significant activities that contribute to the value creation in digital business models for which profit should be attributed. According to the proposal, every activity related to data or users would qualify as an economically significant activity.⁷⁶⁴ The amount of profits to be attributed should be calculated by preference based on the profit split method.⁷⁶⁵

This proposal has currently been put on hold while the European Commission is awaiting the developments at OECD level.

A5.2.4.2 Changes to domestic law in relation to royalty payments

The Netherlands is currently proposing to introduce a 20,7% WHT on royalty payments to group entities based in EU blacklisted non-cooperative or low-tax jurisdictions as of 1 January 2021. The term 'low-tax jurisdiction' is defined as a jurisdiction with a statutory corporate income tax rate of less than 9%. The Dutch Ministry of Finance plans to publish each year a list of such low-tax jurisdictions. 'Non-cooperative jurisdictions' are the jurisdictions on the EU list of non-cooperative tax jurisdictions⁷⁶⁶.

The proposal further aims to primarily target direct payments made by Dutch resident entities or by Dutch permanent establishments of non-Dutch entities. However, indirect payments could also be targeted in abusive situations. This could be the case when a non-low taxed intermediate conduit company has been artificially interposed between a Dutch paying entity and a receiving company in a low-taxed jurisdiction.

With this proposal, the Dutch government seeks to strike a balance between countering tax avoidance and not hindering genuine fund flows.⁷⁶⁷ If implemented, the proposal could serve to discourage the entities established in the Netherlands to channel royalty payments to third countries.

A5.2.4.3 Changes in relation to hybrid mismatches

BEPS Action 2 attempts to neutralise the effects of hybrid mismatch arrangements and hybrid financial instruments. In the 2015 final report on this Action, the OECD proposed new tax treaty rules and suggested domestic measures to prevent such arrangements and instruments from being used for tax planning purposes⁷⁶⁸.

Specifically, as regards mismatches in relation to the classification of legal entities, the final report recommends the introduction of a 'linking rule' in domestic law, pursuant to which the deduction of a payment to a hybrid entity is denied to the extent that it is deductible for the payer but not included as taxable income in the jurisdiction where the

⁷⁶³ Article 3 Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, 21.03.2018, COM/2018/0147 final – 2018/072 (CNS).

⁷⁶⁴ Article 5 Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, 21.03.2018, COM/2018/0147 final – 2018/072 (CNS).

⁷⁶⁵ Article 5(6) Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, 21.03.2018, COM/2018/0147 final – 2018/072 (CNS).

⁷⁶⁶ Note that Bermuda has recently been removed from that EU list (<https://data.consilium.europa.eu/doc/document/ST-8828-2019-REV-1/en/pdf>). However, royalty payments to an entity in Bermuda would still be in scope as Bermuda would qualify as a low-tax jurisdiction.

⁷⁶⁷ <https://www.nortonrosefulbright.com/en-nl/knowledge/publications/44b6bc7e/the-netherlands--2020-tax-budget-summary#section5>

⁷⁶⁸ OECD (2015), *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD publishing, Paris.

payee is established (nor in the jurisdiction of any investor in that payee). Such a situation, where a payment is deductible at the level of the payer but not included as taxable income at the level of the payee (or at the level of the investors in the payee) is referred to as a "D/Ni outcome" ("deduction / no inclusion"). In essence, the recommended linking rule seeks to prevent that outcome by denying the deduction at the level of the payer. That rule, which is intended to apply to a broad range of deductible payments (e.g., interest, royalties or payments for services), would thus remove the tax benefit resulting from the mismatch between the jurisdictions involved.

There have also been initiatives at the level of the EU in relation to hybrid arrangements and instruments, most notably in the 2016 "ATAD" Directive⁷⁶⁹ and the 2017 "ATAD 2" Directive⁷⁷⁰. Article 2(9)(b) of the ATAD defines a as hybrid mismatch, a payment to a hybrid entity giving rise to a deduction without inclusion when that outcome is the result of differences in the allocation of payments made to the hybrid entity under the laws of the jurisdiction where the hybrid entity is established or registered and the jurisdiction of any person with a participation in that hybrid entity.⁷⁷¹ According to article 9(2)(a) of the ATAD, as a primary rule, the state of the payer shall deny the deduction of the payment. Furthermore, article 9a contains a reserve hybrid mismatch rule which entails that a hybrid entity considered as transparent in a member state should be considered as a resident of that member state for tax purposes when that entity is considered as a non-transparent in the jurisdictions of its non-resident associated⁷⁷² shareholder(s) having a share of at least 50% (voting rights, capital interest or rights to a share of profits) in that entity and should be taxable on its income in that member state to the extent that income is not taxed elsewhere.

Applied to the case at hand, these rules would entail that the Netherlands could on the one hand deny the deduction of the royalty payment to A-Co CV in the hands of A-Co BV (in its capacity of state of the payer). On the other hand, it could consider A-Co CV as a resident of the Netherlands for income tax purposes and apply income tax on the royalty received from A-Co BV. The ATAD however provides that a denial of the deduction of the royalty payment is no longer necessary in case the mismatch can already be adjusted under the reverse hybrid mismatch rule (in this in case: if the royalty income can already be taxed in the Netherlands by treating A-Co BV as a tax resident).⁷⁷³

The new anti-hybrid rules should be implemented by 1 January 2020, except for the reverse hybrid mismatch rule of article 9a, which needs to be implemented by 1 January 2022.⁷⁷⁴

⁷⁶⁹ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

⁷⁷⁰ Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

⁷⁷¹ Provided the mismatch occurs between associated enterprises, a taxpayer and an associated enterprise, between a HO and a PE (or several PE's of the same enterprise) or under a 'structured arrangement' as defined under art. 2(11) ATAD (art. 2(9), al. 2 ATAD). In this context the definition of associated enterprise requires a 50% direct or indirect interest (art. 2(4), last subparagraph).

⁷⁷² In this context the definition of associated enterprise requires a 50% direct or indirect interest (art. 2(4), last subparagraph).

⁷⁷³ Consideration 29 of ATAD 2.

⁷⁷⁴ This means that until 2022, denial of the deduction of the royalty payment in the hands of A-Co BV would still be relevant in order to adjust the mismatch outcome.

Annex 6 Case study on the use of letterbox companies for money laundering in Ireland and Luxembourg

The aim of this case study is to examine the use of letterbox companies for the purpose of money laundering. The case study focuses on the use of such companies specifically in the EU, providing examples from Ireland and Luxembourg.

While the issue of anti-money laundering and the money laundering phenomenon is quite broad, it may concern various aspects of company law, as well as measures to prevent money laundering. The focus of the case study is on the use of various legal structures that have the characteristics of shell companies/letterbox companies.

Ireland and Luxembourg have been selected, as both countries have been host to a large number of potential shell companies for investment or tax purposes. For both countries, all indicators linked to the presence of shell companies place them ahead of almost all EU countries: high rates of (inward/outward) FDI as percentage of GDP, or high share FDI stock held by special purpose entities (SPEs), or significantly higher rates of pre-tax profits as percentage of compensation of employees⁷⁷⁵.

A6.1 Anti-money laundering legislation

The terms shell company and offshore company are not used in EU or most national anti-money laundering legislation. Nevertheless, there is strong recognition that such companies are used by professional money launderers to launder criminal proceeds⁷⁷⁶. There are several aspects of EU's anti-money laundering legal framework that contribute to countering the abuse of shell companies or letterbox companies for money laundering purposes. These include:

- Measures to ensure that such companies do not serve as fronts to money-launderers, and therefore ensure transparency of the beneficial owners;
- Measures to control various categories of intermediaries and service providers that may enable or prevent the abusive use of shell or letterbox companies
- Measures to limit the provision of services to shell companies.

The key measures to tackle letterbox type companies are the provisions regarding the various obliged entities (including legal professionals, accountants, and trusts and company service providers (TCSPs)) to undertake due diligence in establishing the beneficial owners, and preventing and reporting suspected cases of money laundering. These obligations stem from the fact that in many Member States, they may be involved in:

- a) forming companies or other legal persons;
- b) acting as or arranging for another person to act as a director/secretary of a company;
- c) providing a registered office, business address, correspondence or administrative address and other related services for a company;

⁷⁷⁵ EPRS, An overview of shell companies in the European Union, October 2018: available at: http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf

⁷⁷⁶ European Commission, Commission Staff Working Document Accompanying the document Report from the Commission to the European Parliament and the Council on the assessment of the risk of money laundering and terrorist financing affecting the internal market and relating to cross-border activities, COM(2019) 370 final, available at: https://ec.europa.eu/info/sites/info/files/supranational_risk_assessment_of_the_money_laundering_and_terrorist_financing_risks_affecting_the_union_-_annex.pdf

- d) acting/arranging for another person to act as a trustee of an express trust or a similar legal arrangement;
- e) acting/arranging for another person to act as a nominee shareholder for another person.

With regard to **beneficial owners**, the key EU legislation is the **4th AML Directive**⁷⁷⁷, which required the set-up of national registers of beneficial owners of companies and some trusts and provided a definition of a beneficial owner. It also foresees that ongoing customer due diligence should be applied 'at appropriate times to existing customers on a risk-sensitive basis' (Article 14(5)). However, the abusive use of an LBC may take place only within a period of a few months or only in a single criminal scheme, which makes it difficult for obliged entities to determine the 'appropriate times' or have the resources to effectively apply customer due diligence with such frequency.

To improve identification of the ultimate beneficial owner, **the 5th AML Directive of 2018**⁷⁷⁸, amending the 4th AML Directive, provides for public access to the national registers of beneficial owners for legal entities, and links these registries across the EU. The Directive also allows Member States to require obliged entities to apply additional measures, in cases of higher risk. These measures included enhanced monitoring of business relationships and transactions. Requirements were also foreseen for special mitigation measures supporting or going beyond enhanced due diligence, with regard to entities and transactions linked to high-risk third countries.

A6.1.1 Ireland

Irish anti-money laundering legislation is set out in the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, amended by Criminal Justice Acts in 2013 and 2018.

The 2018 Act transposed the 4th AML Directive into Irish Law. It built on the 2013 amendment, which implemented the 3rd AML Directive. Irish law does not define shell companies and there are no specific measures foreseen to limit services to such companies. Instead, the Irish Central Bank has advised firms or banks to consider transactions involving shell companies or corporations as 'high-risk'⁷⁷⁹. Measures aim to ensure better regulation of TCSPs. With the 2013 amendments, anyone wishing to function as a TCSP needed to obtain an authorisation from the Minister for Justice and Equality. The 2013 Act also included TCSPs as 'designated persons'.

From 2019, some 300 TCSPs were authorised by the Minister for Justice and Equality, as the State competent authority for this sector in Ireland⁷⁸⁰. An authorisation is valid for a period of three years.

⁷⁷⁷ Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU.

⁷⁷⁸ Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU.

⁷⁷⁹ Central Bank of Ireland, Anti-Money Laundering and Countering the Financing of Terrorism Guidelines for the Financial Sector, 2019, pp. 20, 48, available at: <https://www.centralbank.ie/docs/default-source/regulation/how-we-regulate/anti-money-laundering-and-countering-the-financing-of-terrorism/guidance/anti-money-laundering-and-countering-the-financing-of-terrorism-guidelines-for-the-financial-sector.pdf?sfvrsn=4>

⁷⁸⁰ In this section of the NRA, the term 'State competent authority' is taken to refer to the Minister for Justice and Equality with regard to TCSPs not regulated within the financial sector. Information extracted from the report from the Irish Department of Finance, 'Money laundering and Anti-terrorist Financing', 2019, available at: <https://assets.gov.ie/8242/80ab9a41b1354405adcec66bfb1c0715.pdf>

TSCPs authorised by the State competent authority undergo a rigorous authorisation process where the beneficial owners and principal officers of a TCSP must undergo a fitness and probity assessment and must also be vetted by the Irish police (An Garda Síochána). In addition, they are inspected by the Anti-Money Laundering Compliance Unit (AMLCU) at least once every three years on a risk-based approach. The AMLCU is committed to collaborating with other supervisors to enhance the cross-sectoral supervision of TCSPs⁷⁸¹.

However, while TCSPs are required by legislation to be authorised by the State competent authority, it is suspected that several entities offering trust or company services may be operating without such authorisation⁷⁸².

The 2018 amendment to the Criminal Justice Act also transposed Article 30 of the 4th AML Directive and provided for the adoption in 2019 of Statutory Instrument (No. 110 of 2019), which established a Central Register of Beneficial Ownership (RBO) of Companies and Industrial and Provident Societies as per the requirements of the 4th AML Directive. The RBO became operational only in July 2019⁷⁸³, and aims to further improve corporate trust and transparency in Ireland and the EU by making it clear to law enforcement agencies, regulators, obliged entities, other businesses and the public about who ultimately owns and controls Irish companies⁷⁸⁴.

A6.1.2 Luxembourg

In Luxembourg, the anti-money laundering legal framework is based on the Law of 12 November 2004 on the fight against money laundering and the financing of terrorism, the Grand-Ducal Regulation of 1 February 2010 specifying certain provisions of the law of 12 November 2004 and CSSF regulation 12-02 of 13 December 2012 on the fight against money laundering and the financing of terrorism as applicable. In January 2019, the Law on Ultimate Beneficial Owner Register (*Loi instituant un Registre des bénéficiaires effectifs*) came into effect on 1 March 2019, implementing provisions of the 4th AML Directive. In addition to the main forms under which SPEs are registered⁷⁸⁵ (limited liability companies, public limited company, partnership limited by shares), the law also covers branches of foreign entities, European companies, and special limited partnerships⁷⁸⁶.

In March 2020, the Luxembourg Chamber of Deputies adopted two bills transposing the provisions of the 5th AML Directive: Law 7467, which modified the Law of 12 November 2004, and Law 7512, which established a central electronic data retrieval system for bank and payment accounts and safe-deposit boxes. Law 7467 transposed (among other provisions) a number of measures to reinforce risk assessment activities and customer due diligence by professionals (including mandatory proof of registration in the beneficial owner database)⁷⁸⁷. One of the key measures to prevent money laundering was the Law of 31 May 1999 governing the domiciliation of companies, which foresees criminal liability for persons using an LBC without entering into a written domicile agreement with an official agent. To **avoid the use of letterbox companies for criminal purposes**, domicile agents are subject to a range of professional obligations, which are specified in a CSSF circular (circular 01/47). They must identify beneficial owners on a continuous basis, they have to supervise the activities of

⁷⁸¹ Irish Department of Finance, 'Money laundering and Anti-terrorist Financing', Report, 2019, pp.59, available at: <https://assets.gov.ie/8242/80ab9a41b1354405adcec66bfb1c0715.pdf>

⁷⁸² *ibid.* p. 60.

⁷⁸³ <https://rbo.gov.ie/about.html>

⁷⁸⁴ Companies needed to file their beneficial ownership details until 22 November of 2019.

⁷⁸⁵ <http://www.startup-luxembourg.com/verbriefungsorganismus-spv.html>

⁷⁸⁶ <https://www.nortonrosefulbright.com/en/knowledge/publications/92a14ac7/luxembourg-register-of-ultimate-beneficial-owners>

⁷⁸⁷ <https://home.kpmg/lu/en/home/insights/2020/04/implementation-5th-aml-directive-in-luxembourg.html>

companies which they set up (e.g., knowledge of mail, following up financial transactions) and they are subject to a duty of cooperation with Luxembourg enforcement authorities (including a duty to report on indications of money laundering).

These measures indicate that using Luxembourg LBCs to hide criminal activities would mean being criminally liable for using an LBC without a domicile agent, or its criminal activities could be discovered by that agent, who supervises the business and is subject to a duty to report⁷⁸⁸.

In addition to its overarching legislation, Luxembourg has a strong tradition of **self-regulation**. Auditors, chartered accountants, notaries and lawyers who provide trust and company services are self-regulated professions in Luxembourg, and hence are supervised for AML/CFT purposes by their respective self-regulatory body ("SRB")⁷⁸⁹. The government supports such self-regulation by providing specific anti-money laundering guidance, including to TCSPs, outlining recommended best practices in customer due diligence and risk identification⁷⁹⁰.

A6.2 The use of letterbox companies in money-laundering schemes

Shell companies continue to be used by professional money launderers as part of money laundering schemes. While there are variety of possible schemes, this section aims to present a typical way in which shell companies/ letterbox companies can be used for the purpose of money laundering. The main characteristic that makes such companies attractive to money launderers is that they can obfuscate the beneficial owners of criminal assets. Setting up a company with a generic declared activity and no real economic activity is low-cost. For a higher cost, a shell company can be acquired, with a history of being in operation for some time⁷⁹¹.

Use of shell companies is part of the professional money laundering process, particularly during the so-called layering stage, where criminal funds are transferred to bank accounts managed by money launderers. The complex layering schemes or proxy structures involve multiple shell company accounts, which are typically established both domestically and abroad. The main objective is to mix the funds from legal and/or illegal clients within the same accounts, which makes it difficult to trace the funds transferred by one particular client⁷⁹².

⁷⁸⁸ Information update after interview with Mr Olivier Voordeckers.

⁷⁸⁹ Luxembourg, National Risk Assessment, 2020, p.109.

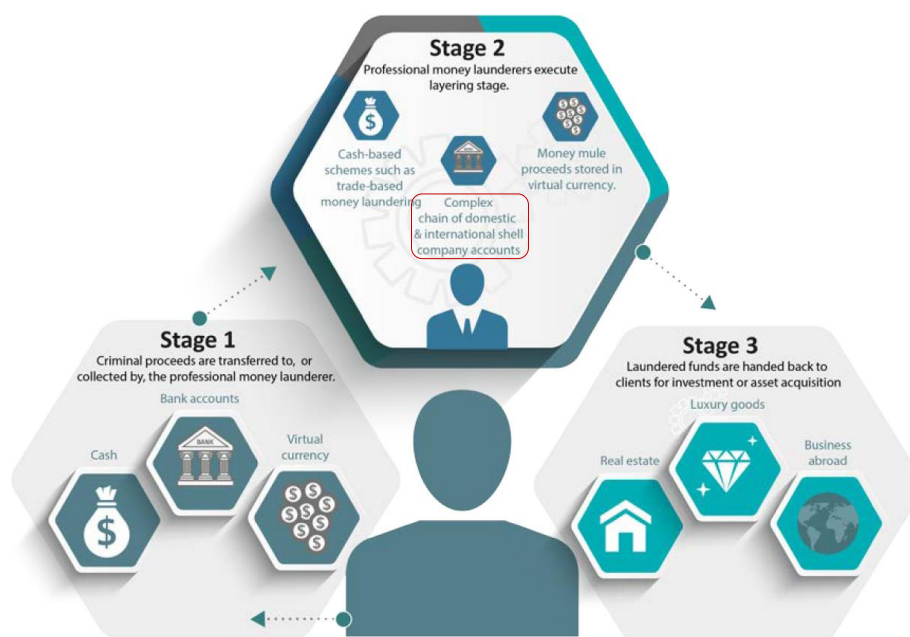
⁷⁹⁰ http://www.aed.public.lu/blanchiment/Guides-Sensibilisation-prevention/GUIDE_PS_SOCFID_NOV-2018.pdf

⁷⁹¹

https://ec.europa.eu/info/sites/info/files/supranational_risk_assessment_of_the_money_laundering_and_terrorist_financing_risks_affecting_the_union_-_annex.pdf, p.131

⁷⁹²

Figure 37. Professional money laundering process



Source: FATF⁷⁹³

A typical scheme arranged by a proxy network includes the following steps:

- **Step 1:** the criminal proceeds are transferred to accounts opened in the name of shell companies controlled by the money launderers or operating on their behalf. If the criminal proceeds were obtained in cash, controllers arrange to deposit the cash into the accounts of shell companies controlled by money launderers.
- **Step 2:** Funds are moved through a complex chain of accounts established by domestic shell companies under fictitious contracts. The funds from different clients are mixed within the same accounts.
- **Step 3:** Funds are then transferred to shell companies abroad, using fictitious trade contracts, loan agreements, securities purchase agreements between the shell companies. In most cases, accounts of the first-level layer of foreign companies are controlled by the same money launderers who facilitated Step 1, or by foreign money launderers who act in collaboration with the domestic ones.
- **Step 4:** Funds are moved through a chain of international transfers. The accounts opened in the name of shell companies are typically used to channel money that comes from all over the world. These international money transfers often demonstrate similar geographical patterns.

Professional launderers may operate these accounts from overseas, while they are locally managed by service providers and nominal directors. The funds received in the shell companies' accounts are usually transferred out of the jurisdiction within a few days.

- **Step 5:** Funds are returned to the accounts controlled by the initial clients or companies and arrangements related to them.

⁷⁹³ FATF, 2018, p. 18, available at: <http://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf>

It is important to note that money launderers and their proxy networks involving shell companies depend on their ability to connect to a global international network. Through this network they manage to achieve an effective layering process where money flows are mixed and tracing is made difficult. Case 1 below shows how such steps work in practice.

Case 1: Operation Snake was initiated following suspicious transaction reports from Spanish banks. A group of Chinese nationals and related (mostly shell) companies made small cash deposits followed by transfers to China in a total value of more than EUR 6 million. The investigators established that all were members of an organised criminal group that imported counterfeit goods or committed customs crime avoiding import taxes on consumer goods. The participants used 'smurfing' – making multiple deposits - by low-level associates (trafficked workers), using fraudulent documents, into personal and shell company bank accounts. The shell companies were also registered in the names of trafficked workers. The shell companies then transferred the money back to China. Some of the cash was also transferred in other ways – by mid-level cash carriers or via a Chinese informal cash transfer mechanism -- Feich'ien (Chinese Hawala). In total, 126 companies were indicted for laundering EUR 300 million.

A6.3 The role of intermediaries

The above-described schemes are facilitated by various factors. One of the key vulnerabilities targeted by EU legislation is the possible role of intermediaries involved in the establishment or operations of letterbox companies, such as legal, accounting and TCSP professionals. Failure to carry out due diligence of clients (whether deliberate or not) and the establishment of beneficial owners is a key factor that may facilitate money laundering and the abuse of letterbox companies⁷⁹⁴. The table below illustrates a possible money laundering scheme that involves TCSPs.

Figure 38. Money laundering schemes via shell companies using TCSPs

ML stages	TCSPs role
Placement	Sets up a shell company, of which a criminal is the beneficial owner Provides a nominee shareholder for the shell company at the point of incorporation, allowing the criminal to conceal their identity The shell company can then be used to open a bank account The payments can then be made to the bank account by the criminal, on the ground of fictitious services
Layering	One or several TCSPs are appointed as nominee directors of multiple shell companies across multiple jurisdictions TCSPs then carry out wire transfers between the shell companies on behalf of the criminals The layers conceal the original company making the transfer and distance the criminal from the source
Integration	TCSP sets up a shell company (A), whose main objective is to carry out the 'integration' of the laundered money to the criminal

⁷⁹⁴ FATF, Money laundering using TCSPs, 2010, available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/Money%20Laundering%20Using%20Trust%20and%20Company%20Service%20Providers..pdf>

	The TCSP acts as the nominee director for the registered shell company (A) The shell company (A) receives money via the layering process from another shell company (B) TCSP in its capacity of director of the shell company (A) makes a direct loan to the criminal The criminal can then use the loan money to purchase assets.

Source: CSSF, 2020⁷⁹⁵

A6.4 Money laundering risks and threats in Ireland

Ireland's national risk assessment (NRA) discusses a number of areas, where letterbox/shell companies were potentially involved. It concludes that **financial crimes pose** a significant threat of money laundering in Ireland. Financial crimes include a range of traditional and computer-enabled fraud offences perpetrated either by individuals or criminal groups. The proceeds generated from such crimes are processed via electronic payments. The money is then moved through the banking, payments, and financial sectors, using not only mule accounts or bogus accounts, but also **corporate accounts** of shell companies.

A6.4.1 Economic sectors and legal structures

With respect to economic sectors and types of legal structures and arrangements, Ireland's NRA assesses a wide range of possible risk areas (Figure 39), only some of which involve the use of shell companies:

- In the **financial sector**, recognised risks include **retail banking**, where shell company accounts are set up and proceeds moved, as well as **investment funds and funds administrators, and SPEs** (in particular, so-called Section 110 companies), especially those involved in financial services.
- In the non-financial sector, these includes the various categories of companies allowed under Irish law⁷⁹⁶ and the range of intermediaries (TCSPs, legal and accounting firms).

⁷⁹⁵ Commission de Surveillance du Secteur Financier, *FL/TF Sub-Sector Risk Assessment - Specialised Professionals of the Financial Sector providing corporate services (Trust and Company Service Provider activities)*, 2020, p. 20 (elaboration based on case studies presented in FATF, Money Laundering using TCSPs, 2010 and FATF and Egmont Group, Report on Concealment of Beneficial Ownership, 2018).

⁷⁹⁶ These include LTDs, companies limited by guarantee (CLG), unlimited companies and designated activity companies (DAC).

Figure 39. Risk rating by sector

Assessed Sector	Rating
Retail Banking	High
Non-Retail Banking	Medium-High
Money Remittance Firms	High
Payment Institutions (other than Money Remitters)	Medium-Low
Bureau de Change	High
Life Assurance	Medium-Low
Funds/Funds Administrators	Medium-High
Asset Managers	Medium-Low
Investment Firms	Medium-High
Credit Unions	Medium-Low
Moneylenders	Medium-Low
TCSPs (Trust or Company Service Providers) (subsidiaries of credit or financial institutions)	Low
Retail Intermediaries	Low
PMCs (Private Members' Clubs)	Medium-High
HVGDs (High Value Goods Dealers)	Medium-High
TCSPs (Trust or Company Service Providers) (excl. subsidiaries of credit or financial institutions)	Medium-High
Notaries	Medium-Low
PSPs (Property Service Providers)	Medium-Low
Legal Services Sector	Medium-High
Accountancy Services Sector	Medium-High
NPOs (Non-Profit Organisations)	Medium-Low

Source: NRA, Ireland⁷⁹⁷

A6.4.2 Financial sector

Ireland's financial system is well developed and globally interconnected, to an extent that the proceeds of foreign financial crimes may pass through the Irish financial system without being detected by financial institutions or law enforcement. The financial services sector in Ireland is the fourth largest exporter of financial services in the EU.

The **funds sector** is one of the most important parts of the Irish financial services industry. The value of fund assets under administration in Ireland for Irish-domiciled and non-domiciled funds reached a combined value of **EUR 4.2 trillion** by the end of 2018 (about 11 times Ireland's GDP). Of the 13 914 funds, about half (6 624) are non-domiciled. These investment funds **employ on average 1.1 persons per fund – or 16 003 employees**⁷⁹⁸. That one person is typically a 'fund administrator', who is supposed to implement anti-money laundering measures and rules. The fund management - its core economic activity - is therefore outside Ireland.

Although there is a variety of funds and legal setups⁷⁹⁹, what makes Ireland attractive is the fact that investment funds are generally exempt from taxes on income and gains⁸⁰⁰.

According to the NRA, the funds sector is considered to have various vulnerabilities, as its investor base includes complex-structured corporate customers. Investments from

⁷⁹⁷

http://www.justice.ie/en/JELR/National_Risk_Assessment_Money_Laundering_and_Terrorist_Financing_Oct16.pdf/Files/National_Risk_Assessment_Money_Laundering_and_Terrorist_Financing_Oct16.pdf, p.4

⁷⁹⁸ <https://irishfunds-secure.s3.amazonaws.com/1557754571-Indecon-Report-Executive-Summary-FINAL.pdf>

⁷⁹⁹ The Irish NRA lists five different vehicles: investment company, unit trust, investment limited partnership (ILP), Irish Collective Asset Management Vehicle (ICAV), Common Contractual Fund.(Department of Finance, *Legal Persons and Legal Arrangements Risk Assessment*, 2020, p.17.

⁸⁰⁰ <https://hedgenordic.com/2019/12/why-ireland-ticks-the-box-as-a-fund-domicile/>

holding companies based in offshore jurisdictions or nominee investments pose particular difficulty in establishing the ultimate beneficial ownership and the origin of proceeds. The NRA on Legal Persons and Legal Arrangement notes that while there are no notable domestic threats from the abuse of investment vehicles, the main risks are related to foreign-based politically exposed persons, high-net worth individuals, and complex structured corporate structures. The NRA noted that the investment vehicles may be abused (including from international organised crime) at the layering (Stage 2) and integration (Stage 3) stages of money laundering (see Figure A6.1 above). In the layering stage, investment vehicles may be part of complex transactions, involving multiple banks/accounts and other companies or trusts. In the integration stage, they may be used as investments, much like any other high-value asset investment⁸⁰¹. Nevertheless, due to the complexity and expertise required in laundering money through such structure, the NRA notes that there is 'limited evidence' of such misuse.

In 2014, an assessment by Ireland's Central Bank of the implementation of anti-money laundering measures in investment funds found a range of shortcomings related to measures that such funds were supposed to implement, including overall lack of oversight from the service companies, lack of monitoring of ongoing transactions, and no procedures and controls for ceasing provisions of services to investors who fail to provide or update customer due diligence documents⁸⁰². The NRA also notes that more and more fund administrators outsource some of their activities, including the customer due diligence and transaction monitoring, to subsidiaries or third parties in lower cost jurisdictions, where such entities may not be regulated.

Another higher risk category, **SPEs**, are used both for financial (securitisation) and non-securitisation (tax) purposes. Ireland provides legal possibilities for a variety of alternative investment vehicle schemes. These have been described by some observers as representing a 'parallel banking system' and a source of risk⁸⁰³.

One such scheme which rose to prominence in the 1990s was the Irish Section 110 SPV, widely known as a 'section 110 company'. This is an Irish tax resident company, which holds and/or manages 'qualifying assets'⁸⁰⁴ and profits from a special tax regime. Such SPVs do not to pay taxes, VAT, or duties in Ireland. It is widely used by international banks (for off-balance sheet assets), asset managers and investment funds for securitisations and investment platforms⁸⁰⁵. Section 110 companies are not necessarily letterbox companies, but they bear some LBC characteristics: they largely have no employees or fixed assets, and are typically owned by trust or charitable trust companies that are managed by service providers⁸⁰⁶.

At the end of 2019, there were 2 603 SPVs in Ireland, managing total assets of **EUR 789 billion** (about twice Ireland's GDP). Of these, about half were Section 110 firms (see Figure A1.3). The overall employment provided by these SPVs was 3 057, or **1.2 persons per company**⁸⁰⁷.

Ireland's NRA notes that both securitisation and non-securitisation SPEs pose a similar risk as investment funds, with many having a complex ownership structure, where

⁸⁰¹ Department of Finance, 2020, p.23.

⁸⁰² <https://www.centralbank.ie/docs/default-source/regulation/how-we-regulate/anti-money-laundering-and-countering-the-financing-of-terrorism/legislation/report-on-amlcft-fs-compliance-in-the-irish-funds-sector.pdf?sfvrsn=6>

⁸⁰³ <https://www.washingtonpost.com/politics/2019/04/25/ireland-is-tax-haven-thats-becoming-controversial-home/?noredirect=on>

⁸⁰⁴ Under Section 110 of the Irish Taxes Consolidation Act 1997.

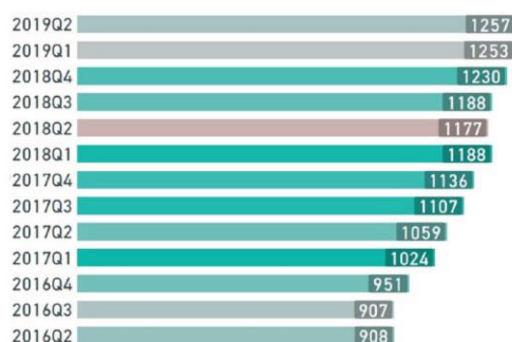
⁸⁰⁵ PwC Ireland, Services webpage, International Tax and Structured Finances: Section 110, available at: <https://www.pwc.ie/services/tax/international-tax/structured-finance.html>

⁸⁰⁶ https://www.tasc.ie/assets/files/pdf/seminar_on_section_110_12th_jan_2017.pdf

⁸⁰⁷ <https://astarconsulting.net/wp-content/uploads/2019/10/Irish-SPV-Report-Q2-2019.pdf>

beneficial owners may remain unclear. SPEs may be used in both the layering stage (due to the complex transactions involving multiple banks, accounts, and companies) and the integration stage, where they may be used for investment in high value real estate⁸⁰⁸. While the NRA reports limited evidence of the misuse of SPEs for money laundering, an academic study examining the period 2007-2015 indicated that the scale of the abusive use may be underestimated (See Case 2 below).

Figure 40. Total Section 110 firms, 2016-2018, by quarter



Source: Central Bank of Ireland, quoted by Atlantic Star Consulting⁸⁰⁹

Case 2: Russian connections of Section 110 firms⁸¹⁰

Academic research highlighted that Russian companies and financial institutions under international sanctions or involved in illegal practices used section 110 companies over the period 2007-2015, and continue to use them. The research identified a total of 125 section 110 firms with Russian connections, with EUR 61.4 billion in assets. All SPVs had a common business model, which involved raising funds, often via the Irish Stock Exchange, and lending these funds to a Russian-based firm. In others, they purchased property mortgages from a Russian bank. Most firms were themselves owned by a charitable trust. The average reported pre-tax profits were typically EUR 1 000 or less. The research showed that six of the firms were connected to Russian firms under EU sanctions. One of the key risks related to SPVs is that regulators cannot trace the destination of loans or debt proceeds once the money is transferred out of Ireland to individuals or companies.

⁸⁰⁸ Department of Finance, 2020, p.33.

⁸⁰⁹ <https://astarconsulting.net/wp-content/uploads/2019/10/Irish-SPV-Report-Q2-2019.pdf>

⁸¹⁰ https://www.tasc.ie/assets/files/pdf/ireland_global_finance_and_the_russian_connection.pdf

Figure 41. Illegitimate illegal connections and Russian companies

Section 110	Russian Firm	Connections	Source
Alfa Bond Issuance Alfa Holding Issuance	Alfa Bank	"Significant favours continue to be done in both directions, primarily political ones for Putin and business/legal ones for Alpha" – Steele Dossier	Steele Dossier p. 25-26 Executives on 'oligarch list'
Bom Capital	Bank of Moscow	Taken over by VTB Bank in 2011. The Financial Times states that the takeover followed "police raids on Bank of Moscow and the homes of its senior executives last week as part of a criminal investigation into the alleged embezzlement of Rbs. 1 bn (\$449 m.) from bank of Moscow"	Catherine Belton, 'VTB in Bank of Moscow victory', Financial Times February 26, 2011.
Eurochem Global Investments	Eurochem	Widespread reports concerning improper and illegal activities regularly undertaken by EuroChem, its owner, Andrey Melnichenko, and/or those associated with them".Source: Complaints filed by International Mineral Resources	Eileen Sullivan et al NYT July 14 2017
Peresvet Capital	Peresvet Bank	Peresvet debt was downgraded on 24 th Oct 2016, following appointment of an administrator by the RCB. Preceded by the disappearance of the chief executive and a report by Fitch that "roughly half of Peresvet's capital — had been issued to companies and individuals with "no real assets".	https://themoscowtimes.com/news/head-of-russian-bank-controlled-by-church-disappears-reports-5575 .
Renaissance Consumer Funding	Renaissance Capital	Connected to Murdered lawyer Magnitsky, who was investigating fraud.	Daily Telegraph 13 th April, 2017
Rosneft Internat. Rosneft Internat. Finance Plus 3 more	Rosneft	The CEO (Sechin) is described as part of a group of all powerful businessmen "perceived in Russian society to be above the law and answerable only to the Kremlin" and a "powerful arm of Russian foreign policy".	Referred to in Steele Dossier p. 30 Henry Foy, F.T. March 1st 2018.
Sibur securities	Sibur Holding	Leonid Mikhelson subject to sanctions. Described as a "company with crony connections"	Irish Times Feb. 27 2018.
VEB Finance	VEB (Vnesheconombank)	Dec. 2017 meeting between Chief executive of VEB, Russian ambassador to US, Kushner and others	Reported not to be a bank, but rather an agent of the State ¹ . NYT June 4 th 2017
VPB Funding	Vnesheprom-bank	The \$2.2 billion deficit in its balance sheet follows an investigation by the RCB that "Former managers may have stripped the bank's assets for investments in real estate, expensive vehicles and financial instruments"	Griffin and Brennan, 2016,

Source: Stewart and Doyle, 2018⁸¹¹

A6.4.3 Non-financial sector

The NRA identified some abuses of the various types of companies, such as limited liability companies, which are the most common type of business legal entity (with 205 494 registered in 2019). While in the majority of cases, such companies are abused in trade-based money laundering (for example, using cash-intensive businesses), abuse of 'letterbox' type companies without real economic activities has also been identified. In such instances, the main interest of the criminal groups abusing these legal entities is the establishment of a bank account or taking over a dormant company/ letterbox company that may have established a bank account. Criminals may also try to set up the company using fake identities of directors or secretaries. In such instances, multiple

⁸¹¹ https://www.tasc.ie/assets/files/pdf/ireland_global_finance_and_the_russian_connection.pdf

companies may be used in the layering stage of money laundering (see Figure 41) to carry multiple transactions⁸¹².

A6.4.4 Use of intermediaries in Ireland⁸¹³

There are currently some 300 TCSPs authorised by the Minister for Justice and Equality. TCSPs undergo an authorisation process where the beneficial owners and principal officers are subject to a fitness and probity assessment. More importantly, they must also be vetted by the Irish police. It is suspected that a number of entities offering trust or company services may be operating without authorisation⁸¹⁴.

The overall money laundering risk within the TCSP sector in Ireland is considered **medium-high for several reasons**: the potential exposure to high-risk jurisdictions and customers, little face-to-face contact with customers, difficulty in effectively monitoring customer activity or conducting customer due diligence (TCSPs often outsource customer due diligence), and lack of transparency with respect to the beneficial ownership of shares in companies. The following services are considered to present particular risk⁸¹⁵:

- Acting or arranging for another person to act as a nominee shareholder of a company: money launderers use TCSPs to buy or sell shares on their behalf thereby facilitating the introduction of illicit money into the financial system.
- Acting as a nominee director or secretary of a company: the identity of the TCSP's client is obscured from the Companies Registration Office.
- Providing registered office or business address facilities, especially when not providing other TCSP services to a client – such lack of interaction deprives the TCSP from detecting any illegal activity of the shell company/letterbox company.

In Ireland, both law and accounting professionals are considered to present **medium-high risk** in regard to money laundering. The exploitation of legal services may occur in respect of high-end or more sophisticated money laundering, involving a wide range of perpetrator types. Practising solicitors and barristers in Ireland who provide legal services are included within the definition of 'designated person'. They provide a number of vulnerable services, including i) complicated financial and property transactions, ii) company and trust formations, and iii) complicated cross-border transactions⁸¹⁶. Other services at risk of money laundering include: performing financial transactions on behalf of a client, including offshore banking; accepting large cash deposits in the client's account, followed by cash withdrawals or the issuance of cheques; purchasing real estate, companies or land on behalf of a client; and using the personal account of the legal professionals themselves to receive and transfer funds⁸¹⁷.

⁸¹² Department of Finance, 2020, p.11.

⁸¹³ As of 30 April 2016, there were 38 TCSPs that are subsidiaries of credit and financial institutions registered with the Central Bank. They are considered low risk.

⁸¹⁴ Department of Justice and Equality and Department of Finance, National Risk Assessment for Ireland, 2016, p.55.

⁸¹⁵

http://www.justice.ie/en/JELR/National_Risk_Assessment_Money_Laundering_and_Terrorist_Financing_Oct16.pdf/Files/National_Risk_Assessment_Money_Laundering_and_Terrorist_Financing_Oct16.pdf, p.61

⁸¹⁶ *ibid.*, p.59.

⁸¹⁷ https://ec.europa.eu/info/sites/info/files/supranational_risk_assessment_of_the_money_laundering_and_terrorist_financing_risks_affecting_the_union_-_annex.pdf, p.184.

Case 3 - IOS Group and the Troika laundromat

IOS Group was an established TCSP that set up shell companies for international clients involved in corruption and money laundering, between 1992 and 2017. It was seen as instrumental for the functioning of various money-laundering schemes, controlled by Troika Dialog, previously Russia's largest private investment bank. IOS Group set up shell companies worldwide, in the UK, British Virgin Islands, Panama, the US, Hong Kong, and Cyprus. IOS Group also set up bank accounts for these shell companies in banks, which are now closed, in Baltic countries (Lithuania, Latvia) and former Soviet republics. Transparency International research also identified at least 92 UK LLPs, controlled by shell companies set up by IOS Group, which were involved in corruption and money laundering schemes⁸¹⁸, especially in the so-called Azeri Laundromat, which involved GBP 2.2 billion and 3 500 corporate entities. In that case, IOS purchased shell companies from a Belize-based TCSP, and a UK-based TCSP, before providing the nominal directors and beneficial owners connected to the money laundering scheme⁸¹⁹.

A6.4.5 Ireland - domestic threats

While the above examples primarily involved international schemes, local organised criminal networks that launder criminal proceeds may also involve the use of shell companies. Typically, this involves either criminal groups with significant proceeds, or criminal activities which in some way already intersect with the legitimate economy (illicit cigarettes or fuel, or financial crimes).

Case 4 - Organised crime - assets and activities of two families based in the border region between Ireland and Northern Ireland.

The suspects were involved in fuel laundering and related laundering profits. The companies used and controlled by the organised crime gang to purchase large quantities of green diesel from oil companies. The green diesel was then laundered and sold on as road diesel by buffer companies, also controlled by the organised crime gang. The buffer companies were, in effect, letterbox companies created simply to disguise the beneficial owners of the laundered proceeds, as profits were in effect transferred back to the legitimate company that traded legally with the oil companies. Following the conclusion of the case in 2018 against 21 individuals and companies, the total amount of money seized from this fuel laundering enterprise amounted to EUR 1.1 million⁸²⁰.

A6.5 Money laundering risks and threats in Luxembourg

A6.5.1 Financial sector

With respect to financial sector risks, Luxembourg's retail banking, and in particular private banking, are considered the highest risk. The investment sector (wealth

⁸¹⁸ <https://www.transparency.org.uk/publications/hiding-in-plain-sight/>, p.43.

⁸¹⁹ <https://www.occrp.org/en/troikalaundromat/how-ios-group-supersized-the-shell-company-game>

⁸²⁰ <http://www.cab.ie/en/CAB/CAB%20Annual%20Report%202018%20-%20Reduced.pdf/Files/CAB%20Annual%20Report%202018%20-%20Reduced.pdf>, p.28.

managers, brokers, regulated securitisation vehicles, collective investments) are also considered to have inherent high risk, as are most professional services providers⁸²¹.

In Luxembourg, the government NRA⁸²² concluded that highest threats for Luxembourg in terms of money laundering are crimes committed largely abroad, such as tax crimes, fraud and forgery, drug trafficking, corruption and bribery. However, the **financial sector** constituted 25% of GDP and 11% of employment in 2019 and is dominated by many foreign institutions and foreign-owned assets and financial services providers. Some characteristics of the sector strongly indicate the presence of shell/ letterbox companies:

- Inward FDI is 57 times (5767% of GDP) higher than the country's GDP;
- Outward FDI is 67 times (6749% of GDP) higher than country's GDP⁸²³;
- Around 95% of FDI in Luxembourg is held by SPEs.

Much of Luxembourg's financial sector, including banks, investment sector, money service businesses, and financial sector providers have been assessed by the country's financial intelligence unit (FIU) as high risk for money laundering.

One of the areas where the risks of money laundering have been identified as inherently high risk, is collective investments. Luxembourg-based entities manage EUR 4 trillion worth of assets - the highest in the EU⁸²⁴. In terms of asset value, the majority of **collective investment firms** in Luxembourg are either Undertakings for Collective Investments in Transferable Securities (UCITS) or Specialised Investment Funds (SIF)⁸²⁵. The legal forms of corporate vehicle these funds can adopt are numerous, including limited liability companies or partnerships. The management of the investment funds than takes place via at least eight different types of **investment management companies**, for which there are different regimes and special laws. chief among these are the Luxembourg Chapter 15 ManCo (UCITS Management Company) and Luxembourg-authorized Alternative Investment Fund Managers (AIFM). They primarily originate from other EU countries, the US, UK, and Japan. By law, UCITS are supposed to appoint a depository and an external auditor, but they may also use a range of other **services providers**, including domicile agents, who provide nominal office facilities, correspondence, etc.

While the money laundering risks related to collective investments concern all stages of the money laundering process⁸²⁶, most suspicious activity (SAR) and suspicious transaction (STR) reports concern the layering stage. The main predicate offences concerned in the reports were primarily international in nature (i.e. crimes likely to have been committed abroad) and included various forms of financial fraud, tax crimes, corruption, as well as insider trading or market manipulation⁸²⁷.

⁸²¹ <https://mfin.gouvernement.lu/dam-assets/publications/nra/20122018-NRA-FR.pdf>, p.9.

⁸²² The full government NRA is available only to obliged or other relevant entities based in Luxembourg. The present case study quotes only a summary report and several sector-specific reports published in 2020.

⁸²³ European Parliament, p.22 available at: http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf

⁸²⁴ This section on collective investments is based on: *Commission du Surveillance du Secteur Financier, ML/TF Sub Sector Risk Assessment – Collective Investments, 2020.*

⁸²⁵ These largely respond to the EU category of Alternative Investment Funds, regulated by Council Directive 2011/61/EU, and not covered by EU Parliament and Council Directive 2009/65/EC on UCITS – therefore venture capital, hedge funds, private equity and real estate.

⁸²⁶ Placement may take place via 'contribution in kind', while integration may take place via 'distribution in kind'.

⁸²⁷ In 2019, of a total of 213 SRT and SAR, 43 were linked to financial crimes, 39 to fraud, 22 to corruption (Luxembourg Financial Intelligence Unit, Report of Annual Activities, 2019, p.35, available at: <https://justice.public.lu/content/dam/justice/fr/publications/rapport-activites-crf/rapport-crf-2019.pdf>).

Table 48. Suspicious activity and suspicious transaction reports filed with the FIU by collective investment stakeholders, 2018

Reporting entity	SAR	STR
Luxembourg Chapter 15 ManCo	106	10
AIFM	15	3
SICAR	0	0
UCI/UCITS	2	32
Service providers (depository)	30	5

Source: FIU, 2018⁸²⁸

The NRA identifies a number of factors that contribute to the high risk: the huge volume of the sector, the **high number of service providers and third parties** which perform anti-money laundering/CFT⁸²⁹ controls, **the international nature of business** with a wide distribution of UCI outside the borders of Luxembourg, and the **volume of transactions**. Investment managers, such as **Luxembourg Chapter 15 ManCo**, represent high risk, as they are often involved with politically exposed persons. Other categories of investment managers, such as EU UCITS ManCo, are located and supervised outside of Luxembourg – primarily in Germany, Ireland, France, Italy and the UK. Most other types of investment managers are also located outside of Luxembourg, which is considered an inherent risk from a regulatory point of view.

Case 5 - Luxembourg

A case reported from the Luxembourg's FIU shows how letterbox companies were used primarily for financial crimes, taking advantage of the country's tax legislation. A specialised investment fund (SIF)⁸³⁰ based in Luxembourg "LuxCI") acquires 100% of the shares of a Hong Kong-based company (HKCo). The managers and beneficial owners of both LuxCI and HKCo being the same individuals; there is therefore an inherent conflict of interest in this purchase.

The objective of HKCo was to invest in commodities by providing loans to other companies active in this field. In addition, the loans supposedly granted by the HKCo did not arrive in the accounts of the target investment companies. Instead, they were transferred to **letterbox companies** located in other jurisdictions and again controlled by the leaders of the LuxCI/HKCo. In this case, the investors in this SIF sub-fund have been defrauded and the funds thus diverted have been laundered via the personal accounts of LuxCI's managers. Since this sub-fund did not comply with the diversification rules of an SIF, Luxembourg's regulators demanded that part of the sums loaned should be repaid to the SIF by the HKCo. However, HKCo did not make any reimbursement and a summons has been lodged with the Commercial

⁸²⁸ Luxembourg Financial Intelligence Unit, Report of Annual Activities, 2018, p.73, available at: <https://justice.public.lu/dam-assets/fr/publications/rapport-activites-crf/rapport-crf-2018.pdf>

⁸²⁹ CFT: Countering the Financing of Terrorism

⁸³⁰ An SIF is an investment fund that can invest in all types of assets. It usually qualifies as an alternative investment fund (AIF) and can be sold to well-informed investors allowing for greater flexibility in terms of investment policy. SIFs that have appointed an EU AIFM can market their shares, units or partnership interests via a specific passport to well-informed investors across the EU.

Court in Luxembourg. HKCo lodged an appeal and the case remains pending before the Luxembourg courts⁸³¹.

Private banking in particular is considered to be very high risk⁸³², as some of the clients are not individuals (ultra/high net worth) but offshore/shell companies controlled by such individuals. Shell companies can play various roles, depending on the particular money laundering scheme.

Case 6 - Money laundering via credit

The Luxembourg NRA presents one possible scenario, where a shell company is used to launder money at the integration stage via a credit scheme:

- A high-net worth individual sets up a shell company in an offshore jurisdiction with strict bank secrecy, which is not a member of the CRS, where a bank account may receive funds from illicit activities layered via different transactions. The link with the individual as a beneficial owner is not transparent.
- The high-net worth individual requests a credit to their Luxembourg private bank service for the purchase of real estate.
- The Luxembourg bank requests collateral for the credit.
- The high-net worth individual presents as collateral the bank deposit from the shell company in the off-shore jurisdiction.
- The credit by the Luxembourg bank is then approved and the real estate is purchased.
- After a few payments of instalments, the individual defaults on payments. The Luxembourg private bank calls in the collateral from the shell company bank account to cover its losses. The high-net worth individual keeps the real estate and the shell company money has been laundered.

A6.5.2 Use of intermediaries in Luxembourg

In Luxembourg, TCPs are considered to have an inherent high risk of money laundering⁸³³. Luxembourg has a large and sophisticated professional services sector which supports both the financial centre and other commercial activities. It includes almost 9 000 different professional services, including accountants, auditors, lawyers, tax and economic advisers, notaries and bailiffs. These services are exposed to significant risks of money laundering or terrorist financing because of their role as gatekeepers of access to the system of financial and other services and their possible role in the creation and management of legal structures. These risks differ for the different categories of providers.

The number of professionals authorised to provide TCSP services is relatively small (107). They provide various services, including incorporation (42), directorship/secretarial services (77), domiciliation (68), trust, and nominee shareholder services

⁸³¹ Financial Intelligence Unit, 2018.

⁸³² *ibid.* p.9 (The private banking sub-sector in Luxembourg has EUR 363 billion in assets under management – Commission du Surveillance du Secteur Financier (2020) *ML/TF sub-sector risk assessment Private Banking*, p.26.

⁸³³ Luxembourg, Ministry of Finance, *National risk assessment of money laundering and terrorist financing*, 2018, p.9, available at: <https://mfin.gouvernement.lu/en/publications/Divers/NRA/NRA.html>

(3). The sector-specific NRA concluded that the threat of money laundering proceeds from domestic crime was not high but international crime presented a very high threat, especially money laundering linked to fraud, tax crimes, corruption and bribery, given the international exposure of Luxembourg's TCSP industry⁸³⁴.

Table 49. Suspicious activity or transactions reports within PFS providing TCSP services

	Number of SARs/STRs filed in 2018	Number of SARs/STRs filed in 2019
Fraud and forgery	98	65
Tax crimes	49	42
Corruption and bribery	18	17

Source: CSSF, 2020⁸³⁵

However, many other professionals can act as TCSP in Luxembourg. The country's 2020 national risk assessment identified this factor as a key weakness. The NRA⁸³⁶ notes that "a range of professions in Luxembourg conducts at least one (or more) of what the 2004 AML/CFT Law defines as TCSP activities as described above. Entities that act as TCSPs include banks, investment firms, specialised PFSs, professionals of the insurance sector (PSA), lawyers, audit professionals and chartered professional accountants, amongst others. The NRA provides an overview of each sector's size, which allows calculating the number of potential TCSP at almost 6.000. It is important to note that this number identifies the professionals who might act as TCSP, though in practice many do not provide such services.

A6.6 Providing an assessment of the scale of the phenomenon

There is no globally agreed method to estimate the size of money laundering. The key studies assessing the size of global or EU money laundering do not provide estimates of the share of the different methods used to launder criminal proceeds, including the use of shell companies/letterbox companies.⁸³⁷ In 2009, estimates of the globally illicit economy's total criminal profits being laundered were placed at 2.7% of global GDP (or USD 1.6 trillion) for traditional organised crime activities, and as much as 5% of GDP if tax and customs crimes were to be included. In the EU, the total value of sums reported in suspicious activity reports from 10 EU FIUs was EUR 99.4 billion in 2014, EUR 178.8 billion in 2014. They note that 'based on an EU GDP of around EUR 14 trillion, these equate to between 0.7-1.28% of annual EU GDP'⁸³⁸.

The share of these laundered assets via off-shore, shell or letterbox companies is not known, and it differs depending on the type of crime.

⁸³⁴ Commission de Surveillance du Secteur Financier, 2020, p.23.

⁸³⁵ *ibid.* p. 25.

⁸³⁶ <https://mj.gouvernement.lu/dam-assets/dossiers/blanchiment/NRA-2020.pdf>

⁸³⁷ https://www.unodc.org/documents/data-and-analysis/Studies/Illicit_financial_flows_2011_web.pdf; <http://www.transcrime.it/wp-content/uploads/2017/05/ProjectIARM-FinalReport.pdf>, p. 44.

⁸³⁸ Europol, *From Suspicion to Action*, 2017, p.26, available at: <https://www.europol.europa.eu/publications-documents/suspicion-to-action-converting-financial-intelligence-greater-operational-impact>

A World Bank report examining cases of corruption-related money laundering, estimated that 85% of the 150 money laundering schemes analysed included some sort of company. In at least half of the cases involving companies (about 65), these were shell companies, while for one-quarter of the cases it was not possible to establish with certainty if the company was a shell company or not⁸³⁹.

The funds data provided for Ireland shows that while the number of investment funds or SPVs involved is only about 15 000, almost EUR 5 trillion is managed and flows through these companies. Only a small fraction, however, are likely to involve laundering of criminal profits.

The risk of money laundering is to a certain extent inherent to shell companies and to professionals involved in the provision of services to companies and trusts, as FIUs in Ireland and Luxembourg have suggested.

The use of shell companies in situations with special international tax agreements or poor transparency requirements can facilitate the concealment of the origin of assets or the hiding of beneficial owners⁸⁴⁰. That is why the 4th AML Directive, as part of its ultimate objective of preventing the use of financial system for the purpose of money laundering or terrorist financing, obliges all Member States to set-up central registers containing data on companies' beneficial owners (the so-called BO register, see Section 6.2).

The number of jurisdictions with a beneficial ownership registration system have increased, not only at EU level. As of early 2020, 65 jurisdictions worldwide have beneficial ownership register laws in place, including all EU Member States⁸⁴¹.

All EU Member States but four (85%)⁸⁴² identify as the beneficial owner all individuals with an ownership of shares of more than 25% of the company. This standard is sometimes depicted as being too soft, insofar as it only takes five shareholders to equally share a company to be able to circumvent the rule, a measure that does not seem very discouraging for criminals. If both Ireland and Luxembourg have ultimate beneficial owner registers in place, the two countries also appear in the top 10 inward direct investment reporting economies in the world (see Figure 2, Section 3.1.1), an indicator used to estimate the presence of letterbox companies.

Large financial inflows and outflows, and poor control and monitoring over investors and beneficial owners, as well as the fairly low number of suspicious activities reports by domicile agents or professional service providers, may be an indicator that the scale of the use of letterbox or shell companies or SPEs for money laundering purposes may be underestimated. Even though professional money launderers coordinating major cross-border operations may not be necessarily based in Ireland or Luxembourg, the sheer volume of financial transaction passing through their economies and the large number of letterbox companies/SPEs constitute significant risk factors and may facilitate money laundering activities, much of which may remain undetected.

⁸³⁹ van der Does de Willebois et al., 2011, p. 34.

⁸⁴⁰ EPRS, 2018, p. 27.

⁸⁴¹ Knobel, A., Harari, M., Meinzer, M. and Palanský, M., 'Ownership registration of different types of legal structures in international comparative perspective. state of play of beneficial ownership – update 2020', *Tax Justice Network*, 2020, available at <https://fsi.taxjustice.net/en/>.

⁸⁴² ES, LV, HU, FI.

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