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## DUTCH IMPLEMENTATION PROPOSAL FOR EU BEPS ANTI-TAX AVOIDANCE DIRECTIVE PUBLISHED

The OECD's initiative to crack down on Base erosion and Profit Shifting (BEPS) world-wide was "gold plated" in the EU BEPS Anti-Tax Avoidance Directives, ATAD 1 and ATAD 2. Member States of the European Union ("EU") are currently in the process of putting these EU Anti-Tax Avoidance Directives ("ATAD1 and 2") into national law.

On 10 July 2017, the Netherlands published a preliminary proposal ("the Proposal") to implement ATAD1, as adopted by the EU in 2016. The Proposal addresses earnings stripping rules, exit taxation, general anti-abuse ("GAAR") and Controlled Foreign Companies ("CFC"). Implementation of ATAD1 into Dutch law must be completed as of 1 January 2019. ATAD1 also contains rules in regard to hybrid mismatches, which were expanded based on the directive that the EU adopted on 29 May 2017 (ATAD2). Because these expanded ATAD2 rules will not become effective until 2020, they will be addressed in a separate proposal. The Proposal contains new rules to limit the deduction of interest on the basis of earnings stripping and CFC rules. In addition, the Proposal provides for minor adjustments to the exit taxation rules. The GAAR will not be implemented separately, due to the Dutch Legislator's view that the abuse of law-doctrine in Dutch case law achieves the same goal.

Below, we have outlined the key features of these rules below.

### New Government

Following the Dutch parliamentary elections in March of this year, the Netherlands is still governed by the outgoing government. Rules may be strengthened or expanded once the new government is in office.

### Earnings Stripping Rules

According to the proposed rules, the deduction of net borrowing costs is limited to the highest of (i) 30% of the earnings before interest, taxes, depreciation and amortization (EBITDA) and (ii) an amount of Euro 3 million. The Proposal contains two variants for a group escape. Under the first variant, the limitation does not apply if the taxpayer can demonstrate that, based on the consolidated commercial accounts, its average equity / average total assets is at least equal to the corresponding group ratio. Under the other variant, the percentage of 30% as it applies in the EBITDA rule is replaced with the ratio of net group interest income to pre-tax result of the group, if that ratio is more than 30. Otherwise, non-deductible interest can be carried forward.

It is unclear whether the existing Dutch interest deduction limitation rules will be abolished or amended as a result of the implementation of these new earnings stripping rules. This is definitely a topic for further debate.

### CFC Rule

Under the proposed CFC-regime, specified types of so-called tainted income of a controlled foreign company ("CFC") are included in the Dutch corporate income tax base of a corporate taxpayer in proportion to the interest held in the CFC to the extent the income has not been distributed to the corporate taxpayer at the end of the financial year. The following types of passive income are taken into account (1) interest or other benefits from financial assets, (2) royalties or other income from intellectual property, (3) dividend income and capital gains in relation to the alienation of shares, (4) financial lease income and (5) income less related expenses with respect to invoicing activities existing out of sales and services purchased from or rendered to affiliated companies or affiliated individuals that add no or limited value. If on balance the tainted income of CFC's results in a loss, the loss is not included in the Dutch corporate income tax base of the taxpayer but instead is carried forward for a period of up to 9 years to be offset against positive tainted income of subsequent years.

A CFC is a subsidiary (a) in which the taxpayer – without or together with affiliated companies or an affiliated individual – has an interest of at least 50% of the (i) nominal paid-in capital, (ii) the voting rights, or (iii) profits, and (b) whose income is not subject to taxation that is reasonable according to Dutch standards. Taxation is considered reasonable according to Dutch standards if it results in taxation against a corporate tax base, in line with Dutch standards, and has a tax rate that amounts to at least 50% of the applicable Dutch tax rate (whereby income of a permanent establishment is not taken into account if that income is not subject to a profit tax or is exempt from it). Therefore, if less than 12.5% Dutch corporate tax is levied on taxable profits based on Dutch standards, it does not meet the fair tax test under these rules.

A company is not considered a CFC if (a) the income of the CFC at least predominantly (70% or more) exists of non-tainted income or (b) if the company is a financial institution as referred to in article 2(5) of ATAD1 and the tainted income is predominantly derived from others than the taxpayer or affiliated companies/affiliated individuals. The CFC-regime is not applicable to the extent that the CFC, in relation to which tainted income is included in the Dutch corporate income tax base, carries out a fundamental economic activity supported by personnel, equipment, assets and buildings.

Local profit tax paid at the level of the CFC can in principle be credited against Dutch corporate income tax due.

Various clauses are included in the Proposal to avoid unintended accumulation with the existing rules on (passive low taxed) shareholdings as part of the Dutch participation exemption regime.

## Exit Charge

The exit charge included in ATAD1 basically consists of two elements. Firstly, corporate income tax is charged on a capital gain (i.e. difference between the fair market value and the book value for tax purposes) of an asset at the time the asset is transferred cross-border. Secondly, upon request of the taxpayer, the corporate income tax on a capital gain is deferred and becomes payable in five annual and equal installments.

With respect to the first element, the Dutch Corporate Income Tax Act 1969 already includes provisions that trigger taxation of a capital gain upon the transfer of an asset abroad. In this respect, Dutch corporate income taxation already meets the requirements of ATAD1. With respect to the second element, the Dutch Tax Collection Act already includes rules for deferred payment. However, given that these rules provide for a 10-year period during which the exit tax due should be paid (in annual and equal installments), the ATAD1 only allows a 5-year period. It has been proposed to shorten the deferral to five years.

## Conclusion

Currently, it is not clear how ATAD1 will be implemented in the Dutch legislation as the proposed rules may be strengthened or expanded once the new Dutch government is in office.

# ADDITIONAL DUTCH COUNTRY–BY-COUNTRY REPORTING RULES ("CBCR") AND TRANSFER PRICING ("TP") DOCUMENTATION - EFFECTIVE 5 JUNE 2017.

Additional Dutch Country by Country Reporting Rules ("CBCR") and Transfer Pricing ("TP") Documentation were adopted by the Dutch Senate on 23 May 2017. These rules took effect on 5 June 2017 and will apply to reporting for fiscal years that commence on or after 1 January 2016. See the summary of these new rules and how they may impact your business below.

## The Incomplete Country-by-Country Report ('Secondary Filing')

The new rules offer the possibility to (i) designate one group entity within the European Unity ("EU") as the reporting entity and to (ii) allow a designated Dutch group entity to file an incomplete Country-by-Country report with all the information at its disposal (the 'secondary filing mechanism').

This incomplete Country-by-Country report will not automatically be exchanged with other EU or non-EU countries Therefor, it is not possible for an EU group entity to prepare the incomplete Country-by-Country report and act as the 'designated group entity' for EU purposes. The notification about the incomplete Country-by-Country report will be exchanged with all EU Member States.

## Permanent Establishment as Surrogate Parent Entity or Designated Group Entity?

The Dutch Ministry of Finance recently clarified that a permanent establishment qualifies as a group entity. Because of this, there must be a Master and Local File where the Group has a consolidated group turnover of EUR 50 million or more (see below).

However, the new rules state that a permanent establishment situated in the Netherlands cannot act as the surrogate parent entity or the designated group entity.

## Expansion of Penalty After Notification

The penalty provision for not complying with the reporting requirements for the Country-by-Country report is expanded to cover the notification. This takes effect as of June 5, 2017 and thus will not be applied retroactively.

Under the new rules, the maximum amount of the potential pecuniary penalty has been increased from EUR 20,250 to EUR 820,000.

## Master File and Deviating Reporting Fiscal Years

In his 12 April 2017 letter, the Dutch State Secretary for Finance confirmed that if the reporting fiscal years for the foreign ultimate parent entity and for a Dutch group entity deviate, the reporting fiscal year of the ultimate parent entity can be used for the Master File. This was already explicitly noted as law for the Country-by-Country report.

The Local File will continue to cover the reporting fiscal year to which the Dutch corporate income tax return relates.

The Country by Country Rules discussed above are in addition to the Dutch Transfer Pricing rules that became effective on 1 January 2016. These TP rules are incorporated in articles 29b through 29h of the Dutch Corporate Income Tax Act 1969.

The new TP rules include the following compliance measures:

**I.** International Groups with their head office in the Netherlands and a consolidated turnover exceeding EUR 750 million must submit a CBCR file along with their annual Dutch corporate income tax return. The CBCR file must include descriptions of several indicators (such as turnover, profit, paid taxes, and employees) per country.

The Dutch constituent entity of the multi-national enterprise group must notify the Dutch tax authorities by filing the CBCR notification before the last day of their reporting fiscal year at the latest.

**II.** International Groups with cross-border operations and a consolidated group turnover of EUR 50 million or more must expand their transfer pricing ("TP") documentation in order to comply with the new Dutch and international requirements.

Essentially, this means that the Netherlands follows the proposed guidance of OECD BEPS Action 13 documentation requirements regarding the master file and local file concept for multinationals enterprises (MNE's). Groups that have a subsidiary or permanent establishment abroad qualify as a MNE.

It is noteworthy that a benchmarking study will be required for Groups with a world-wide consolidated turnover exceeding EUR 50 million. Furthermore, a Ministerial Decree provides additional rules regarding the contents of a Master File and a Local (i.e. country specific) File. Note that the Group turnover threshold amounts consist of the total amount based on revenues received due to sale of inventory, properties, services, royalties, interest, premiums, and other amounts.

See the comparison between the previous TP rules and new TP rules effective 1 January 2016 in regard to the preparation of the Master and Local File.

| Previous TP Rules | TP Rules as of 1 January 2016 |
| --- | --- |
| **Transfer Pricing Documentation**<br>A statutory obligation to prepare and keep transfer pricing documentation applies. However, there is no exhaustive list of the categories of information that should be included in the transfer pricing documentation as the information required will depend on the specific case. Non-compliance with the transfer pricing documentation requirements can result in the burden of proof shifting to the taxpayer. | **Transfer Pricing Documentation**<br>An important and new requirement is that the master file and the local file must be part of the Dutch entity's administration prior to filing the corporate income tax return. This is a major change from the current practice which requires the taxpayer to provide transfer pricing documentation within two months after a formal request has been issued by the Dutch Tax Administration. Noncompliance with the documentation requirements results in the reversal of the burden of proof and may constitute an offence under Dutch criminal law. It is clear that the master file should also include a Transfer Pricing Policy and worldwide allocation of the Group's income. |
| **Deadline to prepare documentation**<br>Upon request of the tax authorities, the taxpayer must within 8 weeks provide the required information. In case of complex transactions the deadline may be extended to 3 months. | **Deadline to prepare documentation**<br>The annual corporate income tax return must be filed 5 months after the preceding financial year is closed. Therefore, the 2016 corporate income tax return must be filed before 1 June 2017 unless an extension of time for filing is granted. |

## In summary

For tax years 2016 and onwards, a Dutch taxpayer's TP documentation must be completed no later than the due date of filing the corporate income tax return.

A Dutch taxpayer that does not meet this requirement will face increased penalties and reversal of the burden of proof.

The time that is required to produce the local and master file should not be underestimated.

For more information or assistance with assessing your company's readiness in meeting OECD Master File and Local File transfer pricing documentation requirements, as well as the preparation of benchmarking studies, please contact one of your Dutch Kreston (International Tax Department) contacts below:

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## Further information:

We will keep you informed of these and other developments relating to transfer pricing and International Tax issues. For specific comments, questions or concerns, please contact us.

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