NovioTax

Summary of international and Dutch tax developments in 2017

February 2018

2017 was a year in which the international tax climate continued to change rapidly: the OECD persisted in its efforts to tackle tax avoidance, the European Commission opened state aid investigations into the tax treatment of Apple in Ireland and IKEA in the Netherlands, and some key jurisdictions introduced or proposed significant tax legislation, thereby affecting all multinational enterprises having arrangements in these jurisdictions. It was also a year of major political change, with elections in Italy, Netherlands, the UK, Germany and France, and a new president in the USA. In blog 9, we have discussed the implications of the new legislation introduced by the Dutch government as of 1 January 2018. In addition, the new government announced some of its tax plans for the coming years, which means that we expect even more changes for the Dutch budget in autumn. In this blog, we will look back at tax year 2017 and review the changes that have an impact on businesses / multinational companies in the Netherlands. It should be noted that we have focused on the relevant items that on a day-to-day base affect our clients.

Anti-Tax Avoidance Directive

In line with other EU Member States, the previous Dutch government published its proposed implementation of the EU Anti-Tax Avoidance Directive ("ATAD") for public consultation. The final proposal is expected to be published in the next few months. It is likely that implementation of the ATAD will affect interest deduction limitation rules. In this respect we expect that the Netherlands will implement similar interest limitation rules as in Germany: the interest expenses that exceed the interest income (net interest expenses) are generally only tax deductible up to 30% of the current year's taxable EBITDA. It is uncertain to what extent the Netherlands will implement controlled foreign companies / "CFC" legislation.

Multilateral Instrument

More than 70 countries, including the Netherlands, signed a multilateral instrument ("MLI") in an effort to close the gaps in existing international tax rules by transposing results from the Base Erosion and Profit Shifting ("BEPS") project into bilateral tax treaties worldwide. The MLI implements among others (i) minimum standards to counter treaty abuse, (ii) a new definition of permanent establishments (see also blog 6 on the Dell case) and (iii) mandatory binding arbitrage rules to improve dispute resolution mechanisms.

Bilateral tax treaties will only be modified if both parties have signed the MLI and have made "matching" choices with respect to the MLI. Parties to the MLI have the freedom to opt out of certain parts of the instrument. The Netherlands has chosen to adopt the anti-abuse principal purpose test ("PPT"), but did not adopt a limitation of benefits ("LOB") clause. The PPT, in general, denies tax treaty benefits if the corporate structure can be considered as artificial and contrary to the aim and purpose of the tax treaty or its provisions. It is expected that the first bilateral tax treaties will be affected from 2019, as both parties need to ratify the MLI. Ratification by the Netherlands is expected this year. It is also the expectation that more countries will sign the MLI later in 2018.

Innovation Box

The Netherlands has made changes to the innovation box regime, which taxes profits allocated to innovations / R&D at a reduced rate, such in line with BEPS Action 5 recommendations. As a result of the amendments, larger companies (i.e. taxpayers with a consolidated group turnover of EUR 250m or more, or with IP income of EUR 37,5m or more) are required

to meet stricter conditions to benefit from the reduced innovation box rate. In addition under the revised Netherlands innovation box regime, qualifying income is determined per qualifying intangible asset or per coherent group of qualifying intangible assets ('tracking-and-tracing').

Based on experiences obtained, we have observed that the main methods used under the current innovation box regime to determine qualifying income remain applicable to a certain extent. This includes, in particular, the commonly used profit split method. The administrative burden for companies, as well as the Dutch Tax Authorities, has however increased observing the automatic exchange of any innovation box ruling. To avoid international scrutinization or triggering Mutual Agreement Procedures ("MAP"), the profit allocation and in particular the profit mark-up for supporting activities conducted outside the Netherlands needs attention.

Among others, the method of allocating the profits and any assumptions made in doing so need to be documented. Internal data may be helpful where the profit allocation factor is based on a cost accounting system, e.g. headcounts involved or time spent by a certain group of R&D employees on certain tasks. Typically however the profit allocation should be based on some kind of value chain or functional analysis. This should determine where and how value is created in the business and also determines the level of integration between products (which may determine the level at which profits or revenues should be allocated) and the economically relevant contributions (which may determine the factors to use to allocation of profits).

Interestingly we often see that excess profits (of what the market would otherwise allow) related to certain products or product groups that are associated with unique intangibles are captured in this kind of analysis (i.e. first mover advantages, unique R&D contributions, protection due to barriers to entry to potential competitors et al). For some companies this creates opportunities to prepare detailed supporting documentation, which may increase benefits.

Dutch fiscal unity regime potentially not in line with EU law

In an opinion on X BV (Case C-398/16) and X NV (Case C-399/16), the Advocate General of the Court of Justice of the European Union ("CJE") draws the conclusion that the Dutch fiscal unity violates the EU concept of freedom of establishments, such in line with CJE's decision in Groupe Steria (Case C386/14). As the Dutch fiscal unity interacts with various other anti-abuse rules, including the Dutch interest limitation rules of article 10a and 13l Corporation Income Tax ("CIT") Act and the loss rules of 20a CIT Act, the case could have major consequences if the CJE decides to follow the above opinion. The previous Dutch government proposed legislation to repair these potential consequences, although the proposed amendments do seem to contain overkill. Multinational companies that are potentially impacted by the Dutch anti-abuse rules are advised to monitor the relevant developments.

General exemption dividend WHT

In our November 2017 Blog (#9) we have discussed the impact of the legislative amendments effective on 1 January 2018. The new law introduces a dividend WHT obligation for holding cooperatives. Under the old legislation, such cooperatives, which are also used in international tax structures, were not subject to dividend WHT, except for certain "abusive" situations. The new legislation aims to eliminate the difference between holding cooperatives and public and limited liability companies by imposing the withholding obligation on such cooperatives and to broaden the general exemption from the withholding obligation for public (NV's) and limited (BV's) liability companies.

As a result of the legislative amendments, which have been adopted by the upper house of the Dutch parliament on 19 December 2017, investors using Netherlands holding companies that currently face challenges in respect of satisfying a number of anti-abuse provisions such as the PPT (Double Tax Avoidance Agreement ("DTAA") Netherlands – UK and Netherlands – Switzerland), LOB provisions (DTAA Netherlands – US and the Netherlands – Curaçao tax regulation) or that are faced with 5-10% dividend WHT on participating investments (>10%+) in a Dutch company may check whether they are able to satisfy the new requirements to enable application of the general dividend WHT exemption.

In this respect, the Netherlands government has recently disclosed extended substance requirements which require intermediate companies to incur employment costs of at least EUR 100,000 (adjusted to the CPI) in relation to its intermediary holding functions. Examples of CPI indexes to be taken into account with respect to other countries are 90% for Cyprus, 100% for Luxembourg, 80% for Malta and 100% for Switzerland. In addition the intermediate company should have (for at least 24 months) own office space at its disposal used for carrying out the intermediary holding functions.

Information disclosure provision

In day-to-day practice we have received questions in respect of the information disclosure provisions that have also been amended in the Dividend Withholding Tax Act (“DWTA”). In article 4, paragraph 11 DWTA, a holding company is required to inform the Dutch Tax Authorities of application of the general dividend withholding tax (“WHT”) exemption. From the outset, the necessary information should not be new. In the Dutch Corporation Income Tax (“CIT”) return, for instance, the names of the larger shareholders have already been disclosed. In addition, distributed dividends have also been reported in the Dutch CIT return.

In our opinion, the most relevant aspects are however that as from January 1, 2018 a dividend WHT exemption form needs to be filled in and submitted with the Dutch Tax Authorities within one month of a dividend distribution and that at the end of the form the person signing the form should declare that it has satisfied (among other elements) article 4, paragraph 3 DWTA. This paragraph more or less functions as a PPT (i.e. Action 6 of the OECD BEPS Project and also the Parent-Subsidiary Directive).

Hence, it should be assessed if the interest in the Dutch entity (e.g. holding cooperative, BV or NV) is held with the main purpose, or one of the main purposes, to avoid dividend WHT abroad (subjective test), and if the structure should be considered as an artificial arrangement (objective test). The latter test would be failed if the structure is not based on valid business reasons reflecting economic reality. In this respect it needs to be considered if the intermediate shareholder carries-on an active business itself, or accordingly meets the requirements for having relevant substance in relation to intermediate companies. In this respect we expect that a large amount of attention will be given to the extended substance requirements.

Deister Holding and Juhler Holding

On 20 December 2017, the CJE gave its decision in the joined cases (Case C-504/16, C-613/16) Deister Holding and Juhler Holding concerning the compatibility of the Germany “look through approach” in case of insufficient substance as clarified in Sec. 50d para. 3 German Income Tax Act, with the Parent-Subsidiary Directive (“PSD”) and freedom of establishment. This case is interesting for most Netherlands groups operating in Germany that have received dividends from Germany, which in most cases start with questionnaires about the relevant Netherlands substance at the level of the company receiving the German dividend.

Juhler Holding

Juhler Holding is a holding company with its registered office in Denmark. Juhler Services Limited, a company incorporated under Cypriot law, holds 100% of the capital in Juhler Holding. Juhler Services Limited’s sole shareholder is an individual resident in Singapore. Juhler Holding has holdings in more than 25 subsidiaries. The group in question supplies personnel procurement services to the extent of a third of the volume of such services in Denmark. Since 2003, Juhler Holding has held 100% of the capital in temp-team Personal GmbH, a company established in Germany.

Juhler Holding has, in addition, a property portfolio, exercises financial control within the group so as to optimise the group’s interest costs, is responsible for supervising and monitoring the performance of the individual subsidiaries and has a phone line and an email address. Juhler Holding is listed as a contact partner on the group’s homepage. Juhler Holding does not, however, have its own offices. If necessary, it uses the premises, as well as the other facilities and staff, of other companies within the group. Lastly, Juhler Holding’s chief executive is also on the boards of various companies in the group.

In 2011, Juhler Holding received dividends from temp-team Personal GmbH. Since those dividends were subjected to WHT and the solidarity surcharge, Juhler Holding applied for a refund of those taxes. Following decisions in which the tax authority rejected that application and the objection raised against the rejection, Juhler Holding brought an action against those decisions before the Finanzgericht Köln (Finance Court, Cologne), on the ground that the relevant legislation in the main proceedings is incompatible with the freedom of establishment and the PSD.

Deister Holding

Deister Holding is the successor in title of Traxx Investments NV (C 504/16: hereafter ‘Traxx’), which had its registered office in the Netherlands. Traxx principally had holdings in several companies established in various jurisdictions and financed those companies, inter alia, by making loans to the companies of the group in question. From 2005, Traxx had

a holding amounting to at least 26.5% of the capital in Deister electronik GmbH, a company incorporated under German law. From March 2007, Traxx had a rented office in the Netherlands and two employees there in 2007 and 2008. Traxx's sole shareholder, Mr. Stobbe, was resident in Germany.

On 19 November 2007, Deister electronik paid dividends to Traxx, on which Deister electronik withheld the tax on income from capital tax and the solidarity surcharge, and remitted the amounts to the tax authorities. On 16 May 2008, Traxx applied for an exemption from the tax and surcharge in respect of that distribution of dividends. Following decisions in which the tax authority rejected that application and the objection raised against the rejection, Deister Holding, as the successor in title of Traxx, brought an action against those decisions before the Finanzgericht Köln (Finance Court, Cologne, Germany) on the ground that the relevant legislation in the main proceedings is incompatible with the freedom of establishment and the PSD.

Decision CJE

The CJE followed its previous case law (in particular Case C-6/16 Eqiom) and stated that Sec. 50d para. 3 German Income Tax Act was not covered by (old) Article 1(2) of the PSD, which allows Member States to deny the benefits of the Directive only on the basis of domestic norms aimed at counteracting wholly artificial arrangements not reflecting economic reality and purported to obtain illegitimate tax advantages. In addition, provisions establishing a general presumption of fraud and abuse go beyond what is necessary to achieve that result and conflict with the PSD (para. 60-62 and 74). The same arguments were applied by the CJE to conclude that Sec. 50d para. 3 German Income Tax Act infringed the freedom of establishment and were not justified by the objective of preventing fraud and abuses (para. 97).

Impact Netherlands HoldCo's

Interestingly, the CJE noted that the fact that the parent companies exclusively manages the assets of its subsidiaries or that its income derives solely from that management could not be regarded, of itself, as implying the existence a wholly artificial arrangement (para. 73). 'The fact that the economic activity of a non-resident parent company consists in the management of its subsidiaries' assets or that the income of that company results only from such management cannot per se indicate the existence of a wholly artificial arrangement which does not reflect economic reality.' Contrary to what Sec. 50d para. 3 German Income Tax Act provides, the finding of such an arrangement requires that, on a case-by-case basis, an overall assessment of the relevant situation should be conducted. Relevant factors should be the organizational, economic or other substantial features of the involved group of companies and strategies of the particular group (para. 74).

In a 2017 blog we have looked at the implications of this case in more detail.

Proposals from the new government

On 10 October 2017, the new Dutch government published its coalition agreement outlining its policy for the next four years. The agreement also contains tax measures, which aim to ensure that the Netherlands remains a have a competitive tax climate for (international) companies whilst also addressing the OECD recommendations to tackle tax avoidance. The key tax measures are arguably the elimination of dividend withholding tax and the introduction of interest, royalty and dividend WHT on outbound financial streams in relation to low-tax jurisdictions.

Other important corporate income tax measures include:

- Reduction of corporate income tax rate from the current 20-25% to 16%-21% respectively by 2021.
- Limitations to the ability to carry-forward losses.
- An EU blacklist for non-cooperative countries, expected to be published by the EU later this year, will be introduced.
- Measures to limit the deductibility of debt will be introduced (in line with OECD recommendations).

The full elimination of dividend WHT has met heavy resistance in parliament, but the new government seems determined to implement this proposal into legislation. We will monitor the developments of these proposals, and publish a new blog once more certainty/information on the new legislation is available.

Developments in Transfer Pricing ("TP")

Chevron (TP on loan relationships)

The Chevron case, which deals with the pricing of related party loans, is considered as the most high-profile case of 2017. The case addressed the arm's length amount of the interest payable by Chevron Australia with its subsidiary in the US ("Chevron US").

Based on the terms of the loan, Chevron Australia paid approximately 8.5% per annum on the funds borrowed from Chevron US. Interestingly, Chevron US borrowed the advances to Chevron Australia in the US commercial paper market, at a rate of approximately 1.2% per annum – the difference between interest payable on the external debt and on the group's internal loan was therefore approximately 7.3%. This high difference was caused by the terms and conditions of the credit agreement, including the following:

- Chevron US borrowed to Chevron Australia an amount equivalent to USD 2.5 billion.
- Maturity date of the loan was approximately 5 years and 1 month following the borrowing (with Chevron Australia having an option to repay earlier, and Chevron US having entitlement to terminate the credit facility at any time without cause).
- The ultimate parent of the group did not provide a guarantee to Chevron US, and Chevron Australia did not provide to Chevron US any security over its other assets.

Chevron argued that the credit facility was at arm's length, given the risks of the terms and agreements. Chevron Australia claimed deductions for the interest payments, but the Australian Tax Office denied those deductions. The Australian Tax Office argued in court that TP rules not only relate to adjustments of the price on a non-arm's length agreement, but also to the terms and conditions on the loans – would this not be the case, multinational companies could optimise their interest deductions by attaching unrealistic (i.e. non-arm's length) terms and conditions to internal borrowings.

In April 2017, the Federal Court of Australia unanimously decided in favour of the Australian Tax Office and confirmed that the loan was indeed not a genuine "arm's length" transaction, thereby strengthening the position of the Australian Tax Office in challenging financial arrangements where multinationals are regarded to evade taxes. The case illustrates that multinational companies should review their internal borrowings, especially where there are large differences between the rates payable on external debt and those on the group's internal loans.

In a 2017 blog we have looked at the implications of this case in more detail.

Intragroup services (chapter 8 OECD TP Guidelines)

In 2017, transfer pricing and the deductibility of intragroup services became the most common controversy topic for multinational companies. It is an issue that has the potential for significant costs if it is not managed properly, as it could lead to time and resource consuming tax audits around the world, double taxation and insecurity involving the tax position for a long period of time. The OECD has developed a transparent model for the allocation of shared-service charges, such to ensure consistency for a wide category of common, low-value/routine intragroup services that usually require little or no markup. However, a number of countries (in particular developing countries) still do not recognize this model and challenge the local country profitability. In addition, it has become apparent that major countries are not fully aligned with OECD's Guidelines, including China (which does not allow deductions for management fees that are charged based on allocations), and Korea and India (these countries require a direct connection between each expense and the local benefit).

Master and Local filing (update)

Most OECD countries have introduced the OECD master file / country-by-country documentation requirements in 2017, meaning that taxpayers are required to document information on their intragroup services and their policy when filing the 2017 tax return. In case there remains to be an issue in some countries, despite having consistent allocation models and supporting documentation in place, separate contracting with these countries may be considered to resolve the issue.

ABOUT NOVIOTAX

NovioTax is a Dutch research-oriented tax consultancy firm with offices in Amsterdam and Nijmegen. Our employees are members of the Dutch Association of Tax Advisers (NOB) and the International Fiscal Association (IFA), have many years of experience and some are much sought-after guest speakers on tax policy and other topics that fall within their field of expertise. We typically serve midsized and large MNE clients, coordinate discussions with the DTA and closely cooperate with international law and tax law firms.

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