Trends I Netherlands moves away from fiscal offshore industry

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The Netherlands is slowly but surely steering away from facilitating the use of its corporate income tax system by companies that are set up merely to obtain tax benefits. These companies, which often do not actually carry out activities in the Netherlands, have contributed to the perception among policy makers – and the public in general – of the Netherlands being a 'quasi-tax haven'. What are the international driving forces behind the policy change that is taking place in the Netherlands and what impact will they have on the Dutch tax system during 2017 and beyond? While the Dutch tax system will continue to benefit businesses that create employment in the Netherlands while also operating internationally, those who are setting up shop in the Netherlands purely for tax purposes will find it increasingly difficult to obtain the benefits that have been commonplace.

For many years, the Netherlands very skilfully managed to perform a successful balancing act in the field of international taxation. It managed to create a corporate income tax system that was able to efficiently raise considerable amounts of revenue from Netherlands-based enterprises, including not only many SMEs that are critical for new employment and are often at the forefront of successful new R&D, but also a surprisingly large number of MNEs that are headquartered in the Netherlands. Simultaneously, the Dutch system allowed – some may say sponsored – the creation of a very successful fiscal offshore industry, resulting in the formation of tens of thousands of 'letterbox companies'.

This dual position also produced some downsides. As an offshore centre, the Netherlands has clearly been surpassed by Luxembourg where until very recently, in the absence of a meaningful domestic enterprise sector, free reign could be given to the needs and desires of the local offshore industry without jeopardising the revenue from Luxembourg groups. At the same time, there are strong indications that the impact of the offshore industry on the reputation of the Netherlands may have weakened the Dutch negotiating position, both when discussing new double taxation agreements and in international tax forums.

Signs indicate that this situation is going to change. Like any political development, changes in official tax policies are not one-dimensional, but there is a strong trend towards a tax policy with a greater focus on the attractiveness of the Netherlands both for new inbound investments of established MNEs and innovative SMEs while simultaneously signalling that the days of the Netherlands as a quasi-tax haven are over. The reasons behind these changes in policy are many, but a key role is played by the altered global perception towards aggressive tax avoidance.

With this in mind, we believe that three tax themes – harmonisation, transparency and anti-abuse measures – will dominate the tax scene in 2017 and beyond.

Transparency
Increased transparency appears not only in the form of new rule making, such as country-by-country reporting and the EU and OECD initiatives to exchange information on advance tax rulings, but also in the increasing trend among MNEs to be more transparent about their internal tax policies.

Harmonisation
Many of the aggressive tax planning techniques widely used by MNEs have been facilitated by the lack of harmonisation between national tax systems. While commercial accounting rules have been strongly harmonised (IFRS or US GAAP) this development has been largely absent in the tax field, principally because national legislators have been unwilling to yield power in this area. Particularly for smaller countries and economies, this presumed fiscal autonomy in practice merely results in a race to the bottom. As a result of political and social pressures, national governments and law makers now seem more prepared to transfer power in the taxation area than they were in the past. Examples include the agreement on the multilateral convention implementing the treaty-related aspects of the OECD/G20 BEPS project in tax treaties around the world, and the adoption of the Anti-Tax Avoidance Directive in the EU. More harmonisation initiatives are pending; in particular, the CCCTB proposals and the proposals to extend the anti-hybrid mismatch rules adopted in the EU to third country relations.

Anti-abuse measures
Countering abuse has been a key driving force in the move towards more transparency and harmonisation. ATAD I and ATAD II essentially shut down most of the tax planning techniques that had been commonplace over the last several decades, at least in the EU. Avoiding base erosion through interest payments on regular debt instruments and by using hybrid instruments plays a central role in the anti-abuse initiatives. But interestingly, base erosion through royalty payments is not specifically addressed, other than in the area of transfer pricing.

Some of these legislative initiatives are discussed in further detail below.

ATAD I

In July 2016, the EU's Economic and Financial Affairs Council (ECOFIN) reached agreement on the Anti-Tax Avoidance Directive (ATAD I). ATAD I requires EU member states to implement some of the recommendations from the OECD/G20 BEPS project and certain other anti-avoidance measures in domestic law: (i) interest limitation, (ii) controlled foreign companies (CFCs), (iii) general anti-abuse rule (GAAR), (iv) intra-EU hybrid mismatches and (v) exit taxation. More information on this directive can be found here.

EU member states must implement this directive by 31 December 2018. Although one of the objectives of ATAD I is a coherent implementation of these anti-avoidance measures within the EU, we do not believe that this will be achieved, as ATAD I only sets minimum standards, allowing for more restrictive rules to be laid down, and contains many optional and alternative provisions. Also, the language of ATAD I lacks detail and is very much principle-based, which again leaves room for member states to

deviate in their national implementation. A similar effect occurred during the implementation of the amendments to the Parent Subsidiary Directive in 2015.

Impact of ATAD I in the Netherlands

The Dutch government has indicated that it will release an ATAD I implementing bill for internet consultation in the autumn of 2017. The interest limitation rule and the CFC rule are the provisions to look out for in the consultation document. As to the interest limitation rule, the main question is whether some of the anti-base erosion measures presently contained in the Dutch corporate income tax code will also be eliminated or amended when the rule introduced. As to the CFC rule, ATAD I contains two options; the first is an approach that attributes income based on the allocation of assets, functions and risks, while the second is a more classical CFC approach that identifies specific categories of passive income for inclusion in taxable income. There are indications that the Netherlands will opt for the first approach. With respect to other provisions in ATAD I, Dutch tax law is largely compliant already, especially as the use of intra-EU hybrid mismatches has already been addressed by the amendment of the Parent Subsidiary Directive in 2015.

ATAD II

ATAD I does not address hybrid mismatch structures involving third countries and hybrid permanent establishments, as well as certain other hybrid structures. The European Commission published a separate proposal for a directive correcting these omissions in October 2016 (ATAD II). As for ATAD I, the proposed implementation deadline for ATAD II is 31 December 2018. No agreement has been reached on this proposal so far. It will be discussed again at an ECOFIN meeting during the Maltese presidency of the EU in the first half of 2017. This proposal would effectively end many, if not all, of the typical hybrid mismatch structures between companies in different EU member states and between companies in EU member states and companies in third countries.

Impact of ATAD II in the Netherlands

In the Dutch context, ATAD II would put an end to the well-known CV-BV structures, which are currently used by many US multinationals to optimise their non-US operations. The Dutch government has requested a postponement of the implementation date until 31 December 2023 to give the US time to implement tax reform that would end the benefits of hybrid mismatches such as those achieved through the CV-BV structure. The Dutch government has also argued that an earlier implementation would not be appropriate in view of the time needed by US multinationals to adjust their corporate structures. Without a transition period, the Dutch government fears the impact ATAD II may have on jobs created by US multinationals in the Netherlands. In our view, the link between CV-BV structures and the level of employment seems tenuous. Furthermore, a seven-year grandfathering period appears disproportionate to us. Finally, a continued use of these structures may motivate the European Commission to more actively consider possible state aid aspects of these structures.

CCCTB

In October 2016, following an unsuccessful first attempt in 2011, the Commission relaunched the European corporate tax base project by publishing two directives, one for the introduction of a common corporate tax base (CCTB) and one regarding a common consolidated corporate tax base (CCCTB). The CCTB aims to fully harmonise the corporate tax base within the EU and create a limited form of cross-border loss relief. It will be mandatory for large MNEs (those with group revenue exceeding EUR 750 million) and voluntary for other companies. The implementation deadline in the proposal is 31 December 2018. The Commission considers the CCTB only an intermediary step towards the CCCTB. Under the CCCTB, all European group profits are determined on a consolidated basis and allocated among EU member states on a formulary apportionment basis. The proposed implementation deadline for the CCCTB is 31 December 2020. The CCCTB proposals do not aim to harmonise corporate tax rates; like the Commission's other proposals on taxes, these require unanimous agreement in the ECOFIN.

Dutch position on CCCTB

The Dutch government has expressed serious reservations to both proposals, claiming the proposals do not help avoid aggressive corporate tax planning and will lead to very significant administrative costs. While we appreciate the hesitation of the Dutch government, it seems to us that only by introducing a fully harmonised tax system can intra-EU corporate tax avoidance be effectively prevented. Also, although the introduction of a new system will inevitably result in administrative costs, one should not underestimate the benefit to multinationals of no longer having to deal with up to 27 different national tax systems. Finally, transfer pricing disputes within the EU will not be entirely eliminated, but should be substantially reduced in a CCCTB environment. These initiatives have been widely supported by the larger EU economies, which is why we believe there is a good chance that at least the CCTB will be adopted.

STATE AID

Besides initiating legislative action to counter corporate tax planning, the Commission has also applied the EU state aid rules for challenging corporate tax planning structures introduced by individual EU member states in recent years. This has resulted in the EUR 13 billion state aid recovery decision against Apple in Ireland, and in decisions declaring tax rulings with FIAT (Luxembourg) and Starbucks (the Netherlands) to be unlawful state aid. The respective companies and EU member states have submitted or announced appeals against these decisions to the European Court of Justice. It will take a number of years before the ECJ can reach a final decision on these cases. Further investigations into tax rulings issued to McDonald's, Amazon and Engie (all in Luxembourg) are pending, while the Commission is analysing a large number of other tax rulings issued by EU member for possible state aid connections – making it likely that we will see further action from the Commission in this area.

An interesting feature of the Apple case was the Commission's invitation to both source countries and the US to claim taxation rights on part of the relevant profits, accepting that these claims would reduce the amount of illegal state aid granted by Ireland. This is another reason to closely watch local tax authorities' actions. In response, a number of countries, including Spain, Italy and Austria, have already announced they are investigating possibilities to recoup lost tax revenues from Apple. Finally, the Commission has also challenged the Belgian excess profit regime,

which is of particular importance to the Netherlands given its similarity with the informal capital rulings obtained by foreign multinationals in the Netherlands.

State aid and the Netherlands

So far, the Commission has not publicly announced further investigations into alleged state tax aid granted by the Netherlands. However, we have reason to believe that the Commission is actively exploring certain Dutch tax rulings. Some experts are already speculating that both the CV-BV structures and informal capital rulings especially may give rise to state aid concerns.

TAX TREATIES

In November 2016, the OECD released the Multilateral Convention (MC). The MC seeks to implement the treaty-related measures of the OECD/G20 BEPS project into existing tax treaties between jurisdictions that are parties to the MC. Close to 100 countries participated in the negotiations. The MC covers a broad range of topics, including measures to avoid treaty shopping, provisions to deny treaty benefits in certain hybrid mismatch arrangements, and a lower threshold for permanent establishment status. The MC will enter into force once it has been signed and ratified by at least five jurisdictions; a signing ceremony is planned for June 2017. The MC will have effect if two parties to a tax convention have both elected for a specific provision of the MC to apply; for example, if Country A and Country B have both elected to implement the principal purpose test into their tax treaties, the tax treaty between country A and B will be supplemented accordingly. If the elections do not match, then no change will generally occur in their bilateral relations.

Impact of MC on Dutch tax treaties

The Dutch government has indicated that it will sign the MC in June 2017 and that it is in favour of all the measures included (except for the savings clause, which is irrelevant in the Dutch tax context). As many tax treaties as possible will be brought within the scope of the MC. As to the prevention of treaty shopping, the Netherlands will elect for the principal purpose test included in the MC to apply to Dutch tax treaties. The Dutch government has not yet indicated what choices it intends to make in connection with the other provisions of the MC. This will be revealed, on a preliminary basis, when the MC is signed in June 2017, and further elaborated after ratification.

DIVIDEND WITHHOLDING TAX

The Netherlands levies a 15% withholding tax on dividends distributed by Dutch resident NVs and BVs. No withholding tax is generally levied on distributions made by cooperatives. The absence of withholding tax has led to widespread use of cooperatives in international tax structuring. The Dutch government has announced plans to eliminate this difference in treatment between NVs/BVs and cooperatives. This will be done by introducing a withholding tax obligation for cooperatives in respect of distributions to members holding a 5% or greater membership interest. At the same time, NVs/BVs and cooperatives will be allowed to apply withholding exemption to distributions made to 5% or larger shareholders and members who are resident of a treaty jurisdiction. The exemption will be subject to anti-abuse rules. Distributions to shareholders with interests in NVs below 5%, which includes most shareholders in publicly traded companies, and in BVs will continue to be subject to dividend withholding tax. A bill will be published for consultation in the first half of 2017. The government's intention is for the new rules to become effective on 1 January 2018.