Welcome to our quarterly Europe update. This newsletter is a selection of De Brauw publications in the last three months about relevant legal developments in Europe.

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Competition & Regulation

- European Union and China want to improve cooperation in merger review
- Cartel facilitators no better than participants
- Dominance and rebates: beware
- The handyman can: national competition authorities may get bigger enforcement toolbox
- Ignorance is no longer bliss: liability for anti-competitive actions by third parties
- European Commission back to the drawing board after air freight fright

Intellectual Property

- First German ruling since Huawei judgment against infringer of standard-essential patents
- European trade secrets rules soon to become reality

Regulatory & Criminal Enforcement

- First penalty under UK Bribery Act for failure to prevent bribery

Tax

- EU combats international tax planning: the Amended Parent Subsidiary Directive
- Dutch tax bill introduced to expand fiscal unity regime
- Landmark ECJ ruling about VAT treatment of fund management fees

- Conditions relaxed for Dutch master-feeder LP and mutual investment fund structures

Competition & Regulation

European Union and China want to improve cooperation in merger review

The European Commission and the Ministry of Commerce of the People's Republic of China have signed a best practices agreement for collaboration in the review of mergers and acquisitions. The agreement aims to provide "practical guidance" to further strengthen cooperation and to facilitate closer communication between parties about procedural and substantive issues.

Although it remains to be seen to what extent the new framework will affect the level of cooperation, the intentions of the European Commission and MOFCOM are expected to lead to the merger review processes becoming more uniform. This may also result in more consistency in outcomes. We will keep you informed of further developments.

The agreement, which was signed on 15 October 2015, aims to provide "practical guidance" to increase the level of coordination and interaction between the European competition authority and its Chinese counterpart. According to the agreement, both competition authorities have a common interest in merger review outcomes that are efficient, consistent and non-conflicting.

China's merger control regime has become an increasingly important consideration for global transactions, and the country is today considered one of the world's major merger control enforcers. In recent years, MOFCOM has increased its enforcement of the obligation, under China's Anti-Monopoly Law, to report notifiable transactions and has started publishing the fines it has imposed on parties infringing this obligation.

The European Commission and MOFCOM signed their first cooperation agreement in 2004 and have expanded their cooperation in recent years. As part of their efforts to further strengthen cooperation, both parties have now agreed to communicate more closely about procedural and substantive issues, such as the definition of relevant markets, the assessment of the competitive impact and the design of remedies. In addition, the new guidance provides for the opportunity to coordinate information requests to the parties involved in the transaction and the designation of a liaison officer who facilitates case cooperation.

The extent to which the new framework will lead to greater cooperation between the competition authorities in Europe and China remains unclear, as details of the framework agreement's implementation are not yet known. However, we expect that the intentions of the European Commission and MOFCOM as reflected in the framework agreement will eventually lead to more coordinated and uniform merger review processes and potentially also result in more consistency in outcomes.

Cartel facilitators no better than participants

Participating in a cartel as well as contributing to the implementation of a cartel can lead to substantial fines. The European Court of Justice recently confirmed that a consultancy firm may be held liable for infringement of the cartel prohibition where it actively contributes, in full knowledge of the relevant facts, to the implementation and continuation of a cartel among participants active in a different market. According to the ECJ, the consultancy firm played an essential role in the cartel infringement by organising meetings where it was present and participated actively; collecting and supplying sales data to the cartel participants; offering to act as a moderator in the event of arising tensions; and encouraging cartel participants to compromise, and it received remuneration for all of these activities. Companies should be aware that the cartel prohibition covers all levels of cartel participation, whether active, passive or supportive.

Dominance and rebates: beware

The European Court of Justice recently confirmed that dominant companies need to be careful about granting rebates. If the rebate scheme makes it easier for the dominant company to tie its own customers to itself and attract the customers of its already weaker competitors, the rebate scheme may qualify as abuse.

The case concerned a retroactive rebate scheme implemented by Post Danmark in 2007 and 2008 regarding bulk advertising mail. At the time, Post Danmark was controlled by the Danish State and had a statutory monopoly on the distribution of letters, including – in the case of bulk mail – direct advertising mail weighing up to 50 grams. The rebate scheme operated by Post Danmark had three main features:

- it was a standardised rebate scale: all customers were entitled to receive the same rebate on the basis of their aggregate purchases over an annual reference period;
- the rebates were conditional: Post Danmark and its customers concluded agreements at the beginning of the year where estimated quantities of mailings for that year were set. At the end of the year, Post Danmark made an adjustment where the quantities presented were not the same as those that had been estimated initially;
- the rebates were retroactive: where the threshold of mailings initially set was exceeded, the rebate rate applied at the end of the year applied to all mailings presented during the period concerned and not only to mailings exceeding the threshold initially estimated.

The **ECJ** first reiterated its settled case law that, in contrast to a quantity discount linked solely to the volume of purchases from the manufacturer concerned, which is not, in principle, liable to constitute an abuse of a dominant position, a loyalty rebate, which by offering customers financial advantages tends to prevent them from obtaining all or most of their requirements from competing manufacturers, amounts to an abuse. However, Post Danmark's rebate scheme could neither be regarded as a simple quantity rebate, since the rebates were not granted for each individual order, nor as a traditional loyalty rebate, because it was not coupled with an obligation for, or promise by, purchasers to obtain all or a given proportion of their supplies from Post Danmark. Consequently, to determine whether Post Danmark's rebate scheme constituted an abuse of its dominant position, it was necessary to consider all the circumstances, particularly:

- the criteria and rules governing the grant of the rebate, and to investigate the exclusionary effects, that is, whether the rebate tends to remove or restrict the buyer's freedom to choose his or her sources of supply and to bar competitors from access to the market, and
- the extent of Post Danmark's dominant position and of the particular conditions of competition prevailing on the relevant market.

The ECJ considered the three main features of Post Danmark's rebate scheme and noted that because Post Danmark held 95% of the relevant market, competition on that market was very limited. Based on these circumstances, the ECJ held that a rebate system operated by a dominant company which, without tying customers to it by a formal obligation, nevertheless tends to make it more difficult for those customers to obtain supplies from competing companies, produces an anti-competitive exclusionary effect.

The ECJ furthermore held that the "as-efficient-competitor test" laid down in the *European Commission's guidance on its enforcement priorities regarding exclusionary conduct by dominant undertakings*, although a useful tool, was of no relevance in this case, since the structure of the market made the emergence of an as-efficient competitor practically impossible.

The handyman can: national competition authorities may get bigger enforcement toolbox

The European Commission recently launched a public consultation on whether the EU's national competition authorities should be given additional tools to enforce the EU antitrust rules. The consultation follows up on a 2014 Commission review that assessed the effectiveness of the cooperated enforcement. A number of action points were identified to further strengthen the national enforcement powers. For instance, national competition authorities should be independent in the exercise of their tasks and have effective investigative and decision-making tools, as well as tools for imposing deterrent and proportionate fines. The EU's commissioner for competition, Margrethe Vestager, recently indicated that not all national competition authorities have the same enforcement powers. This is why the Commission is looking for feedback on a number of potential improvements. Interested parties have until 12 February 2016 to submit their views.

National competition authorities (NCAs) and courts are empowered to apply the EU competition rules within their jurisdictions on the basis of Regulation 1/2003. To ensure the consistent application of these rules, the European Commission and the 28 national competition authorities of the EU cooperate with each other in the European Competition Network. In 2014, the Commission assessed the effectiveness of cooperated enforcement in its Communication on ten years of antitrust enforcement under Regulation 1/2003. It identified a number of action points to further strengthen the enforcement powers of NCAs, including actions guaranteeing that they:

- are independent in the exercise of their tasks and have sufficient resources
- have a complete set of effective investigative and decision-making tools
- have effective tools for imposing deterrent and proportionate fines and well-designed leniency programmes.

In a **speech** of 20 November 2015, the EU's commissioner for competition, Margrethe Vestager, elaborated on these action points. She mentioned that not all NCAs currently have the same enforcement powers. Some NCAs do not have the authority to gather evidence stored on digital devices, such as smartphones or laptops, during a dawn raid. In addition, because most NCAs have their own leniency programme, a company applying for leniency cannot always be sure it is the first to approach every single relevant NCA. And a penalty for the same offence can be as much as 25 times higher in one EU country compared to another because different principles apply in different member states. Furthermore, cartel members may have time to destroy evidence, because not all NCAs have sufficient resources to carry out simultaneous raids at all cartel members. Other NCAs cannot afford to purchase tools to extract hidden data from a company's computer system.

It is for these reasons that the Commission has launched its public consultation on how to fix this. The Commission is considering a number of improvements regarding:

- the resources and independence of NCAs
- the enforcement toolbox of the NCAs
- the sanctioning powers of the NCAs
- leniency programmes

Ignorance is no longer bliss: liability for anti-competitive actions by third parties

Companies may soon be held responsible for anti-competitive actions by their external contractors. In a recent opinion, Advocate General Wathelet suggested introducing a rebuttable presumption that companies be liable for competition law infringements carried out by external contractors. The presumption would apply even if the contractor's anti-competitive actions were distinct from the tasks assigned to it and without proof of the company having been aware of or having consented to the contractor's actions. If the opinion is followed by the European Court of Justice, a company could rebut the presumption of liability by demonstrating that (i) it took all the necessary precautions when hiring the contractor and monitoring the execution of the contractor's assigned tasks, (ii) the contractor acted outside of the assigned tasks, and (iii) it publicly distanced itself from the contractor's actions or reported these to the authorities as soon as becoming aware of them.

The Advocate General's opinion relates to a request for a preliminary ruling regarding a public procurement case for the supply of food products to educational institutions in Latvia. Three companies submitted tenders: DIV un Ko, Ausma and Pārtikas. Pārtikas had sought assistance in the preparation of the tender from a legal firm, which in turn hired subcontractor MMD Lietas for this purpose. Pārtikas sent MMD Lietas a bid proposal. Without informing Pārtikas, MMD Lietas also undertook to prepare the bid proposals for DIV un Ko and Ausma. It used Pārtikas' bid proposal as a benchmark for the two other bid proposals. The Latvian Competition Authority imposed fines on DIV un Ko, Ausma and Pārtikas for bid rigging. In the appeal proceedings, the Latvian Supreme Court requested a preliminary ruling by the European Court of Justice on whether a company can be held liable for anti-competitive conduct without evidence of the company's directors having been personally engaged in conduct or having been aware of, or consented to, conduct by persons providing an external service to the company.

The Advocate General noted that because the prohibition on anti-competitive conduct and the penalties for infringing the prohibition are well known, the conduct usually takes place in a clandestine fashion, with meetings held in secret and associated documentation reduced to a minimum. It would therefore be too easy to circumvent application of the competition rules by "hiding" behind an external third party. Furthermore, he found that the importance of safeguarding free competition justifies that companies, when assigning tasks to external third parties, need to take all necessary precautions to prevent anti-competitive conduct by those third parties, in particular by avoiding negligence and recklessness in defining and monitoring the assigned tasks. The Advocate General therefore suggested establishing a rebuttable presumption that a company is liable for the anti-competitive actions by an external third party assigned by it to perform certain tasks. The presumption would apply even if the contractor's anti-competitive actions were distinct from the assigned tasks and no evidence existed of the company having been aware of or having consented to the third party's actions.

Consequently, for the company's presumption of liability to come into play, a competition authority will only need to prove that a party working for the company, without directly or indirectly being part of the company's organisation chart, has carried out anti-competitive actions. It is then up to the company to rebut this presumption by providing evidence that it had no knowledge of the third party's actions and by proving that it took the following measures to prevent the anti-competitive actions:

- When hiring the third party, measures were taken relating to the choice of third party, the definition of the third party's tasks and the monitoring of the execution of these tasks, the conditions for using subcontractors, the obligations to ensure – among other things – competition law compliance, the penalties for non-compliance with the contract, and the necessary authorisation for actions outside the contract's scope.
- During the contract period, measures were taken to oversee that the third party strictly adhered to the assigned tasks.
- As soon as the company became aware of third party's anti-competitive conduct, it took measures to publicly distance itself from the conduct, to prevent it from happening again and/or to report the conduct to the authorities.

European Commission back to the drawing board after air freight fright

The General Court recently annulled the European Commission's decision to impose fines totalling EUR 790 million on a number of air carriers for their participation in an airfreight cartel. According to the General Court, the contradictions between the grounds and the operative part of the Commission's decision were liable to infringe the air carriers' rights of defence. This is not only a blow to the Commission, which will need to consider whether to appeal the ruling or amend the decision, but also to the claimants seeking damages from the air carriers. We will keep you informed as the case proceeds.

In November 2010, the European Commission fined a number of air cargo carriers for operating a worldwide cartel which affected cargo services within the European Economic Area. The carriers coordinated their actions on surcharges for fuel and security without discounts over a six-year period. All air carriers except one brought actions before the General Court against the Commission's decision. According to the air carriers, there were discrepancies between the grounds of the decision, which describe a single and continuous infringement in the European Economic Area and Switzerland, and the operative part of the decision, which refers to four separate infringements relating to different periods and routes.

In its ruling, the General Court reiterated that the principle of effective judicial protection requires that the operative part of a Commission decision must be particularly clear and precise. Furthermore, because national courts are bound by a Commission decision – provided it has not been annulled or invalidated – the meaning of a decision's operative part must be unambiguous. It must enable national courts to understand the scope of the infringement and to identify the persons liable, so that they can draw the necessary inferences with regard to claims for damages by cartel victims.

The General Court agreed with the air carriers on there being a contradiction between the grounds and the operative part of the contested decision. The grounds describe a single and continuous infringement in relation to all of the routes covered by the cartel and which all of the carriers at issue allegedly participated in. The operative part of the decision refers to either four separate single and continuous infringements or just one single and continuous infringement, liability for which is attributed only to the carriers which, as regards the relevant routes, participated directly in the unlawful conduct or were aware of the collusion on those routes and accepted the risk.

The General Court ruled that these inconsistencies could infringe the air carriers' rights of defence and prevent the Court from exercising its power of review. It therefore annulled the decision.

The European Commission has the right to appeal the General Court's ruling.

Intellectual Property

First German ruling since Huawei judgment against infringer of standard-essential patents

For the first time since the ECJ's *Huawei* judgment, a German court has ruled on the infringement of standard essential patents (SEPs) and Fair Reasonable and Non-Discriminatory (FRAND) licensing terms.

The court in Düsseldorf, Germany, held that under the given circumstances – where injunction proceedings were brought before the Huawei judgment – the SEP holder's obligation to inform the alleged infringer about the infringement was met when the infringer received the statement of claim. As the alleged infringer did not fulfil the ECJ's minimum requirement to render accounts and provide security while continuing to make use of the patents in question, the court decided to grant injunctive relief. The court made no substantive assessment on whether the claimant's original offer or the defendant's counteroffer were FRAND or whether the claimant held a dominant position within the meaning of article 102 TFEU.

The ruling shows that it is important for an alleged infringer to make sure that it complies with its obligations formulated in the Huawei judgment, although it remains to be seen whether other national courts will adopt the stringent approach of the Düsseldorf court.

Huawei v. ZTE
In its Huawei judgment, the ECJ provided some guidance on interpreting article 102 TFEU from the vantage point of an SEP holder enforcing a patent. More specifically, the ECJ provided a framework for the negotiation dynamics between the prospective licensor and licensee in cases where they are competitors and the licensor holds a dominant market position. First, it is up to the SEP holder to alert the alleged infringer by specifying the patent and the way it has been or is being infringed. Second, if the alleged infringer has expressed a willingness to conclude a licence agreement on FRAND terms, the SEP holder must

present a specific, written offer for a licence on FRAND terms to the alleged infringer. This offer should specify, in particular, the royalty and the way in which it is calculated. Third, the alleged infringer must diligently respond in good faith to the offer made by the SEP holder, and observe recognised commercial practices in the sector. Good faith must be established on the basis of objective factors and implies that there should be no delaying tactics. If the alleged infringer does not accept the initial offer, it must promptly submit a written counteroffer on FRAND terms to the SEP holder. If the SEP holder rejects the counteroffer, the alleged infringer should provide appropriate security for the payment of royalties and render accounts of its past and current use of the SEP in question.

The ruling of the Düsseldorf court

In *Sisvel v. Haier*, the Düsseldorf court first summarised the steps as formulated by the ECJ in the Huawei judgment and then considered whether the parties complied with these steps. According to the court, Sisvel's obligation, as the SEP holder, to inform the alleged infringer Haier about its infringement was met when Haier gained knowledge about the infringement through the statement of claim in the action brought by Sisvel. A relevant factor in this was that the action had been brought before the Huawei judgment. The court then confirmed that Sisvel had made a suitable licence offer to Haier. In that respect, the court noted that it was sufficient that this offer was made to Haier's parent company as opposed to all individual affiliates. After Sisvel rejected Haier's counteroffer, Haier did not respond in a timely manner. Whether this was by itself detrimental to Haier's FRAND defence was not decided. According to the court, Haier should have provided, at a minimum, security for the payment of royalties and rendered accounts for past and current use of the SEP within a month of Sisvel's rejection of the counteroffer. Because Haier did not do so, the court held that Haier could not rely on a FRAND defence. Therefore, Sisvel was granted injunctive relief. Because Haier was barred from relying on a FRAND defence, the court did not decide on whether Sisvel held a dominant position or whether Sisvel's offer and Haier's counteroffer were indeed FRAND.

Implications of the ruling

The ruling shows that it is important for an alleged infringer to ensure that it complies with obligations as formulated in the Huawei judgment. By neglecting to do so, the alleged infringer could be prevented from raising a FRAND defence. The ruling does not provide any guidance in cases where the alleged infringer does fulfil its obligations, nor does the ruling provide any guidance on what constitutes a FRAND offer (for example, whether a portfolio licensing offer is FRAND) or on when a dominant position of the SEP holder is to be assumed. These questions remain unanswered. The ruling does show that a national court could apply the framework provided in the Huawei judgment quite strictly, although it remains to be seen if other national courts will adopt the stringent approach of the Düsseldorf court.

European trade secrets rules soon to become reality

The EU Trade Secrets Directive is close to becoming a reality. In a previous edition of In context we already reported on this. A new version of the Directive agreed by the European Parliament and the European Council is now available. This version is expected to be finalised soon. Once adopted, Member States will need to implement the provisions of the Directive within two years.

As the agreed text may be finalised in the coming months, now is the time for companies to rethink their trade secrets strategy. This includes having appropriate policies and contractual arrangements in place, and also raising awareness and support within your company. Moreover, companies should anticipate potential third party claims based on the Directive.

Some highlights of the new version of the Directive – getting your company ready

Previously, the European Commission, European Council and European Parliament each had their own preferred version of the Directive. After a recent triologue there is now a new joint version which only needs formal approval by the European Council and European Parliament. Below we highlight the main elements of the new version that companies should be aware of.

Minimum harmonisation
The Directive provides minimum harmonisation, which means that Member States will be able to provide wider protection than the Directive requires. It remains to be seen how Member States will decide to implement the Directive.

What constitutes a trade secret?
Similar to article 39(2) of TRIPS, the Directive defines a trade secret as information which:

- is secret: that is, not generally known or accessible;
- has commercial value, whether actual or potential; and
- has been subject to reasonable steps, under the circumstances, to keep it secret.

The types of information which may qualify for trade secret protection are not limited by the Directive. In fact, the recitals make clear that its scope also "extends beyond technological knowledge to commercial data such as information on customers and suppliers, business plans or market research and strategies". This means that a company's trade secret policy is not only relevant in relation to technical trade secrets, but also in relation to confidential commercial information.

Getting ready for this Directive means that your company – if it has not done so already – will need to put reasonable steps in place, as required by the specific circumstances (for example, taking into account the type of company) to protect the information considered a trade secret. These steps do not only entail policies and appropriate clauses in agreements. To be effective they also entail raising awareness and convincing "trade secret developing groups" within the company – such as R&D and sales – to act in accordance with the trade secrets policy.

Worker mobility and employment agreements
One of the key objectives of the European Parliament was to guarantee workers' professional mobility. In contrast to both the original proposal of the Commission and the Council draft, the draft Directive now states that an employee can freely use the following types of information:

- information that does not constitute a trade secret; and
- information that is part of the experience and skills gained by the employee in the normal course of their employment.

In practice, it will be challenging to distinguish between "a company's trade secret" on the one hand and "information acquired by the employee in the normal course of their employment" on the other. This distinction is not only relevant to a company's own employees, but also to future employees that switch from a competitor to the company, as well as to employees leaving the company for a competitor or to start their own business.

The Directive stresses that it will not offer any grounds for imposing any additional restrictions on employees in their employment agreements, other than in accordance with any union membership or national law. However, the Directive clarifies that it is “(not) intended to affect the possibility of concluding non-competition agreements between employers and employees, in accordance with the applicable law”.

Thus, it is important that the legal and HR department of a company align the way the company deals with employees and trade secrets, making sure that appropriate and valid non-compete and confidentiality obligations are in place for all employees involved in trade secrets.

Infringement of trade secrets and remedies
ecret carried out by unauthorised access, copying or appropriation, or any other conduct considered contrary to honest commercial practices will constitute infringement of a trade secret. Use or disclosure of a trade secret by a person who unlawfully acquired that trade secret will also constitute infringement, as will the use or disclosure of a trade secret in breach of a contractual obligation.

The Directive provides a range of new and robust remedies to enforce trade secret rights. When a trade secret is infringed, an injunction against further use or disclosure can be obtained. A damage award is also part of the arsenal of remedies available.

An infringer who knew or should have known that he or she was engaging in unlawful acquisition, disclosure or use of a trade secret, may be ordered to pay the trade secret holder damages appropriate to the actual prejudice suffered as a result of the infringement. The Directive’s aim is to ensure that an injured trade secret holder will be adequately compensated for the prejudice suffered as a result of the infringer’s wrongful conduct.

The Directive also provides remedies with respect to goods whose design, characteristics, functioning, manufacturing process or marketing significantly benefits from the use of a trade secret. These remedies include seizure and injunctions against the production, marketing, sale, storage, import or export of these goods, as well as the recall and destruction of all documents, objects or data embodying the trade secret. Put differently: trade secrets within the meaning of the Directive gain, for practical purposes, the status of a quasi IP right.

Secondary infringement – anticipating third party claims
The acquisition, use or disclosure of a trade secret is also unlawful whenever a person knew or should have known that the trade secret was directly or indirectly obtained from someone else that unlawfully obtained it. The same applies to the production, marketing, import, export or storage of infringing goods. This means that the scope of protection under the Directive also covers secondary infringement. It explicitly encompasses protection against abuse by third parties, including passive recipients of trade secrets, even if they initially acted in good faith. In this respect, it is important to keep in mind that there might be third party claims in the future on the basis of this Directive. It is advisable to take this into account when developing your company’s trade secret strategy.

Limited exceptions for infringement of trade secrets
The acquisition of trade secrets is considered lawful – and may thus not constitute infringement of a trade secret – when obtained by:

- independent discovery;
- reverse engineering;
- exercise of the right of workers or their representatives; and
- any practice which, under the circumstances, is in conformity with honest commercial practices.

With respect to reverse engineering, the recitals of the Directive provide a helpful insight. The Directive states that it does not create any exclusive right on the know-how or information protected as trade secrets, thereby distinguishing this from patent protection. That said, the Directive does mention that it is possible to contractually limit reverse engineering by parties with whom your company shares its trade secrets, such as licensees or suppliers. The draft text states that "reverse engineering of a lawfully acquired product is a lawful means of acquiring information except when otherwise agreed by contract. The freedom of entering into such contractual arrangements may however be limited by law." It may be worthwhile to review whether a company's agreements include a provision limiting reverse engineering. Furthermore, it is advisable to review if these provisions are allowed by national law in the main jurisdictions a company is active in.

In addition to the methods to obtain a trade secret which are considered lawful as listed above, the Directive also lists certain 'exceptions' to its scope. The application in respect of measures, procedures and remedies provided for in the Directive is to be dismissed in the following cases:

- exercising the right to freedom of expression and information;
- whistleblowing for the purpose of protecting the public interest;
- legitimate disclosure by workers to their representatives; and
- protecting a legitimate interest recognised by union or national law.

There seems to have been little consideration for the abuse of these exceptions by third parties.

Implementation
We now have to await the formal agreement of the Directive and subsequent implementation by Member States. To benefit from these new rules, companies are advised to devise or continue to devise a trade secret strategy and implement the appropriate measures.

Regulatory & Criminal Enforcement

First penalty under UK Bribery Act for failure to prevent bribery

Brand-Rex Limited in the UK has become the first company to be penalised for violating section 7 of the UK Bribery Act 2010. Scotland's Civil Recovery Unit has announced that Brand-Rex had agreed to pay GBP 212,800 under a settlement. The company accepted that it had benefited from the unlawful conduct of a third party acting for or on its behalf, an independent installer working for the company. This settlement emphasises not only the need for companies to have adequate policies in place that include third party conduct, but also to effectively enforce those policies.

Brand-Rex specialises in cabling solutions for network infrastructure and industrial applications. It operated an incentive programme named “Brand Breaks” from 2008 through 2012. By exceeding set sales targets, Brand-Rex distributors and installers could earn rewards, including holidays abroad. Problems arose when one of the installers offered traveling tickets earned under the Brand Breaks programme to a Brand-Rex end-user employee. This end-user employee was in a position to influence decisions in order to obtain or retain a business advantage for Brand-Rex. The installer allegedly gave the tickets to the employee with the intent of inducing him to select Brand-Rex products.

For doing this, Brand-Rex has been penalised under section 7 of the UK Bribery Act 2010. A commercial organisation is guilty of an offence under this section if it fails to prevent bribery by associated persons acting for or on its behalf. Third parties, such as agents or distributors, are considered associated persons. In this instance, the third party was an independent installer.

The incentive programme was not unlawful in itself, and Brand-Rex did not settle for its lack of having adequate policies to prevent bribery by third parties. The terms of the Brand Beaks programme provided that rewards were intended for third party suppliers. The issue was that Brand-Rex did not enforce the terms.

After an internal investigation by outside counsel and forensic accountants, Brand-Rex self-reported the issue to the Scottish Crown Office and the Procurator Fiscal Service. Brand-Rex accepted its responsibility for failing to prevent bribery by an associated person. The case was resolved under an initiative in Scotland that enables companies to avoid criminal prosecution if they self-report.

This settlement emphasises the need for companies to have adequate procedures in place that also cover the conduct of third parties. But this is not enough: the procedures should be effectively enforced, for example by training and monitoring third parties. Having adequate procedures in place also puts companies in a stronger position towards UK enforcement authorities if, despite all efforts, isolated incidents occur. Given the broad international scope of the UK Bribery Act 2010, companies outside the UK should keep in mind that obligations under the Act may also apply to them.

- Media release Scotland’s prosecution service

Tax

EU combats international tax planning: the Amended Parent Subsidiary Directive

You have probably read about the OECD’s comprehensive base erosion and profit shifting (or BEPS) action plan aimed at tackling undesirable international tax planning by corporates. In recent years, the EU, particularly the European Commission, has put substantial effort into accelerating BEPS-like measures in an EU context. A striking example is the amended Parent Subsidiary Directive. Originally designed to prevent economic double taxation of profits distributed within an EU corporate group, this directive is now also being deployed to counter undesirable tax planning. It does so by requiring member states to implement both a general anti-abuse provision (AAP) and a specific anti-hybrid rule in their domestic laws by 31 December 2015. The amendments raise important implementation questions that could result in domestic laws varying considerably. The Best Friends Tax Network has put together an implementation outline in respect of major EU jurisdictions, which can be found under *read more.* For more background on the BEPS project, have a look at *Musings on BEPS*, an article by the Best Friends Tax Network following the OECD's publication of the final BEPS package – comprising over 2,000 pages – in October 2015.

Download

- Some musings on BEPS
- Implementing the revised Parent Subsidiary Directive across the EU-outline

Dutch tax bill introduced to expand fiscal unity regime

This bill largely codifies a decree the State Secretary of Finance issued on 16 December 2014 expanding the fiscal unity regime in the Dutch Corporate Income Tax Act. The bill allows fiscal unities between Dutch sister companies held by an EU/EEA resident parent company. It also enables a Dutch parent company and a Dutch sub-subsidiary to create a fiscal unity if the sub-subsidiary is held by an EU/EEA resident intermediate company. The bill is expected to come into force on 1 January 2016. In anticipation of this, multinational enterprises are advised to start investigating if it is advantageous for them to restructure in order to benefit from the new legislation.

New possibilities in tax bill to amend fiscal unity regime
The Dutch fiscal unity regime is a consolidation regime for corporate income tax purposes that provides for the offset of losses and profits and the non-recognition of gains and losses on transactions between members of the fiscal unity. On 12 June 2014, the European Court of Justice **ruled** in three joined cases that parts of the Dutch fiscal unity regime are contrary to the European principle of freedom of establishment.

In *SCA Group Holding B.V.* and *MSA*, the ECJ ruled that Dutch legislation is contrary to EU law where it allows a Dutch parent company to form a fiscal unity with a Dutch sub-subsidiary held through one or more Dutch intermediate companies, but does not allow this where the intermediate company is a non-resident. In *(X)*, the ECJ also ruled that the Dutch prohibition against forming a fiscal unity between Dutch sister companies with a common EU/EEA parent company is contrary to the freedom of establishment principle in the EU.

On 15 September 2015, the ECJ ruled in ***Groupe Steria*** that the French fiscal unity regime conflicts with the EU principle of freedom of establishment. The Dutch State Secretary of Finance has stated that this and other case law should be examined carefully before Dutch legislation is amended again. He has also stated that it is not currently possible to estimate the consequences the bill might have and the measures necessary to respond to these situations. It appears that the State Secretary of Finance will not react to ECJ case law regarding the fiscal unity regimes of other EU/EEA countries. Therefore, it seems that no action will be taken before the ECJ explicitly declares the Dutch fiscal unity system contrary to European Law.

The bill brings the Dutch rules in line with the ECJ's rulings. A new paragraph 2 is added to Article 15 of the Dutch Corporate Income Tax Act, and other paragraphs are amended. Under the bill, it is possible to form a fiscal unity between:

- two Dutch sister companies where an EU/EEA resident top entity has full legal and beneficial ownership of at least 95% of the shares in those sister companies
- And a Dutch parent company and its Dutch sub-subsidiaries where one or more EU/EEA resident intermediate holding companies have full legal and beneficial ownership of at least 95% of the shares in those sub-subsidiaries.

In the first situation, the top entity must be an NV, BV, cooperative, mutual insurance association, or other comparable entity under foreign law. The parties are, in principle, free to choose which sister company is to be regarded as the parent of the fiscal unity; they must specify their choice in the fiscal unity request. But if one sister company directly or indirectly holds one or more shares in the other company, it must be designated as the fiscal unity parent. The activities and assets of the sister company designated as the subsidiary form part of the activities and assets of the fiscal unity parent. Once the sister company acting as the parent is sold, the entire fiscal unity is terminated. This means that parties should examine carefully which sister company should act as the parent. Alternatively, a new sister company can be created to take on this role.

- In the second situation, each EU/EEA intermediate resident company should meet the following requirements:
- be a tax resident of another EU/EEA country (Dutch intermediary entities must always be part of the fiscal unity);
- be an NV or BV or other comparable entity under foreign law with capital divided into shares;
- be subject to tax in the EU/EEA member state, without the possibility to choose or obtain an exemption; and
- not have a permanent establishment in the Netherlands.

Including a permanent establishment in the fiscal unity
The bill also makes it easier to include a Dutch permanent establishment of entities resident elsewhere in the EU/EEA in a fiscal unity. Under current law, a permanent establishment and a subsidiary of an EU/EEA entity can form a fiscal unity. The permanent establishment of a foreign entity can form a fiscal unity insofar as the Dutch subsidiary is attributable to the permanent establishment in the Netherlands. The new bill allows fiscal unity in this situation, even if the shares in the subsidiary of the EU/EEA entity do not form part of the assets of the Dutch permanent establishment. Click here.

If an EU/EEA company has more than one permanent establishment in the Netherlands via separate EU/EEA intermediate companies, these permanent establishments can also be included in a sister fiscal unity.

Amendment of accompanying fiscal rules
To accommodate these new rules in the existing fiscal unity regime, a number of accompanying rules are amended. Most of these rules contain measures against double loss utilisation.

First, the liquidation loss rules have been amended to avoid a double loss set-off when an intermediate company is liquidated. This new rule makes it impossible to claim a deduction for liquidation losses that have already been taken into account as fiscal unity losses.

Second, the rules for the write down of receivables are amended to prevent the companies within the fiscal unity from double loss utilisation. In the following situation a double loss could occur: a Dutch holding company grants a loan to an EU/EEA intermediate company that on-lends to a Dutch sub-subsidiary that forms a fiscal unity with the Dutch holding company. If this sub-subsidiary is loss-making, these losses suffered by the sub-subsidiary can be set-off within the fiscal unity against the profits of the holding company. In addition, the intermediate company may write down the receivable on the Dutch sub-subsidiary. The bill contains rules that prohibit the holding company from writing down the receivables against the profits of the fiscal unity. Otherwise, a double loss could occur.

Third, the excessive subsidiary interest rules are amended. These rules limit the interest deduction on loans entered into to finance participations. This limitation is determined by a comparison between the total amount of debt and equity. The two new fiscal unity structures mentioned before, might give rise to a double calculation of equity, and this could lead to more participation interest being deducted than intended. If a Dutch sub-subsidiary is included in a fiscal unity through an intermediate entity, the equity of the fiscal unity increases by the intermediate company’s equity and the Dutch sub-subsidiary’s equity. This double count is eliminated in the bill.

Anticipation to this tax bill

Multinationals, international investors and investment funds with Dutch headquarters or group companies should investigate if these new fiscal unity rules are beneficial to them. It is advisable to check if the proposed legislation has any consequences for international groups with existing fiscal unities or for fiscal unity requests, or if the international group does not yet include a fiscal unity through EU/EEA entities. We would be happy to explore whether any of the new possibilities offered under the bill could improve your structure as of 1 January 2016.

Implementation of the new fiscal unity rules

We recommend that those companies potentially affected by this bill stay abreast of developments, particularly because, if adopted, the changes are likely to become effective as of 1 January 2016. However, the bill may be amended during the legislative process. The Dutch fiscal unity regime may be amended again in the near future, in response to new case law and ongoing developments. We expect more clarification on the interpretation of the new rules as well as guidance from the Dutch tax authorities before 1 January 2016.

Landmark ECJ ruling about VAT treatment of fund management fees

The European Court of Justice issued a ruling on the VAT exemption for investment fund management on 9 December 2015. The ECJ held in Fiscale eenheid X that investment funds are eligible for this exemption if they are subject to specific state supervision. Real estate funds and other non-UCITS funds also qualify for the exemption if they meet that same condition. In addition, the ECJ ruled that management of real estate held by a qualifying investment fund does not qualify for the exemption.

This ruling is significant for the investment management industry in the Netherlands and the EU as a whole. The consequences can be advantageous or disadvantageous, depending on the activities of the investment fund. It raises questions about what constitutes specific state supervision and how management fees paid in the past are to be treated.

Below we answer a number of important questions raised by this ruling.

What was this ruling about?

The case concerned three real estate investment vehicles established by a group of pension funds and managed by a management company. The services provided by the management company included both portfolio management and property management. The management company took the position that these services qualified for the VAT exemption. The Dutch tax authorities disagreed. The Dutch Supreme Court submitted the following preliminary questions to the ECJ:

- Can a vehicle that solely invests in real estate – rather than transferable securities like UCITS – be a qualifying investment fund for the purpose of the exemption?
- If so, does property management also qualify as exempt fund management?

The ECJ ruled that real estate investment funds can qualify for the exemption provided they are subject to specific state supervision, but property management does not qualify for the exemption. The specific state supervision condition was raised and addressed by the Advocate General of the ECJ. The Dutch Supreme Court had not asked questions about this.

Why is the ECJ ruling important?

This ruling is important because it could significantly increase or reduce the VAT costs of managing investment funds or pools. The following examples illustrate this.

Example 1. A real estate investment vehicle invests in commercial real estate. The rents are all subject to VAT. The vehicle has an external manager that provides services similar to fund management services. The vehicle and the vehicle’s manager are not regulated because the vehicle does not qualify as an undertaking for collective investments in transferable securities (UCITS) or as an alternative investment fund (AIF). The VAT to be charged on the management fees is fully recoverable by the vehicle because the vehicle exclusively supplies services, the rents, subject to VAT. The benefit of the exemption not applying to the manager is that input VAT paid on goods or services delivered to the manager is recoverable to a greater extent. This reduces the cost base of the manager.

Example 2. A closed-end investment fund with only pension funds as investors and with an external manager was established in 2010. Under the Dutch regulatory supervision laws applicable until 22 July 2013, no licence was required. The EU Directive on alternative investment fund managers (AIFMD), as implemented in Dutch law, requires managers of these funds (AIFMs) to be licensed as of 22 July 2013, but this requirement does not apply to this fund pursuant to a grandfathering rule on the condition that the fund makes no new or follow-on investments. The investments of the fund do not involve “VATable” supplies of goods or services. This means that neither the fund nor its participants – which do not provide VATable supplies either – can recover input VAT on fees and other costs. If the exemption does not apply to the management fees charged by the external manager, 21%

VAT must be charged on those fees. This VAT significantly increases the costs of the fund or reduces the revenues of the manager because it cannot be recovered.

What is the origin of the "specific state supervision" condition?

The ECJ takes the UCITS regulation – which has been harmonised within the EU since the implementation of the UCITS I Directive from 1985 – as the starting point for defining qualifying investment funds. The ECJ finds that, in addition to UCITS, investment funds which display features that are sufficiently comparable to compete with UCITS also qualify. According to the ECJ, only funds subject to specific state supervision can be considered sufficiently comparable. On this basis, AIFs will typically qualify as well.

What does "specific state supervision" mean?

The ECJ has not defined the term specific state supervision. In addition to UCITS regulations, the ECJ ruling suggests that regulatory supervision of AIFMs based on the AIFM Directive qualifies as specific state supervision.

However, many AIFMs were not regulated in the Netherlands before the Dutch financial supervision rules implementing the AIFM Directive took effect on 22 July 2013. Hence, the AIFs that these AIFMs manage or managed could probably not benefit from the VAT exemption before that date.

The following types of closed-ended AIFs managed prior to 22 July 2013 are grandfathered and therefore exempt from regulatory supervision:

- AIFs that do not make additional investments after 22 July 2013
- AIFs whose subscription period closed prior to 22 July 2011 and, according to their constitutive documents, will terminate no later than 22 July 2016.

The first type of AIF is not subject to any AIFMD requirement; the second type must comply with AIFMD reporting and asset stripping requirements. The ECJ ruling does not indicate whether grandfathered AIFs can be considered subject to specific state supervision as of 22 July 2013. We believe there are good arguments that grandfathered AIFs also qualify for the exemption, in particular because they display typical features that are identical to non-grandfathered AIFs (see question 3 above). The argument is stronger for the second type of AIF, which must comply with the AIFMD requirements referred to above. However, it remains to be seen how courts will deal with this issue given the unpredictability and inconsistency of the ECJ in applying this exemption.

Subthreshold AIFMs – whose assets under management do not exceed EUR 100 million or, if applicable, EUR 500 million – are exempt from the AIFMD licence requirement and may benefit from a "light" regime that requires registration with the Dutch regulator. These AIFMs are only subject to certain information and reporting requirements. With reference to the arguments mentioned above, we support the view that AIFs managed by these AIFMs can nonetheless be considered subject to specific state supervision. A different view could put these AIFs in a significantly worse competitive position towards AIFs managed by licensed AIFMs, and this defeats the purpose of the "light" regime. Similarly, managers of venture capital funds investing in small and medium-sized enterprises could be subject to specific state supervision when regulated pursuant to the Regulation on European Venture Capital Funds (the EUVECA regime).

Previous ECJ rulings (the *ATP* and the *JP Morgan Claverhouse* cases) suggest that pension fund supervision and stock exchange regulations applicable to listed investment funds also qualify as specific state supervision.

Arguably, other forms of regulatory supervision applicable in respect of investment funds and investment fund management could qualify as well.

Are there other conditions for being “sufficiently comparable”?

Yes. The *Fiscale Eenheid X* ruling and previous ECJ rulings indicate that, at a minimum, the following conditions should also be satisfied:

- The investment fund must be funded by participants
- The investment fund should operate based on the risk diversification principle
- The investors should bear the investment risks.

AIFs and funds regulated under the EUVECA regime (see question 4 above) will typically satisfy these conditions.

Previous cases have raised the question of whether investment funds that are closed-ended or that are not open to the public or a wide group of investors could still qualify for the exemption. The ECJ ruling in the *JP Morgan Claverhouse* case indicates that the closed-ended character of funds does not preclude application of the exemption. Further, the ECJ rulings in the *Fiscale Eenheid X* and *ATP* cases imply that restrictions to the group of (potential) investors do not prohibit application of the exemption either.

Which services qualify as “management”?

ECJ case law shows that services qualify for the exemption if they are essential and specific to the management of qualifying investment funds. These services include portfolio management and certain fund administration and reporting services. Depository and custody services do not qualify. In line with current practice in the Netherlands, the ECJ confirmed in *Fiscale Eenheid X* that property management does not qualify either. The ruling suggests that, when it comes to the qualification of services that relate to the investments held by the investment fund, a distinction must be made between qualifying portfolio management – which include strategic decisions on investment policy and the making and disposal of investments – and non-strategic services in respect of the investments.

Can the Netherlands unilaterally expand the scope of the exemption?

No. The EU VAT Directive allows member states to define which investment funds qualify for the exemption. The ECJ held in *Fiscale Eenheid X* that this discretion is restricted by, among other things, the principle of fiscal neutrality and the objectives of the EU VAT Directive, and that on this basis only investment funds subject to specific state supervision qualify. Hence, member states can only expand the scope of the exemption by making currently non-regulated funds subject to supervision. If member states nonetheless allow a wider application of the exemption, they risk enforcement action by the European Commission.

What are the consequences of the ECJ ruling?

The prevailing view in Dutch practice was that investment funds which are not subject to regulatory supervision could nonetheless qualify for the exemption under certain circumstances. This is supported by the position taken by the Dutch State Secretary of Finance. This position entails that investment funds as defined in the Dutch financial supervision laws qualify for the VAT exemption, without reservation as regards funds that benefit from a regulatory exemption or grandfathering. In addition, in the view of the Minister of Finance, non-regulated funds and asset pools qualify for the exemption if they are sufficiently comparable to an investment fund as defined in Dutch financial supervision law in that they collectively make investments and are collectively exposed to investment risks. The ECJ ruling confirms that these non-regulated funds were not eligible for the VAT exemption. Hence, positions taken in VAT returns or agreed with the tax authorities in a ruling may turn out to be incorrect.

A VAT recapture by the Dutch Revenue Service (DRS) for management services provided to “comparable” non-regulated Dutch funds before the ECJ ruling may violate the principle of legal certainty or breach agreements (rulings) between the DRS and taxpayers.

The key question is how non-regulated funds will be treated going forward. In a number of cases where the ECJ overruled Dutch VAT law policy, the Netherlands did not revoke the relevant policy. This arguably allows taxpayers to claim continued application of VAT-favourable treatment based on the principle of legal certainty. In other cases, the Netherlands has revoked the policy.

What should you do?

You should analyse the implications for your non-regulated investment funds, including both existing funds and funds that have terminated in the past five years. Assuming that no enforcement action will be taken by the tax authorities before year-end 2015, the years open for re-assessment are 2011 onwards. For existing funds, you should analyse whether alternative structures are available going forward, if needed. This could include, for example, the formation of a VAT group if the manager and a majority investor are part of the same group. You can also see whether your fund structure can be transformed into a regulated fund structure. For example, if an existing fund is grandfathered on the basis of it being open solely to the group companies of its manager, an alternative would be to have a third party investor participate in the fund.

Also, you should verify the contractual allocation of any VAT risks. If the exemption has been applied incorrectly while the management contract states that the fees are exclusive of any VAT, the manager could seek to claim the VAT from the fund.

Conditions relaxed for Dutch master-feeder LP and mutual investment fund structures

The Dutch State Secretary of Finance has issued amended decrees on the Dutch tax treatment of limited partnerships (LPs) and funds for joint account (FGRs). Dutch LPs and FGRs are frequently used as investment funds because of their flexibility and tax efficiency.

The key change is that the amended resolutions simplify the requirements that the State Secretary of Finance believes should be met in order to secure a Dutch tax transparent treatment of master-feeder structures involving LPs or FGRs. Where previously the transfer or issue of partnership interests in a feeder or master required the consent of all partners of both the master and feeder, under the new rules only the consent of the partners in the relevant master or feeder is required. This new rule applies from 1 January 2016. To benefit from this simplification, funds should include the simplified consent in the fund documentation or, in the case of existing funds, inform the Dutch tax authorities that they have elected to apply the simplified consent requirement.

In contrast to Dutch NVs and BVs that are subject to Dutch corporate income tax (CIT), LPs and FGRs may, under certain conditions, be treated as tax transparent. As regards its limited partners, an LP is only treated as transparent from a Dutch CIT and Dutch dividend withholding tax perspective if the admission and replacement of limited partners is subject to the prior approval of all other partners, both general and limited (the consent requirement). An FGR is treated as transparent if (i) the consent requirement is satisfied or (ii) if participations may only be redeemed to and re-issued by the FGR itself (the redemption alternative).

In two previous resolutions, the State Secretary of Finance expressed his views on the application of the consent requirement and the redemption alternative to master-feeder structures. The view of the Dutch State Secretary of Finance under the previous resolutions was that all participants in the master are deemed to be also participants in the feeder, and vice versa. In the diagram below, the participants in entity 2 are deemed to participate in entity 1 as well. Under the previous resolutions, the Dutch State Secretary of Finance took the position that in order to preserve the transparency of both entities, the unanimous consent of all partners in all participating and underlying entities was required in the case of a new limited partner’s admission to one of the participating transparent entities. The diagram below indicates that the admission or replacement of any other partner in LP 2 required, in addition to the consent of all of LP 2 other partners, the consent of each of the limited and general partners of LP 1 for LP 2 to retain its closed character. Besides, the admission and replacement of any partner of LP 1 also required the consent of all limited and general partners of LP 2 for LP 1 to retain its closed character. This clearly indicates the very strict approach of the Dutch tax authorities in determining when a LP is tax transparent. Click here.

With a view towards removing undesired restrictions on the structuring of investments funds in the Netherlands, the new resolutions introduce a simplified consent requirement for master-feeder structures. Admission or replacement of a limited partner in a master or feeder only requires the consent of the general and the limited partners in the relevant master or feeder.

In order to maintain the closed-end status of LP 1 in the diagram, only the consent of the limited and general partners of LP 1 is required if a new partner joins LP 1. The general partner of LP 1 may grant the consent on behalf of LP 2. Furthermore, if a new partner joins LP 2, only the consent of the partners of LP 2 is required.

The new resolutions also explicitly allow a FGR that applies the redemption alternative to participate in a LP or FGR that applies the consent requirement, and, vice versa, such LP or FGR to participate in a FGR that applies the redemption alternative.

Besides the simplification of the consent requirement, the new resolutions provide for leniency for limited partnerships which have – in the view of the Dutch State Secretary of Finance – not duly applied the consent requirement to a transfer of LP and FGR interest by means of a legal merger, demerger, or a transfer by way of a liquidation payment. Leniency is granted under the condition that the prior consent was not withheld deliberately, abusively or repeatedly. Subsequently, the limited partnership should immediately report to the relevant tax inspector and inform the limited partners about the applicability of the requirement to obtain consent. In our view, it is debatable whether the consent requirement applies to a transfer as part of a legal merger, demerger, or a transfer by way of a liquidation payment.

The simplification of the consent requirement applies from 1 January 2016. This simplification is only applicable if the simplified consent requirement is reflected in the fund documentation, or in respect of existing funds, the fund informs the competent tax authorities that it has elected to apply the simplified consent requirement. However, upon the first amendment of the constitutional documents, the provisions regarding the requirement to obtain consent should be amended as well.

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