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Law and Practice

Contributed by Stibbe

Contents

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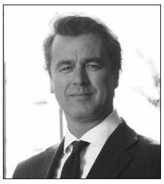
Authors



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1. Types of Business Entities Commonly Used, Their Residence and Their Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

Large businesses in the Netherlands typically carry out their activities via a limited liability company (*besloten vennootschap*, or BV) or – to a lesser extent, typically in the case of a listed company – via a public limited company (*naamloze vennootschap*, or NV) or a no-liability co-operative (*coöperatieve UA*). In practice, a BV is most commonly used. A co-operative is traditionally used in certain industries (eg, the agriculture or financial industry). Each of these legal forms has legal personality so that the entity can own assets in its own name and the shareholders (membership right-holders in the case of a co-operative) as a starting point cannot be held personally liable for corporate obligations.

A BV, NV and co-operative are separate taxpayers for Dutch corporate income tax purposes.

1.2 Transparent Entities

In the Netherlands, tax transparent entities that are typically used are a limited partnership (*commanditaire vennootschap*, or CV), a general partnership (*vennootschap onder firma*, or VOF) and a fund for joint account (*fonds voor gemene rekening*, or FGR). Each of these legal forms lacks legal personality and should be considered as a contractual business arrangement.

As a VOF is tax transparent, it is not a taxpayer for Dutch corporate income tax purposes. Instead, the underlying participants are taxed for their participation in a VOF. Distributions by a VOF are not subject to Dutch dividend withholding tax.

With respect to a CV and an FGR, the Dutch corporate income tax treatment depends on whether it is considered open or closed. An open CV/FGR is subject to Dutch corporate income taxation as such, whereas in the case of a closed CV/FGR, the underlying participants are taxable for the income derived from their interest in the CV/FGR. A CV or FGR is closed if all limited and general/managing partners separately and upfront approve each accession, resignation or replacement of participants. Alternatively, an FGR is also considered closed if participations can exclusively be transferred to the FGR itself.

CVs and VOFs are used in practice to structure joint ventures, alternative investments and/or large projects.

1.3 Determining Residence

For Dutch corporate income tax purposes, a BV, NV or co-operative is deemed to be a corporate income tax resident in the Netherlands (regardless of the place of effective management of the entity) if it is incorporated under the laws of the Netherlands. If a double tax convention is applicable that includes a tie-breaker rule and both treaty contracting states consider a company to be a resident of their state, typically the place of effective management of a company is conclusive, which is the place where the strategic commercial and management decisions take place. Important elements for determining this place are, for example, the residency of board members and the location of board meetings. In several treaties, the number of which is expected to increase due to the effect of the Multilateral Instrument to implement the OECD base erosion and profit shifting project (BEPS), if both treaty contracting states consider a company a resident of their state, the residency is determined on the basis of a mutual agreement between the two states (eg, in the case of the tax treaty with the UK).

1.4 Tax Rates

Corporate income taxpayers are subject to a corporate income tax rate of 25% (2018) with a step-up rate of 20% for the first EUR200,000 of the taxable amount. These corporate income tax rates will be gradually reduced to 20.5% and 15% respectively in 2021. The reduction will take place over a three-year period. For 2019 the rates will be 25% and 19% respectively.

A non-retired individual (the official retirement age in the Netherlands will increase over the coming years to over 67 years) who is a personal income tax resident of the Netherlands is liable for personal income taxation on their taxable income, including business income, at the following progressive rates (rates for 2019):

- 0-20,384 range – 9% tax rate, 27.65% social security rate, 36.65% combined rate;
- 20,385-34,000 range – 10.45% tax rate, 27.65% social security rate, 38.10% combined rate;
- 34,000-68,507 range – 38.10% tax rate, 36.65% combined rate; and
- 68,508 and above range – 51.75% tax rate, 51.75% combined rate.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

The business income of personal income taxpayers and corporate income taxpayers is determined on the basis of two main principles. The first is the at arm's length principle and the second is the sound business principle (*goed koopmansgebruik*), which have been shaped through extensive case law.

It should be noted that the Dutch fiscal concept of business income is, strictly speaking, independent of the statutory accounting rules. In practice, both regimes overlap to a certain extent.

Based on the at arm's length principle, a business income is adjusted as far as it is not in line with it. Thus, both income or expenses can be imputed in a group context for Dutch tax purposes regardless of the statutory or commercial accounting. For corporate income taxpayers this can result in informal capital or hidden dividends. In light of the debate on international tax planning, the Dutch government has announced that it will investigate whether downward adjustments of business income should be abolished.

Based on the sound business principle, a business income is allocated to the appropriate financial years. In this respect the realisation of income and deductibility of expenses is governed by this principle. Profits are taxed on an accruals basis.

Besides these two main principles, numerous specific provisions are included in Dutch tax law that concern, for example, the forming of a tax group (so-called fiscal unity) and the application of the participation exemption (exempting income from qualifying shareholdings).

2.2 Special Incentives for Technology Investments

Two main tax incentives exist. Firstly, the innovation box that, subject to certain requirements, taxes income in relation to qualifying income from intangible assets against an effective tax rate of 7% instead of the statutory rate of 25%. The regime has been amended as of 1 January 2017 amongst others to reflect that only R&D activities that take place in the Netherlands are eligible for the beneficial tax treatment (eg, Nexus Approach). Qualifying intangible assets are R&D activities for which a so-called R&D certificate has been issued or that have been patented (or application to this effect has been filed). Software can also qualify as an intangible asset. Secondly, the wage withholding tax credit, which allows employers to reduce the amount of wage withholding tax that has to be remitted to the tax authorities with 32% up to an amount of wage expenses in relation to R&D activities of EUR350,000 and 14% for the remainder.

2.3 Other Special Incentives

Shipping companies can apply for the so-called tonnage tax regime, whereby essentially the income from shipping activities is determined on the basis of the tonnage of the respective vessel, which should result in a low effective corporate income tax rate. Qualifying income from shipping activities is, for example, income earned with the exploitation of the vessel in relation to the transportation of persons and goods within international traffic, the transportation of persons and goods in relation to natural resources, and pipe and cable laying.

2.4 Basic Rules on Loss Relief

As a starting point, taxable losses can be carried back one year and carried forward nine years. Specific anti-abuse rules have to be observed. So-called holding and financing losses are ring-fenced and can only be offset against holding and financing income; however, a proposal is pending to abolish there rules. Furthermore, anti-abuse rules may apply in some cases by which losses cease to exist in the case of the ultimate ownership of the shares in a company that suffered the tax losses.

As of 2019, the carry forward term has been reduced reduced from nine years to six years. This new rule will first be applied to losses that are incurred in 2019. Losses that are incurred in years before 2019 can still be carried forward for nine years.

2.5 Imposed Limits on Deduction of Interest

As a starting point, interest expenses should be deductible for Dutch corporate income tax purposes. However, a number of interest deduction limitation rules have to be observed to determine if interest expenses are deductible in the case at hand. The most important rules are detailed below.

- As part of the implementation of the EU Anti-Tax Avoidance Directive that was due to enter into effect as of 1 January 2019, the deduction of interest expenses should be limited to 30% of a taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA), the so-called earnings stripping rules. In view of the introduction of the earnings stripping rules, the acquisition debt rules and excessive participation debt rules will be abolished (see further below).
- If a loan agreement economically resembles equity (for example, since the loan is subordinated, the interest accrual is dependent on the profit and the term exceeds 50 years), the loan may be requalified as equity for Dutch corporate income tax purposes, due to which the interest would be requalified into dividend, which is not deductible.
- If the loan agreement is considered a loan agreement for Dutch corporate income tax purposes, to the extent that the interest expenses are not at arm's length, deduction should be denied.
- Interest expenses due on a loan taken on from a group company that is used to fund capital contributions or repayments, dividend distributions or the acquisition of a shareholding should not be deductible. However, the interest may be deductible if it can be demonstrated that (i) both the underlying transaction and the provision of the loan are driven by overriding business reasons or (ii) the interest income received by the creditor is subject to an effective profit tax rate of at least 10% based on Dutch standards. The tax authorities may still deny a deduction if they can demonstrate that even though the income is sufficiently taxed as aforementioned, the transaction is overridingly tax driven. Due to EU case law, a legislative proposal is pending under which it is proposed that this provision should also be applied to companies included in a fiscal unity (ie, a Dutch tax group) as if no fiscal unity has ever existed, with retroactive effect to 1 January 2018.
- Interest expenses due on loans taken on from a group company should not be deductible if the loan has no fixed maturity or a maturity of at least ten years, whilst de jure or de facto no interest remuneration or an interest remuneration that is substantially lower than the at arm's length remuneration has been agreed upon.
- Interest expenses due on a group or third-party loan should not be deductible to the extent that the loan is used (excessively) to fund an investment in a shareholding to which the participation exemption regime applies, unless it can be demonstrated that the investment is used to fund the expansion of operational activities. Due to EU case law, a legislative proposal is pending under which it is proposed that this provision should also be applied to companies included in a fiscal unity (ie, a Dutch tax group) as if no fiscal unity has ever existed, with retroactive effect to 1 January 2018. However, in view of the introduction of the earnings stripping rules as per 2019 (as part of the implementation of the EU Anti-Tax Avoidance Directive), this specific interest limitation rule will be abolished.
- Excessive interest expenses exceeding a EUR1 million threshold, due by a Dutch tax group (a fiscal unity), should not be deductible to the extent that the loan has been used to acquire a subsidiary that has subsequently been included in the fiscal unity. Interest expenses are excessive to the extent that the acquisition debt exceeds an annually decreasing percentage of the acquisition price. The percentage starts at 60 and is reduced annually by five until it reaches a floor of 25. However, in view of the introduction of the earnings stripping rules as per

2019, this specific interest limitation rule will be abolished.

2.6 Basic Rules on Consolidated Tax Grouping

For Dutch corporate income tax purposes, corporate taxpayers that meet certain requirements can form a so-called fiscal unity. The key benefits of forming a fiscal unity are that losses can be settled with positive results within the same year (horizontal loss compensation) and one corporate income tax return should be filed that includes the consolidated tax balance sheet and profit and loss account of the entities consolidated therein. The main requirements for forming a fiscal unity are that a parent company should own 95% of the legal and economic ownership of the shares in a given subsidiary. Furthermore, a subsidiary should have the same financial year as its parent company and should be subject to the same tax regime. Both the parent company and the subsidiary should have a certain legal form (a BV and NV qualify), and both should be resident of the Netherlands under Dutch double tax treaties. A foreign corporate taxpayer's permanent establishment can be included in the fiscal unity as a parent company as well as a subsidiary.

Following case law of the ECJ, the fiscal unity regime has been amended to enable that a fiscal unity can in principle be formed between (i) two or more Dutch companies that are held by a joint parent company that is not a resident of the Netherlands but a resident of another EU or European Economic Area (EEA) member state, or (ii) a Dutch parent company and its indirect subsidiaries that are held via a subsidiary that is not a resident of the Netherlands but a resident of another EU or EEA member state.

Moreover, due to EU case law, an emergency legislative proposal is pending under which it is proposed that several corporate income tax regimes (ie, various interest limitation rules, the participation exemption regime and anti-abuse rules in relation to the transfer of losses) should be applied to companies included in a fiscal unity (ie, a Dutch tax group) as if no fiscal unity has ever existed, with retroactive effect to 1 January 2018. The emergency legislation should be followed up by a new, future-proof, Dutch tax group regime that is expected to replace the current regime in several years.

2.7 Capital Gains Taxation

Capital gains (as well as capital losses) realised on assets of a Dutch corporate income taxpayer are considered taxable income that is taxable at the statutory tax rate, unless it concerns a capital gain on a shareholding that meets all the requirements to apply the participation exemption. Based on the participation exemption, capital gains and dividend income from qualified shareholdings are fully exempt from the Dutch corporate income tax base. Essentially, the participation exemption applies to shareholdings that amount to at least 5% of the nominal paid-up capital of the subsidiary, whose capital is divided into shares whilst these shares are not held for portfolio investment purposes. The latter should generally be the case if a company has substantial operational activities and no group financing or group leasing activities are carried out, or a company is sufficiently taxed with a profit-based tax. The Dutch government is investigating whether the participation exemption regime should be denied in the future to Dutch companies with very limited substance in the Netherlands.

Capital gains realised at the level of a debtor due to the waiver of a debt may be tax-exempt if certain conditions are met pursuant to the debt waiver exemption.

2.8 Other Taxes Payable by an Incorporated Business

Enterprises, be it transparent or opaque, may become subject to value added tax (VAT) when selling services or goods in the Netherlands.

Real estate transfer tax (RETT) at a rate of 6% (except for residential real estate, for which a rate of 2% applies) should, in principle, be due upon the transfer of real estate or shares in real estate companies.

2.9 Incorporated Businesses and Notable Taxes

The transfer of shares in companies that predominantly own real estate may, under certain conditions, become taxable with 6% (except for residential real estate, for which a rate of 2% applies) RETT.

3. Division of Tax Base Between Corporations and Non-corporate Businesses

3.1 Closely Held Local Businesses

Typically, but not always, only small businesses and self-employed entrepreneurs (partially including so-called *zelfstandigen zonder personeel*, or ZZP) operate through non-corporate forms whilst medium and large businesses operate their activities via one or more legal entities (eg, BVs).

According to the Dutch Bureau of Statistics as per Q3 2017, 1.63 million enterprises are recorded, out of which 1.24 million (76%) operate through non-corporate legal forms and the remaining 393,400 operate through legal entities, the large majority (347,900) via a BV.

3.2 Individual Rates and Corporate Rates

There are no particular rules that prevent individual professionals from earning business income at corporate rates. For tax purposes, an individual is free to conduct a business through a legal entity or in person. However, the following should be noted.

Broad Balance Between Taxation of Incorporated and Non-Incorporated Business Income

Until the late 1990s, the same progressive personal income tax rates applied to individuals for earning (non-incorporated) business income and dividend income distributed to substantial shareholders (essentially shareholders holding 33% or more in a company). Thus substantial shareholders experienced economic double taxation on such dividend income because, besides personal income taxation, the income had already been subject to corporate income taxation. To end the abuse this regime provoked, a new regime was introduced that substantially mitigated that double taxation and created a broad balance between the effective rate on dividend income received by substantial shareholders and the tax rate for individuals with (non-incorporated) business income. Since then the policy has been to maintain this broad balance.

Under the current substantial shareholding regime (that roughly applies to individuals holding an interest in a company of at least 5% of the share capital), dividend income (as well as capital gains) is subject to 25% personal income taxation. The corporate income taxation on the underlying profit currently amounts to 20% for the first EUR200,000 and 25% beyond that. This leads to a combined effective tax rate of 40% for the first EUR200,000 and 43.75% beyond that. It has been proposed to increase gradually the personal income tax rate for income in relation to a 'substantial shareholding' to 26.9% in 2021 (in view of the corresponding gradual reduction of the corporate income tax rates to 15% and 20.5% respectively in 2021).

The top personal income tax rate amounted to 51.95% at the time of writing in 2018 and the rate for 2019 is 51.75% (and applying to a taxable income exceeding EUR68,507). Due to the application of several exemptions for individuals earning non-incorporated business income, the effective tax rate is substantially lower.

Broadly speaking, adhering from other factors besides income taxation, with a business income from EUR175,000 it is more attractive to conduct business through a legal entity (usually a BV).

3.3 Accumulating Earnings for Investment Purposes

It is mandatory for substantial shareholders to earn a minimal salary from the BV of which they are a substantial shareholder to avoid all earnings remaining undistributed and due to which the substantial shareholder may unintendedly benefit from social security benefits. In principle, the mandatory minimum salary amounts to the highest of (i) 75% of the salary of the most comparable job, (ii) the highest salary earned by an employee of a company or a related entity, or (iii) EUR45,000. If it can be demonstrated that the highest amount exceeds 75% of the salary of the most comparable job, the minimum salary is set to 75% of the salary of the most comparable job, with a minimum of EUR45,000.

3.4 Sales of Shares by Individuals in Closely Held Corporations

Typically, individuals can conduct business activities in person or as a substantial shareholder of a legal entity (eg, a BV). In the case of business activities that are carried out in person (either alone or as a participant in a tax transparent partnership), the net result of the enterprise is taxed with Dutch personal income taxation at a top rate of 51.95%. The gain upon the transfer of the enterprise (eg, the transfer of the assets, liabilities and goodwill) is also taxable at the top rate of 51.95%.

Where business activities are carried out via a BV, the shares of which are owned by substantial shareholders, the business income is subject to corporate income taxation. To the extent that the profit after tax is distributed to a substantial shareholder in the Netherlands, 25% personal income taxation is due. A capital gain realised by a substantial shareholder is also taxable at the rate of 25%. It has been proposed to increase the 25% rate to 26.9% in 2021.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

Dividend income received by individuals that do not qualify as a substantial shareholder (essentially being a shareholder that holds at least 5% of the shares in a company) is not taxed as such. Rather, the income from portfolio investments (including portfolio dividend) is deemed to be in the range of 2.017% to 5.38% (rates for 2019 range between 1,94% and 5.60%) of the fair market value of the underlying shares (and other investments held by the taxpayer minus debts owed by it). This deemed income is taxable income at a rate of 30% to the extent it exceeds the exempt amount of EUR30,000 (this amount is EUR30,360 for 2019)

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

The Netherlands currently has no withholding tax on interest and royalties. It does have a withholding tax on dividends that, in principle, taxes dividends at a rate of 15%. Based on the EU Parent-Subsidiary Directive, a full exemption should be applicable for shareholders (entities) with a shareholding of at least 5%, subject to certain requirements. If all requirements are met, under Dutch domestic law, a full exemption should also be available if the shareholder is a resident of a state with which the Netherlands has concluded a double tax treaty, even in cases where the double tax treaty would still allow the Netherlands to levy dividend withholding tax. An exemption is only available if the structure or transaction is not abusive and is entered into for valid commercial business reasons.

Furthermore, it has been proposed to introduce a conditional withholding on interest and royalty payments to related entities in low tax jurisdictions and in abusive situations, from 2021 (a legislative proposal in this respect is expected to be submitted in 2019).

4.2 Primary Tax Treaty Countries

The largest foreign investor in the Netherlands is the United States, respectively followed by the United Kingdom, China, Japan and France. The Netherlands has concluded double tax treaties with all these countries.

4.3 Use of Treaty Country Entities by Non-Treaty Country Residents

So far the Dutch tax authorities have not in general challenged the use of treaty country entities by non-treaty country residents. Only in the case, for example, where specific anti-conduit rules are breached will the tax authorities challenge such a structure.

It should be noted, though, that in light of the ongoing international public debate on aggressive international tax planning, the Dutch government aims to discourage the use of so-called letterbox companies (ie, companies with no or very limited activities that add no real value to the real economy). As part of this policy, amongst others, Dutch tax authorities are increasingly more closely monitoring that companies that claim to be a resident of the Netherlands can indeed be considered as such based on their substance. That is to say, that the place of effective management of such companies is indeed located in the Netherlands.

4.4 Transfer Pricing Issues

The Dutch tax authorities strictly apply the at arm's length principle as included in Dutch tax law, in Article 9 of most double tax treaties and elaborated on in the Organisation for Economic Co-operation and Development's Transfer Pricing Guidelines, as amended under BEPS. Therefore, transactions between affiliated companies should be at arm's length, whilst proper documentation should be available to substantiate the at arm's length nature of the transactions. It depends on the type of industry as to which transfer pricing aspects are the biggest issues.

Typically, in an industrial/manufacturing setting, the Dutch tax authorities pay attention to the fact that the remuneration is aligned with the role a manufacturing entity has (eg, a limited risk distributor should run the risks and be remunerated as such). In industries in which IP is important (eg, pharmaceutical industry, fast-moving consumer goods industry), the valuation of IP and the at arm's length character of royalty payments is important. Furthermore, the charging of head office expenses and other intra-group services should be at arm's length.

4.5 Related Party Limited Risks Distribution Arrangements

The Dutch tax authorities scrutinise that, where a remuneration is based on a certain (limited risk) profile (eg, limited risk distributor), the services and risks of that company indeed match the remuneration. For example, if a limited risk distributor has in fact a stock risk, the remuneration should be increased to reflect a remuneration for that risk.

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

The Netherlands generally follows the Organisation for Economic Co-operation and Development's Transfer Pricing Guidelines.

5. Key Features of Taxation of Non-local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims are Settled

Generally speaking, if a transfer pricing claim is settled, the Dutch tax authorities act in accordance with the settlement. Hence, if downward adjustment of the Dutch income has been agreed, it will be allowed.

5.2 Taxing Differences

Local branches (permanent establishments in fiscal terms) are generally taxed on the basis of the same rules and principles as subsidiaries of non-local corporations. However, due to the fundamental difference between a permanent establishment and a legal entity, in practice differences may occur. Due to the nature of a permanent establishment that typically has no legal personality, a functional analysis is required to determine which assets it 'owns' (eg, should be allocated to it). For a subsidiary, of course, it is clear which assets it owns. This difference in practice can lead to other differences. Furthermore, also due to the nature, certain transactions between the head office and its permanent establishment are typically ignored (eg, interest and royalty payments). As a rule, this is still the case, but recently there seems to be a development whereby such 'internal payments' are recognised sooner for tax purposes.

5.3 Capital Gains of Non-Residents

Dutch tax law includes so-called substantial shareholding rules that enable taxation of capital gains on shareholdings realised by non-residents of the Netherlands in the case of abuse. Based on the current domestic tax rules, capital gains are taxable if (i) a shareholder holds an interest of at least 5% of the capital in a Dutch BV with the main purpose, or one of the main purposes, being to avoid personal income taxation and (ii) the structure should be considered artificial, not being created for legitimate business reasons that reflect economic reality.

In the case where the shareholder is a resident in a country with which the Netherlands has concluded a double tax treaty, depending on the content of the specific treaty, the Netherlands may be prohibited from levying capital gains taxation.

5.4 Change of Control Provisions

The change of control due to the disposal of shares by a holding company at a tier higher in the corporate chain (eg, above the Netherlands) as such should not trigger corporate income taxation. However, Dutch tax law includes anti-abuse rules that lead to the cancellation of tax losses in the case of the change of control of certain companies (that broadly speaking have or are going to have limited activities). See also **5.3 Capital Gains of Non-Residents** in relation to capital gains realised on the (indirect) sale of shares in a related Dutch entity.

5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates

The Netherlands typically does not determine the income of (foreign-owned) Dutch taxpayers based on formulary apportionment. Instead, the remuneration of the rendering of services or the sale of goods between related companies is governed by the at arm's length principle.

5.6 Deductions for Payments by Local Affiliates

As to the deduction of cross charges by foreign group companies to the Netherlands, the at arm's length principle is leading. For example, head office charges should be deductible by a Dutch corporate income taxpayer, provided the expenses are at arm's length. It should be noted that in some cases a mark-up is allowed. Cross-charged shareholder costs are not deductible.

5.7 Constraints on Related Party Borrowing

Other than the interest deduction limitations discussed in **2.5 Imposed Limits on Deduction of Interest**, there are no other/specific rules that particularly constrain borrowings of a Dutch subsidiary from a foreign subsidiary as such. However, for example, a deduction of interest expenses due on a loan provided by a group financing company that would be a resident of a tax haven may be denied because the interest income remains untaxed at the level of the creditor.

As discussed in **4.1 Withholding Taxes**, it has been proposed to introduce a conditional withholding on interest payments to related entities in low tax jurisdictions and in abusive situations from 2021 (a legislative proposal in this respect is expected to be submitted in 2019).

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

If a permanent establishment (PE) is recognised to which the assets, risks and functions that generate the foreign income can be allocated, the foreign income should in principle be fully exempt from the Dutch corporate income tax base. It should be noted that currency translation results between the head office and the PE are not exempt.

If certain conditions are met, a loss that a PE on balance has suffered may be deductible, provided (amongst others) that the losses are not utilised in any way in the PE state by the taxpayer (eg, the head office) or a related entity of the taxpayer.

6.2 Non-Deductible Local Expenses

As a starting point, the income that is allocated to a PE is determined based on a functional analysis, taking into account the assets, risks and functions carried out by the PE. On the basis of the outcome of the functional analysis, expenses are allocated to the PE and are as such exempt (eg, non-deductible) from the Dutch corporate income tax base. Furthermore, in some cases expenses charged by the PE to the head office in consideration for services provided to the head office by the PE may be ignored. Other than that, there are no specific rules due to which local expenses are treated as non-deductible.

6.3 Taxation on Dividends from Foreign Subsidiaries

Dividend income distributed to a Dutch company is fully exempt if the participation exemption is applicable. The participation exemption should, broadly speaking, be applicable to shareholdings of 5% of the paid-up capital, divided into shares, that are not held as a portfolio investment company. A shareholding should essentially not be held as a portfolio investment if (i) the company has operational activities and has no substantial group financing or group leasing activities, or (ii) the company is taxed at an effective tax rate of at least 10% based on Dutch standards.

As part of the implementation of the EU Anti-Tax Avoidance Directive, controlled foreign companies (CFC) rules should be introduced in the Netherlands as per 2019 (see also **6.5Taxation of Income of Non-Local Subsidiaries Under CFC-Type Rules**). Under these CFC rules, certain categories of undistributed income of controlled foreign companies should be included in the Dutch corporate income tax base. A controlled foreign company is, in short, a company in which the taxpayer has an interest of more than 50%, provided that the company is a tax resident in a low tax jurisdiction or a state included on the EU list of non-cooperative jurisdictions.

The Dutch government is further investigating whether the participation exemption regime should be denied to Dutch companies with very limited substance in the Netherlands.

6.4 Use of Intangibles

Group transactions in the Netherlands adhere to the at arm's length principle (including the amendments to the transfer pricing guidelines under the BEPS project, such as in relation to hard-to-value intangibles), so the use of locally developed intangibles by non-local subsidiaries should trigger Dutch corporate income taxation. If intangibles are transferred, the capital gain (eg, the fair market value less the fiscal book value) is taxable at the Dutch statutory income tax rate of 25% (20% for the first EUR200,000). Alternatively, if the intangibles would be licensed to non-local subsidiaries, an at arm's length fee should be charged by the Dutch company.

If the intangibles would be developed under the innovation box, the qualifying income (a capital gain or a licence fee) would be taxable against an effective tax rate of 7%.

6.5 Taxation of Income of Non-Local Subsidiaries Under CFC-Type Rules

At the moment the Netherlands, in principle, has no true CFC rules. Local corporations should therefore not be taxed for the income of foreign subsidiaries.

However, in the case of shareholdings of at least 25% in foreign companies (i) that are not taxed reasonably according to Dutch standards and (ii) in which the assets of the company are portfolio investments or assets that are not related to the operational activities of the company, the shareholding should be revalued at fair market value annually. The gain recognised as a result thereof is subject to corporate income tax at the standard rates.

Assuming that passive activities lead to the recognition of a PE, the income that can be allocated to that PE should not be exempt as the object exemption is not applicable to low-taxed passive investments.

A CFC regime should be included in Dutch corporate income taxation following the implementation of the EU Anti-Tax Avoidance Directive that was due to enter into effect from 1 January 2019. Under the adopted CFC rules (the Netherlands has chosen to implement model A on top of the existing tax legislation, which includes the application of the arm's length principle – in fact, model B), certain categories of undistributed income of controlled foreign companies should be included in the Dutch corporate income tax base. A controlled foreign company is, in short, a company in which the taxpayer has an interest of more than 50%, provided that the company is a tax resident in a low tax jurisdiction or a state included on the EU list of non-cooperative jurisdictions. A permanent establishment can also qualify as a controlled foreign corporation.

6.6 Rules Related to the Substance of Non-Local Affiliates

In general, no specific substance requirements apply to non-local affiliates (except for the CFC rules to be implemented). In a broader sense, low substance of non-local affiliates could trigger anti-abuse rules (eg, non-application of the participation exemption due to which inbound dividend income may be taxable, annual mandatory revaluation of low-substance participations against fair market value).

Furthermore, under certain corporate income tax and dividend withholding tax anti-abuse rules, shareholders of Dutch intermediary holding companies, subject to certain requirements, should have so-called relevant substance, including that shareholders must use an office space for at least 24 months that is properly equipped to perform holding activities and wage expenses of at least EUR100,000 should be incurred by the shareholder.

6.7 Taxation on Gain on the Sale of Shares in Non-Local Affiliates

Capital gains derived from the alienation of a qualifying shareholding in a foreign company by a Dutch company are fully exempt from Dutch corporate income tax if the participation exemption is applicable. The participation exemption should, broadly speaking, be applicable to shareholdings of 5% of the paid-up capital, divided into shares, that are not held as a portfolio investment company. A shareholding should essentially not be held as a portfolio investment if (i) the company has operational activities and has no substantial group financing or group leasing activities, or (ii) the company is taxed at an effective tax rate of at least 10% based on Dutch standards.

7. Anti-Avoidance

7.1 Overarching Anti-Avoidance Provisions

Apart from specific anti-abuse rules, the Dutch Supreme Court has developed the doctrine of abuse of law (fraus legis) as a general anti-abuse rule. Under this rule, transactions can be ignored or recharacterised for tax purposes if the transaction is predominantly tax-driven and not driven by commercial considerations whilst the object and purpose of the law are being breached. So far, the Supreme Court has been reluctant to apply the doctrine in cases where a tax treaty is applicable.

As part of the implementation of the EU Anti-Tax Avoidance Directive, the legislator states that the doctrine of abuse of law is very similar to the general anti-abuse rule included in the directive so that effectively no additional provision has to be included in Dutch law in this respect.

The Dutch government has selected most double tax treaties concluded by the Netherlands as covered tax agreements under the Multilateral Instrument for the implementation of BEPS and – as with most other parties to the instrument - it has elected the principal purpose test to be included in Dutch double tax treaties.

8. Other

8.1 Regular Routine Audit Cycle

The Netherlands has no periodic routine audit cycle. Tax audits are typically carried out at the discretion of the tax authorities. Tax audits are extraordinary in the sense that the Dutch tax inspector, upon the filing of the corporate tax return, has the opportunity to scrutinise the filed tax return, raise questions, ask for additional information and, if necessary, make an adjustment upon issuing a final assessment.

9. BEPS

9.1 Recommended Changes

It should be noted that against a background of public disapproval of – alleged – aggressive tax planning by multinational corporations (MNCs) following, for example, Lux Leaks and the Panama Papers, several plans have been introduced that coincide (most obviously the Organisation for Economic Co-operation and Development's BEPS project and the EU anti-tax avoidance package) and have resulted in the Dutch government taking a range of measures that, broadly speaking, relate to BEPS.

In a letter from June 2015, the Dutch government set out its (updated) international tax policy. As a starting point, domestic and cross-border entrepreneurial activities should be treated equally for tax purposes. Thus, foreign-sourced (business) income in principle is exempt from the Dutch tax base, whilst the Netherlands has no source taxation on interest or royalty payments. At the same time, the government is aware of international corporations increasingly eroding domestic tax bases and shifting profits. It is therefore seeking to find a balance between, on one hand, mitigating the risk of abuse by international taxpayers whilst, on the other hand, avoiding unnecessary hindrance of real corporate activities. This has led to the formulation of three central pillars of the Dutch international tax policy:

- promote Dutch cornerstones of international Dutch tax policy, being a large treaty network, advance certainty from Dutch tax authorities, no withholding tax on interest and royalties, participation exemption for income derived from (foreign) subsidiaries and advocation of the use of mutual agreement and arbitrage to end international tax disputes;
- be a front runner and initiate ideas to promote transparency, transfer pricing and stop abuse of tax treaties of developing countries; and
- counter abuse in relation to hybrid mismatches, treaties and preferential tax regimes.

In light of these pillars, currently the following measures have been taken.

- Following the amendment of the EU Parent-Subsidiary Directive to counter abuse, the Dutch participation exemption regime has been amended, due to which, broadly speaking, dividend income is no longer exempt from the Dutch corporate income tax base if the dividend is deductible at the level of the entity distributing the dividend.
- On 12 July 2016 the Anti-Tax Avoidance Directive (ATAD 1 or the 'Directive') was adopted by the European Council, obliging member states to adopt it ultimately by 31 December 2018 (subject to certain exceptions). To adopt ATAD 1 the Netherlands will incorporate (effective as per 1 January 2019) (i) a rule essentially to limit interest expense deductions to 30% of EBITDA (earnings stripping rules) and (ii) a CFC regime, detailed below.
- The earnings stripping rules are summarised as follows.
  - (a) The earnings stripping rules limit the deduction of the balance of interest amounts to the highest of 30% of the adjusted profit (*gecorrigeerde winst*) or EUR1,000,000. The balance of interest amounts is defined as the amount of interest expenses on loans payable reduced by the amount of interest income received on loans receivable, whereby the interest expenses and the interest income should be deductible or taxable respectively absent the earnings stripping rules. The balance cannot be negative and does not include interest amounts that should be allocated to a permanent establishment and are exempt from Dutch corporate income taxation under the object exemption. The adjusted profit is defined as the taxable profit as determined absent the earnings stripping rules, subject to certain adjustments. To the extent that the balance of interest amounts, due to the application of the earnings stripping rules, is not deductible in a given year, it can be carried forward to and deducted in the subsequent years. The balance of interest amounts carried forward is taken into account based on the first in, first out principle. The tax inspector will issue a decree confirming the balance of interest amounts.
  - (b) The Dutch earnings stripping rules are more restrictive than required under the Directive. Thus the Dutch regime (i) will not include a so-called group exemption (that would allow a deduction exceeding 30% of the adjusted taxable profit to the extent that the group's overall debt level exceeds 30%), (ii) includes a EUR1 million threshold as opposed to the EUR3 million threshold included in the Directive and (iii) will also apply in standalone situations (ie, where the taxpayer is not part of a group; this rule

was not included in the coalition agreement).

(c) In view of the introduction of the earnings stripping rules, the following two specific interest limitation rules will be abolished: the acquisition debt rules (Article 15ad Dutch Corporate Income Tax Act 1969, or CITA) and excessive participation debt rules (Article 13l CITA). The acquisition debt rules are aimed at denying the deduction of interest expenses in structures whereby a Dutch resident (ie, typically an acquisition SPV) borrows funds to acquire the shares in a target and subsequently forms a corporate income tax fiscal unity with the target to offset the interest expenses payable in respect of such loan against the taxable profits of the target. The excessive participation debt rules of Article 13L CITA may limit the deductibility of excessive interest expenses on debts if the taxpayer holds shares that qualify for the participation exemption regime (which requires a shareholding of at least 5%).

- The Dutch CFC regime is summarised as follows.
  - (a) The benefits derived from a controlled company are included in the taxable profit of the corporate income taxpayer, taking into account the interest held and the holding period. CFC benefits are defined as (i) interest or other benefits from financial assets; (ii) royalties or other benefits from IP; (iii) dividends and capital gains upon the alienation of shares; (iv) benefits from financial leasing; (v) benefits from insurance, banking and other financial activities; and (vi) benefits from certain, low value-adding, factoring activities ('tainted benefits'); less related expenses.
  - (b) CFC benefits are only taken into account to the extent that the balance of benefits (ie, income less expenses) results in a positive amount and that balance, by the end of the financial year, has not been distributed by the controlled company. Negative CFC benefits can be carried forward six years to offset against future positive CFC benefits.
  - (c) A controlled company is defined as a company in which the taxpayer, whether or not together with related companies or a related person (see below), has an interest of more than 50% (whereby interest is defined in relation to nominal share capital, statutory voting rights and profits of the company), provided that the company is a tax resident in a low tax jurisdiction or a state included on the EU list of non-cooperative jurisdictions (unless the company is taxed as a resident of another state). A jurisdiction is considered low taxed if it does not levy a profit tax or levies a profit tax lower than 9% (the statutory rate should be at least 9%). Prior to each calendar year, an exhaustive list will be published with all designated non-cooperative and low tax jurisdictions for the next taxable period (being the next calendar year). A permanent establishment can also qualify as a CFC.
  - (d) For purposes of the CFC regime, a company or person is related to the taxpayer if (i) the taxpayer has a 25% interest in the company or (ii) the company or that person has a 25% interest in the taxpayer (whereby interest is again defined in relation to nominal share capital, statutory voting rights and profits of the company).
  - (e) A company is not considered a controlled company if (i) at least 70% of the income of the company does not consist of tainted benefits or (ii) the company is a regulated financial company as defined in Article 2(5) of the Directive and at least 70% of the benefits earned by the company are not derived from the taxpayer, a related entity or a related person.
  - (f) The CFC regime does not apply if the controlled company carries out material (*wezenlijk*) economic activities. According to the explanatory memorandum, material economic activities are considered present if the relevant substance requirements that are currently already included in the anti-abuse provisions in the Dutch Dividend Withholding Tax Act 1965 (DWT) are met. Most importantly, the controlled company will need to incur annual wage costs of at least EUR100,000 for employees and the controlled company will need to have its own office space at its disposal in the jurisdiction where it is established during a period of at least 24 months whereby this office space needs to be properly equipped and used. Furthermore, the employees must have the proper qualification and their tasks should not be merely auxiliary.
  - (g) If CFC benefits are included in the taxable income of the corporate income tax payer, foreign profit taxes can be credited against Dutch corporate income tax payable, subject to certain requirements.
  - (h) In the explanatory memorandum, several important clarifications are made. The legislator emphasises that the CFC regime in certain circumstances can lead to double (or more) taxation. However, the legislator considers it appropriate not to mitigate such double taxation as the regime should have a prohibitive effect. From a double tax treaty perspective, the legislator notes that – generally speaking – Dutch double tax treaties concluded before 1996 do not include a so-called switch-over provision (ie, credit method instead of exemption method in the case of passive income). Consequently, under such 'older' double tax treaties, application of the CFC regime to permanent establishments is prohibited by the double tax treaty. Furthermore, the CFC regime in principle does not only apply to companies resident in no/low tax states or in non-cooperative states.
- The Netherlands has signed the Multilateral Instrument that includes the BEPS measures that require amendment of (Dutch) bilateral double tax treaties. The Netherlands has taken the position that all material provisions of the MLI should be included in the Dutch double tax treaties,

except for the so-called savings clause included in Article 11 of the MLI. As such, a general anti-abuse provision (in most cases, the so-called principal purpose test) should likely be included in many Dutch double tax treaties as well as a range of specific anti-abuse rules impacting, for example, the rules for the recognition of a permanent establishment and addressing several types of so-called hybrid mismatches. The legislative process to ratify the MLI is ongoing.
- The Dividend Withholding Tax Act 1965 has been amended whereby co-operatives that are mainly involved in holding and/or financing activities (and that up to now were able to distribute profits without triggering dividend withholding tax unless in cases of abuse) become subject to Dutch dividend withholding tax upon distributing profits. If the recipient of the profit distribution is a tax resident in a country with which the Netherlands has concluded a comprehensive double tax treaty, an exemption from that tax should be available provided that the relevant structure is not abusive. The Corporate Income Tax Law 1969 has also been amended in relation to the above (ie, substantial shareholding rules).
- A law has been enacted to meet the obligations of the Netherlands in respect of country-by-country reporting (BEPS Action 13).
- A law has been enacted to meet the obligations of the Netherlands in respect of the automatic exchange of rulings. Furthermore, the Dutch innovation box regime has been amended to align it with BEPS Action 5 (countering harmful tax practices).
- Further enhancement of the substance requirements for interest and/or royalty conduit companies has been announced, due to which information is automatically exchanged with the respective foreign tax authorities in the case of interest and/or royalty conduit companies not meeting these enhanced substance requirements, including a minimum of EUR100,000 salary expenses and the requirement that for at least 24 months properly equipped office space should be available.
- There has been a proposal to introduce a conditional withholding tax on royalties and interest paid to group companies in low tax jurisdictions or in abusive situations from 1 January 2021.
- Double tax treaties have been and are being renegotiated with 23 developing countries to ensure these tax treaties can no longer be abused, potentially leading to tax budget leakage for the respective developing countries.

Furthermore, the government has announced that it will investigate:

- in 2020, whether the introduction of substance requirements in order to be able to apply the participation exemption is feasible;
- whether the at arm's length principle should be amended whereby imputation of expenses would no longer be possible;
- the amendment of the legal privilege in order to strengthen the position of the tax authorities; and
- the revision of the Dutch ruling practice to discourage tax avoidance.

9.2 Government Attitudes

The central attitude of the Dutch government is to find a balance between, on one hand, ending international aggressive tax planning by promoting transparency and making rules abuse-proof, and, on the other hand, not harming the Dutch economy and thus seeking to take measures on an international level to avoid unilateral measures that would disproportionately harm Dutch corporations and favourable Dutch tax regimes.

9.3 Profile of International Tax

International taxation, especially over the last decade, has gained a high public profile due to extensive coverage of – alleged – aggressive tax planning in leading Dutch newspapers and other media, as well as the exposure generated by NGOs such as Oxfam Novib and Tax Justice. Over the last decade, on a regular basis Members of Parliament have raised their concerns regarding the attitude of MNCs and their supposed unwillingness to contribute their fair share. This attitude may turn out to be especially effective in relation to the ratification of the MLI given that – contrary to typical tax treaty ratifications – the Dutch Parliament is able to change the provisional positions taken by the government when signing the instrument.

9.4 Competitive Tax Policy Objective

The Netherlands has a competitive tax policy, driven by the fact that the Dutch economy relies for a large part on foreign markets, given that the domestic market is relatively small. In a letter from June 2015, the Dutch government sets out its (updated) international tax policy. As a starting point, domestic and cross-border entrepreneurial activities should be treated equally for tax purposes. Thus, foreign-sourced (business) income in principle is exempt from the Dutch tax base, whilst the Netherlands currently has no source taxation on interest or royalty payments. At the same time, the government is aware of international corporations increasingly eroding domestic tax bases and shifting profits. It is therefore seeking to find a balance between mitigating the risk of abuse by international taxpayers whilst avoiding unnecessary hindrance of real corporate activities.

9.5 Features of the Competitive Tax System

As the Dutch government generally takes a balanced approach for each measure, consideration will be given to the pros and cons of existing practices, and the relevance for real business activities, including the accounting and legal services industry. Thus, it is difficult to say which areas are vulnerable to scrutiny, except for structures with low substance and structures that are clearly tax-driven whilst bearing little or no relevance for the real economy.

9.6 Proposals for Dealing with Hybrid Instruments

The proposals addressing hybrid instruments are being approved by the Dutch government and as such will be included in Dutch tax law and/or Dutch double tax treaties. This applies to the measures taken as part of BEPS as well as the extension of the EU Anti-Tax Avoidance Directive.

9.7 Territorial Tax Regime

The Netherlands has no territorial tax regime as it – as a starting point – taxes resident (corporate) taxpayers for their worldwide income, subject to the application of double tax treaties and unilateral rules for the relief for double taxation.

It is difficult to make a general prediction as to the impact of the interest limitation rules for Dutch taxpayers as this is to a large extent fact-driven, whilst (i) the Netherlands already has a range of interest limitation rules and (ii) it is currently proposed to abolish two of the existing interest limitation rules.

9.8 CFC Proposals

A cornerstone of Dutch international policy is to avoid economic double taxation within corporate structures, which is why the Netherlands has exempted dividend income received from foreign group companies for decades (under the so-called participation exemption regime). Furthermore, the Netherlands advocates the principle of so-called capital import neutrality, by which a resident state should exempt foreign-sourced income from its taxation to allow its corporations to make foreign investments on a level playing field (in terms of taxation).

The Netherlands should therefore likely be reluctant to let go of its position to exempt foreign income. As a matter of fact, former proposals to include a so-called switch-over provision (whereby an exemption of taxation is basically replaced by a tax credit for certain types of income) were strongly and successfully opposed by the Dutch government. Still, this international debate has its own dynamics so it is difficult to see if the Dutch government will be able to maintain its position.

Under the Dutch CFC regime, the Netherlands will have a safe harbour rule, as result of which the CFC regime does not apply if the controlled foreign company carries out material economic activities (if the controlled foreign company has sufficient relevant substance).

9.9 Anti-Avoidance Rules

The Netherlands favours a principal purpose test as opposed to a limitation on benefits provision, mainly because the principal purpose test is considered to work out proportionately in most situations. Thus, truly business-driven structures, either inbound or outbound, should not be harmed. Nevertheless, the principal purpose test is principle-driven rather than rule-driven, which makes it less clear which structures will be affected by the principal purpose test. In other words, there may be legal uncertainty, especially in the beginning when there is also little practical experience. Furthermore, some countries might apply the principal purpose test liberally, which might make corporations decide to avoid the Netherlands. However, this remains to be seen, especially as in other countries the same issues should come up.

9.10 Transfer Pricing Changes

Aside from the introduction of country-by-country reporting and to a lesser extent the documentation requirements (eg, master file and local file), the Netherlands has already applied the at arm's length principle as a cornerstone of its transfer pricing regime. Therefore these changes should not lead to a radical change, which should also apply to intangibles.

9.11 Transparency and Country-by-Country Reporting

The Netherlands is in favour of increasing transparency in international tax matters, provided an agreement can be reached on an international level as broad as possible to avoid national economies being harmed by MNCs' decisions to avoid jurisdictions that have transparency requirements.

9.12 Taxation of Digital Economy Businesses

No legislative proposals have been published in this area yet.

9.13 Other General Comments

It is a positive development that aggressive tax planning by MNCs is countered by introducing anti-abuse rules and increasing transparency. It is important, however, that measures are introduced multilaterally to avoid real economies of ambitious states being harmed whilst less ambitious ones benefit from it. In the end, BEPS can only be reduced by measures that are broadly implemented and whereby a fair balance is struck between sparing real economic activity and reducing tax-driven structures.

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