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8th Annual

International Tax Developments Seminar

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During the 8th Annual International Tax Developments Seminar, several Loyens & Loeff tax experts as well as officials from the Dutch Tax Authorities updated the participants on the latest international tax developments. Predictability and control of their tax position, staying up-to-date and decision-taking based on limited guidance are amongst multinational enterprises' challenges today.

Update on the revised Dutch ruling practice

Judith Jansen and Norbert Vis – Dutch Tax Authorities (College Internationale Fiscale Zaken/ Behandelteam Internationale Fiscale Zekerheid)

Certainty in advance is one of the valuable assets of the Dutch investment climate, both for the taxpayer and the tax authorities.

Certainty in advance

In an early stage, the Dutch Tax Authorities and the taxpayer can discuss certain performed or intended (legal) transactions in advance. As a result, it can be determined how the tax laws should be applied in the specific case. In general, each position statement (oral or in writing) by the Dutch Tax Authorities related to tax matters in advance to the levy of taxation or performance of other tasks assigned to the tax inspector should be considered certainty in advance. This means that the term 'certainty in advance' is used until the – first – Dutch corporate income tax return is filed in which the transaction – for which certainty in advance is requested – is included.

Ruling process

The ruling process for cross-border transactions (and related to specified topics of Dutch corporate income tax and dividend withholding tax) includes the following steps:

1. pre-filing meeting (optional)
2. ruling request of taxpayer
3. handling request by the Dutch tax authorities
4. decision making
5. signing of the agreement
6. publication and exchange

Before filing the ruling request for a cross-border transaction with the tax authorities, a meeting can be held in which questions can be raised and attention points for the ruling request can be addressed. Such pre-filing meeting is optional, but appreciated by the Dutch Tax Authorities; in particular, if a taxpayer (i) would like to learn up-front if a topic is eligible for obtaining a tax ruling, or (ii) has questions about the requirements for the ruling process. This way, the process can run more smoothly.

A summary of every ruling request filed in which the Dutch tax consequences of a cross-border transaction are covered, and the outcome thereof, will be anonymously published on a high-level basis on the website of the Dutch tax authorities. This to provide insight to the public about what kind of agreements are concluded between taxpayers and the tax authorities. Transactions between Dutch companies do not fall under these transparency rules.

Topics for tax ruling

Topics of Dutch corporate income tax and dividend withholding tax for which certainty in advance can be obtained include the participation exemption, CFC legislation & hybrids, non-resident taxation, permanent establishments, dividend withholding tax (exemption), holding cooperatives and transfer pricing (Advanced Pricing Agreement (APA)).

Changes

As per July 2019, the ruling policy has changed. With the changing international tax environment as a background, it can be said that the ruling policy changed in terms of transparency and coordination of the process regarding tax rulings in which the Dutch tax consequences of a cross-border transaction are covered. Furthermore, with

the new rules the Dutch Government would like to prevent that companies without real economic presence in the Netherlands and that solely use the Netherlands for tax reasons, can conclude a tax ruling.

Certainty in advance can only be granted in case the following three requirements are cumulatively met:

- There should be sufficient economic nexus in the Netherlands. In this regard, it is important that the company concerned has relevant substance for its activities in the Netherlands for which certainty in advance is requested. The substance required depends on the size and the type of activities carried out.
- The main reason for the transaction cannot be tax saving or tax avoidance. This should not only be regarded from a Dutch perspective, but also from a worldwide perspective.
- There may be no direct relation or transaction with a so-called low-taxed jurisdiction (countries that have a nominal tax rate of 9% or less and countries on the EU-Blacklist).

The tax authorities discussed these requirements on the basis of various examples which show that the requirements are to be assessed on a case-by-case basis.

What does Pillar 2 mean for you?

Charlotte Kiès and Nicolas Lippens

Given the complex nature of the Pillar 2 rules and the counterintuitive consequences that may arise, it is high time for MNEs to prepare for and to model the Pillar 2 impact.

Pillar 2 preparations

Pillar 2 represents nothing less than a revolution in the international tax environment. The purpose is to achieve global minimum taxation and to incentivise jurisdictions to increase their minimum tax rates to the Global Anti-Base Erosion ('GloBE') minimum rate of 15%.

In scope multinational enterprises ('MNEs') should prepare for:

- Pillar 2 top-up tax coming into play;
- Pillar 2 compliance obligations;
- Reorganisations to optimise their Pillar 2 treatment;
- Potential double taxation and litigation issues.

Different stakeholders react differently. Some jurisdictions think of increasing their tax rates to prevent other jurisdictions from levying top-up tax from taxpayers in their jurisdiction. Others are considering how to reshape tax incentives going forward. At the same time, MNEs are reviewing their structures and effective tax rates ('ETRs') and are also preparing their IT systems to be ready for Pillar 2.

Work in progress

Even though extensive rules and commentary thereto have been published by the OECD and EU, further guidance is still expected. For instance, in relation to the safe harbour simplification measures. At the same time, open items remain in the political landscape: on 5 April 2022, Poland was the only EU Member State which opposed the implementation of the Pillar 2 Directive in the EU, because it wants to have a binding link between Pillar 1 and Pillar 2.

Within the EU, if the EU directive for the Pillar 2 implementation is adopted in its current form, the Income Inclusion Rule ('IIR') should apply per 31 December 2023 and the Undertaxed Profits Rule ('UTPR') per 31 December 2024. The recent position of Poland may add some uncertainty to the timing. The Switch-over rule and the Subject To Tax Rule ('STTR') are still under development.

Counterintuitive consequences

The Pillar 2 rules can in many instances lead to counterintuitive consequences. Some examples:

- An MNE group with a global ETR of over 15% may still be affected by the Pillar 2 rules if:
  - The ETR is below 15% in a jurisdiction (whether or not due to the jurisdictional blending);
  - Certain mobile payments are not subject to at least a 9% adjusted nominal rate.

- An MNE group with a jurisdictional nominal rate and domestic ETR of at least 15% may still be affected by the Pillar 2 rules if the GloBE ETR is below 15%. For example, in case of:
  - GloBE income which is not part of the local tax base;
  - A tax deduction which is excluded under the GloBE rules;
  - A local incentive regime;
  - Taxes not qualifying as Pillar 2 covered taxes;
  - Temporary differences which are not covered in the deferred tax accounting for Pillar 2.

- The application of the Partially-Owned Parent Entity rules, which is intended to give priority top-up taxing rights at subholding level. Due to the interplay with jurisdictional blending, it is possible that an entity which has no direct or indirect investment in a low-taxed constituent entity, will bear Pillar 2 top-up tax relating to income realised by high-taxed entities it holds in such same jurisdiction.

Impact assessment

There are many pitfalls when it comes to Pillar 2. It is therefore invaluable for MNEs to start assessing the impact on their structure. An efficient and easy way to start is from the Country-by-Country reporting data. Then the substance-based carve-outs can be taken into consideration, as well as a number of GloBE corrections. Based on this, it would be possible to model and predict the Pillar 2 impact on their structure.

In order to prepare, we recommend MNEs to monitor:

- Further developments, such as safe-habour rules;
- Whether the US GILTI will be Pillar 2 compliant;
- Domestic implementation.

In addition, we recommend MNEs to:

- Assess how to mitigate top-up taxation;
- Make sure that tax attributes, such as loss carry forward, do not ‘get lost’;
- Be consistent with other tax disclosures.

ATAD 3; shell entities and substance – what MNEs should be aware of

Margriet Lukkien and Aline Nunes

The EC is making a big push with its unshell rules. Now is the time for MNEs to map their risks and to assess whether steps need to be taken within their organisation.

Unshell: the background

The European Commission (‘EC’) has rebranded letterbox companies to shell entities with their proposal for a directive to prevent the misuse of shell entities as published in December 2021. In other words, the EC wants to ‘unshell’ these entities. The EC estimates that over EUR 20 billion of tax revenue is lost due to shell entities, and it wants to limit this with rigorous rules that should apply as of 2024.

The approach here is twofold: the unshell rules would effectively eliminate the tax benefits derived from having such shell entity in a structure (most notably pursuant to tax treaties and EU tax directives), leading to an increased tax burden. In addition, through extra reporting obligations and information exchange, the tax authorities of the EU Member States would be able to collect relevant information as a starting point for increased scrutiny and tax audits.

Unshell: a hot topic

The unshell rules are a hot topic for MNEs operating within the EU. With the unshell rules appearing to apply on a per-entity basis, it is also relevant for MNEs with substantial operations and entities with limited substance in the same EU-country.

In addition, the scope of the unshell rules is likely to expand. It has been announced that the EC is working on a separate proposal for non-EU shell entities which is expected later this year. It would not be unexpected if the OECD also gets involved at some point.

Unshell: steps in the rules

A series of steps is proposed to identify whether an entity is at risk of being a shell entity and, ultimately, whether an entity is presumed to be a shell entity or not. It is key to timely assess under what step the entity falls.

Depending on which step is reached in the unshell rules, different consequences may come into play: a reporting obligation, exchange of information or direct tax consequences. The steps include:

- The carve-out step: a carve-out would entirely prevent an entity from any consequences under the unshell rules.

- The 'gateways' step. If an entity meets the following gateways cumulatively, it crosses all the gateways and will in any case face exchange of information:
  - More than 75% of its income over the two preceding years constitutes passive income,
  - Engages mainly in cross-border activities;
  - Outsources its day-to-day administration and decision-making relating to significant functions in the two preceding years.

  One of the most debated aspects of the proposal is the outsourcing gateway in case of intra-group services. It is clear that this gateway covers third party outsourcing of these activities. However, this is not clear for intra-group services. Given the nature and background of the proposed rules it would make most sense that intra-group services are not considered outsourcing. The proposal is however ambiguous on this point. It is in any case recommendable to formalise the intra-group services in proper agreements, so that it is clear what group entities are performing what activities and to map out to what extent third party service providers would (need to) be involved.

  If the directive is implemented as currently proposed, the two-year reference period for assessing the gateways would already have started on 1 January 2022.

- The exemption step: an exemption can be granted by the authorities upon request of the entity at stake if the interposition of the entity does not lead to a tax benefit to the group as a whole.

- The 'substance indicators' step: if the substance indicators are not met, the entity would be presumed to be a shell entity and subject to the direct tax consequences as prescribed in the proposed directive, unless the entity can rely on the rebuttal rules upon request. The substance indicators entail that adverse direct tax consequences can be prevented if the entity, in addition to an active EU bank account, has premises in its EU-country of residence and a qualifying resident director or the majority of the relevant full-time equivalent qualified employees are tax resident in such EU-country.

Time is ticking

We recommend MNEs to investigate timely the impact of the proposed directive. As the implementation is proposed to be effective as of 1 January 2024 and the two-year reference period already begun as of 2022 (before the actual implementation), it is important for MNEs:
- To map their risk areas; which steps do they meet and what would be the impact if they do not take action? The step an MNE falls in can make a big difference for whether there is an additional tax burden and/or information exchange.
- To define the possible actions to take to mitigate the risks under the proposed directive;
- To engage their internal stakeholders (such as their legal and finance teams) for their involvement and support.

Is the EU Global Tax (Pillar 2) in line with the EU Treaty freedoms?

Dennis Weber

As Pillar 2 will be a multilateral measure, it is expected that the European Court of Justice will rule that it is in line with the EU Treaty Freedoms.

In literature, the question is raised whether the proposed EU directive on Pillar 2 and the subsequent implementation ('EU Pillar 2 Rules') - in particular, the Income Inclusion Rule - are in line with the EU Treaty freedoms: is an EU Member State allowed to tax away the tax advantages granted by another Member State?

When looking at EU case law in this regard, *Cadbury Schweppes, case C-196/04* seems most important. In this case, the UK applies CFC rules in cross-border situations which tax away the tax benefits granted by Ireland.
In a completely domestic situation, CFC-rules were not applicable. It follows from *Cadbury Schweppes* that tax benefits can only be taken away from another Member State in the case of a wholly artificial arrangement.

The aim of Pillar 2 is 'to put a floor on tax competition'. The Pillar 2 rules tax away the tax benefit of another Member State. At first glance, it may seem that this is not allowed under EU case law. However, it should be considered that *Cadbury Schweppes* regarded a unilateral measure. When the EU directive with respect to the Pillar 2 rules will be signed, this will be a multilateral measure. By signing, all Member States say yes to the measure. In case of multilateral measures no protection of the sovereignty of Member States by the European Court of Justice is needed. Therefore, current case law relating to unilateral measures may not be relevant with respect to this multilateral EU measure. So, it is expected that the European Court of Justice will rule differently in case of a multilateral measure.

It follows from VAT case law of the European Court, *RPO case C-390/15*, that the review of a tax measure adopted by the EU legislature is limited to whether there is a 'manifest error'. It is expected that the Income Inclusion Rule in cross-border situations is not a manifest error. So, the EU Pillar 2 Rules should be safe. To avoid that the Income Inclusion Rule would be in line with the EU Treaty freedoms, the EC extended the Income Inclusion Rule to pure domestic situations. However, this may be a manifest error in light of the aim of Pillar 2: to end tax competition between Member States.

Transfer pricing – what's going on

Natalie Reypens and Jan-Willem Kunen

People functions is a cornerstone but it should be applied with proper care. The OECD-guidance and business reality is much more nuanced than this.

The people approach of a TP analysis

Value of people

Currently, one of the biggest challenges in transfer pricing ('TP') relates to the value of people: how important are decision-making functions of individuals in a value chain and a TP analysis?

An obvious shift is ongoing in the OECD-guidance for TP analyses towards the allocation of profits to the jurisdiction where the relevant decision-making of senior people within the MNE is located. This has been a response to tackle the concern of tax-driven contractual allocations or the mere storage of assets.

For the allocation of profits, the starting points in a TP analysis are:

- The contractual arrangement;
- The allocation of risk and returns;
- The location of the legal ownership of assets.

Next step is whether the parties actually behave in line with the contractual arrangement. Only if there is a material difference between the actual conduct and the contractual arrangement, the actual behavior will be leading.

Cornerstone of the functional analysis

The actual behavior is determined by the functional analysis. The cornerstone of this functional analysis is the people and the people functions and, in particular, the decision-making people functions.

The question is whether only looking at the people functions is not too short-sighted. In practice, there are many discussions with tax authorities and the interpretation of tax authorities around the globe differ on what decision-making is. Further, it is wrong to say that only decision-making drives profits. For instance, if an important historical investment is made in an asset, the investment should also be valued.

Reality of business

The contractual arrangement remains leading except if actual conduct differs materially. Practice shows that this is sometimes very difficult to apply to the reality of business.

The approach of separate legal entities applies in TP. However, in reality, businesses are often multilayered matrix organisations structured across many legal entities. For instance, with committees that consist of people employed by many different legal entities in multiple jurisdictions. The question is whether the matrix organisation needs to be broken up artificially to do the functional analysis for TP purposes. If so, this is not easy. Another issue is whether decision-making should be considered at operational or at top management level. Furthermore, does decision-making entail only an event that occurs here and now, for example, during a meeting of the board of directors. Or is it rather a longer-term process that leads to a decision finally being made?

Transfer Pricing Mismatches

Pitfalls of new Dutch legislations as of January 2022

As of 2022, new Dutch legislation has been introduced to eliminate double non-taxation through TP mismatches. This legislation has some surprising outcomes and pitfalls for taxpayers, if not reviewed carefully.

Tax profit & loss account

Until 2022, it was possible to make both upward and downward TP adjustments irrespective of whether there was a corresponding adjustment. As from 2022, in case of a downward adjustment, the counterparty to the transaction must take a corresponding upward adjustment into account in its tax base. If there is no such corresponding adjustment, no downward adjustment can be taken into account for Dutch corporate income tax purposes and the agreed or imposed price would then be used for such transaction (a sort of contractual fallback).

Important is that due to this new legislation not only on an aggregated basis the remuneration for a Dutch taxpayer needs to be at arm's length, but that each transaction on its own needs to be priced correctly to avoid potential application of this new legislation. This should also be documented correctly, as this provides the taxpayer's contractual fallback. If possible, it is recommended to include in the documentation mechanisms that can adjust the price, if necessary, to allow for downward adjustments based on the contractual fallback in this provision in case a corresponding adjustment would otherwise be difficult.

Tax balance sheet

TP mismatches in respect of the tax balance sheet may arise if a foreign group company transfers an asset (or liability) to an acquiring Dutch company for a lower (or higher) value than the at arm's length value. Until 2022, the Dutch company could include the asset on its tax balance sheet at the higher arm's length value and use such value as its tax base for depreciation or amortisation for Dutch corporate income tax purposes. In addition, this higher at arm's length value was also the starting tax base for the calculation of any gain to be realised upon a subsequent transfer of the asset by the Dutch company in the future.

Under the new legislation, in case of a transfer, it will only be allowed to include such higher at arm's length value in the tax balance sheet if the transferring company takes the corresponding value also into account for tax purposes. If no such corresponding value is taken into account for tax purposes by the transferor, then the agreed or imposed price would be used as value for Dutch corporate income tax purposes.

For assets that were transferred below their arm's length value in financial years starting as of 1 July 2019 but before 1 January 2022 without a corresponding value taken into account for tax purposes at the level of the transferor, this measure has retroactive effect that limits the amortisation and depreciation as of 1 January 2022. This results in a lower depreciation or amortisation on these assets as of 2022 as if they had been subject to this new legislation. However, this retroactive effect only applies to the amortisation or depreciation but not to the opening tax base of these assets, so there would be no impact on any subsequent transfers.

The at arm's length price should be applied at the time of the transaction to ensure that such asset or liability is included for the correct price in the tax balance sheet of the Dutch taxpayer, where again correct documentation to be able to fall under the contractual fallback would be recommended.

Contributions, distributions, mergers and demergers

Only if a certain value has been taken into account in the transferor's tax base, such value can be used as tax base by the Dutch recipient. This provision for contributions, distributions, mergers and demergers does not include a contractual fallback such as the two previously described TP mismatch provisions. This measure focuses on the value taken into account in the transferor's tax base, which may result in certain transactions that would not concern TP mismatches to be impacted for Dutch corporate income tax purposes in case the transferor does not have a tax base or if the transfer would not be recognised in the jurisdiction of the transferor. We hope that the Dutch Ministry of Finance will further clarify that this provision should only apply to TP mismatches. The aforementioned retroactive effect applies here as well, whereas there is also for the retroactive effect no fallback to the agreed or imposed price. MNEs are recommended to review all contributions, distributions, mergers and demergers as from 1 July 2019 for potential impact on the amortisation and depreciation and as from 1 January 2022 for potential impact on their tax base.

Expected Pillar 2 and other impact in the future
It is expected that this new legislation will have consequences for the outcome of the various calculations to be made under Pillar 2 due to potential deviations between the tax and commercial accounts. In addition, it is expected that this new legislation will result in more discussions with the tax authorities and, thus, in more bilateral / multilateral Advanced Pricing Agreements to mitigate such discussions upfront and Mutual Agreement Procedures to resolve any resulting double taxation after the fact.

In control of tax as of 2022

Joost van Helvoirt and Gino Sparidis

MNEs should think of how they control their risks and what they can do to monitor this.

More, more and more
Tax priorities are determined by the tax landscape in which new business models and technology arise (i.e. platforms, e-commerce and digital solutions). These result in taxation issues with new tax policies to ensure desired taxation. In turn, this means that the tax authorities have to cope with more data, more processes and are pushed to become more digital.

Many of the topics discussed during this seminar show these trends as well. For example, Pillar 2 and ATAD 3, and also DAC 7 and 8 which impose transparency on platforms and cryptocurrency in order to ensure compliance, are basically these types of measures.

These trends result in more rules, more compliance and more transparency.

Cooperative compliance
The tax authorities responded to these trends with cooperative compliance programmes. In 2013, the OECD published a report wherein they rebranded horizontal monitoring into cooperative compliance. In 2016, the OECD gave guidance on what a Tax Control Framework ('TCF') should look like. A TCF is a basic building block for cooperative compliance. If an MNE has a good working TCF, tax authorities are able to monitor such MNE easily and have comfort to reduce their audit capacity. Cooperative compliance programmes are more and more implemented in European countries.

The question is whether horizontal monitoring will be a success. An MNE has to show its TCF to the tax authorities and explain a lot of things. In return, an MNE gets assurance from tax authorities, but not full assurance as an audit is still possible. However, this does not take away the fact that a TCF is a very important tool for MNEs to be in control of their tax position.

Form free TCF
TCFs are form free. The OECD provided guidance on what a TCF should look like. In short, a TCF should include:
- The MNE's tax strategy – strategy may include, for example, the ETR policy and who gets a bonus in which situation;
- An explanation of the tax organisation – including who is responsible for tax, who is accountable for tax, who has been consulted in the process and who has been informed;
- A tax risk analysis – including identification, quantification and prioritisation of tax risks and indication of what action is needed;
- Controls to avoid risks materialising – including expansion of business control framework and IT control framework, use of accounting and internal control systems, tax compliance processes, tax flow charts and manuals;
- Monitoring – including use of quick scan, mini-DD, standard checklist or the sampling method. Under the sampling method, all the bank entries of an MNE are collected; subsequently, based on the turnover, intervals in Euros of those bank entries are determined; finally, based on the intervals in Euros, the bank entries are selected randomly to assess whether the transactions representing the bank entries are treated correctly from a tax perspective;
- Reporting – it is unclear what the tax authorities mean. Tax authorities aim to use internal and/or external audits to improve TCFs. Alternatively, MNEs may proactively report their tax positions publicly. For instance, Global Reporting Initiative GRI 207, a tax reporting initiative, could be a guidance on what to disclose.

What to do with TCF as from 2022

A TCF could be a very important tool for taxpayers. MNEs should only consider whether investments in their TCF brings value for money. They could build on what they already have and start monitoring as it brings value which may be used towards tax authorities.

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