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Transfer Pricing 2023

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Netherlands: Trends and Developments

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Trends and Developments

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Introduction

In 2022, various developments impacted the Dutch transfer pricing landscape. The main developments were the new transfer pricing mismatch legislation, the new transfer pricing decree and the new permanent establishment decree. Besides these main developments, this article will also address the trends and developments in respect of dispute resolution and prevention and the impact of Pillar Two on transfer pricing.

New Transfer Pricing Mismatch Legislation

On 1 January 2022, new legislation was introduced in the Dutch corporate income tax act (CITA) with the aim of eliminating double non-taxation through transfer pricing mismatches. This legislation requires Dutch taxpayers to ensure that transactions are priced at arm's length and correctly documented. Otherwise, this legislation could potentially result in adverse Dutch corporate income tax (CIT) consequences.

The legislation includes three main elements that may affect both existing and new cross-border situations involving the Netherlands.

Article 8bb CITA – no downward adjustment without corresponding adjustment

Article 8bb CITA affects the tax profit and loss account. The arm's length principle is not applied if this leads to a reduction of the Dutch taxable profit (eg, through an "informal capital contribution" or a "deemed dividend") to the extent that the related party to the transaction does not include a corresponding upward adjustment in its profit tax base. If there is no such corresponding adjustment, the agreed or imposed price (even if not at arm's length) would be used for Dutch CIT purposes. This provision must be assessed on a transactional basis and in principle no aggregation of transactions can take place. This assessment on a transactional basis without aggregation will need to be carefully observed, as historically, Dutch taxpayers have often only assessed whether their aggregated result should be considered at arm's length. This is, for instance, typically the case for financing companies where it was sufficient that the aggregated spread earned by the Dutch financing company was at arm's length, instead of documenting the arm's length character of the individual loans as such.

Article 8bc CITA – no (adjustment to) fair market value without corresponding inclusion in tax base

Article 8bc CITA affects the tax balance sheet. No adjustment in the tax basis can be made to the arm's length value for assets and liabilities that are transferred by a related party to a Dutch taxpayer for which the agreed or imposed price is at a value below (for assets) or above (for liabilities) the arm's length value, to the extent that no corresponding adjustment for the arm's length value is taken into account in the transferor's profit tax base. Again, the agreed or imposed price would be used for Dutch CIT purposes if there is no such corresponding adjustment. Taxpayers should ensure that they carefully document their transactions and applied prices, where including the fair market value would be preferred for this provision over the often-used book value in transaction documentation.

Article 8bd CITA–contributions, distributions, mergers and demergers

To complement Article 8bc CITA, a specific provision was included for contributions, distributions, mergers and demergers in Article 8bd CITA. With respect to such transfers of assets and liabilities, the tax base for CIT purposes is at maximum (for assets) or at minimum (for liabilities) the value included in the transferor's tax base. This does not include a provision to fall back on the contractually agreed or imposed price. Furthermore, on 24 January 2023 the Dutch State Secretary of Finance ("State Secretary") issued a decree clarifying that capital contributions and distributions to a Dutch entity by an entity that is not subject to a profit tax are not affected by this provision provided that the fair market value is included in the related civil law documentation and annual accounts. For certain situations and entities this provides a sort of comparable fall-back as for the previous two provisions.

Article 8bd CITA has led to uncertainty, especially in respect of contributions and distributions involving entities that are disregarded for US tax purposes, pension funds and other exempt entities. The recent clarification by the State Secretary addressed many of these uncertainties, especially regarding pension funds and other exempt entities. However, the application of this provision to entities that are subject to a foreign non-recognition or non-realisation regime is not explicitly clarified. This, for example, applies to a share premium contribution by a US corporation into a Dutch company, which is disregarded for US tax purposes. For US tax purposes, this contribution would not be recognised at the level of the US corporation, which then potentially results in no value being attributed to this contribution in the Dutch tax base. For these situations, it is helpful that the purpose and intent of Article 8bd CITA has been (further) clarified. Taxpayers could consider filing a ruling request with the Dutch tax authorities (DTA) to obtain certainty on the application of Article 8bd CITA in situations that were not clarified by the recent decree of the State Secretary. However, without further clarification from the State Secretary or a ruling from the DTA, various situations in which Article 8bd CITA may be applicable will unfortunately remain uncertain.

Depreciation limitation for tax book years on or after 1 July 2019

Besides the provisions mentioned above that apply to transactions as of 1 January 2022, the amount of depreciation to be accounted by a Dutch taxpayer on assets acquired from a related party before 1 January 2022 may be limited going forward due to a specific provision. This restriction applies where the transfer of the

assets to the Dutch taxpayer occurred in tax book years starting on or after 1 July 2019 and which would, at the time of transfer, have been impacted by the new legislation, had the legislation been in force at the time. This depreciation limitation applies both to transactions that would now be covered by Article 8bc or Article 8bd CITA. In practice, the impact of this depreciation restriction seems limited, as for taxpayers with a financial year equal to the calendar year, only the years 2020 and 2021 would be impacted.

More controversy expected

The new legislation puts more emphasis on corresponding pricing on both sides of the transaction to avoid adverse Dutch tax consequences. Taxpayers should ensure that they have consistent pricing and documentation in place across the group. Where there are differences in pricing, more mutual agreement procedures (MAPs) are expected for taxpayers to limit the impact of this new legislation. Following a MAP, assuming a resolution is reached, there would be corresponding pricing on both sides of the transaction. In addition, the impact of this new legislation under the Pillar Two rules should be assessed going forward. Situations affected by this legislation would generally result in differences with the consolidated financial statements used for Pillar Two.

New Transfer Pricing Decree

On 1 July 2022, the State Secretary published a new Transfer Pricing Decree (the "TP Decree") that took effect as of 2 July 2022. This decree represents the views of the State Secretary (and, by extension, of the Dutch Ministry of Finance and DTA) on the interpretation of transfer pricing provisions, where taxpayers can still take deviating positions within the confines of Dutch legislation and case law. Taxpayers should carefully assess the impact of the new TP Decree on a case-by-case basis.

The TP Decree replaces the previous TP Decree from 2018 and is more aligned with the terminology of the 2022 OECD Transfer Pricing Guidelines (TPG). The main changes concern guidance on:

- financial transactions (ie, loans and guarantees);
- the treatment of financial service companies (SCs);
- more wording in relation to avoiding "tax abusive situations" (ie, avoiding (other) mismatches that are not covered by the transfer pricing mismatch legislation); and
- new guidance on COVID-19 related topics.

Financial transactions

The updated section on financial transactions in the TP Decree has been aligned with the content of chapter X of the TPG on financial transactions. This section emphasises, among other things, that it should first be determined whether a prima facie loan should be considered a loan for transfer pricing purposes. If adjusting the interest rate and/or other conditions of the loan transaction is not sufficient to make the transaction at arm's length, part of the loan may be reclassified to equity for transfer pricing purposes. The State Secretary believes that an arm's length interest charge should then be determined only for the remainder of the loan.

Based on existing case law of the Dutch Supreme Court, a loan should be considered (quasi-) equity if it is considered either:

- a "bottomless pit loan" ("*bodemloze put lening*");
- a "sham loan" ("*schijn en wezen*"); or

- a "profit-participating loan" ("*deelnemersschapslening"*).

If a loan does not qualify under the three (quasi-) equity situations, the loan could qualify as a "non-businesslike loan" (" *onzakelijke lening"*). A non-businesslike loan is a loan whereby a lender takes up a debtor's risk that no third party would be willing to take on without sharing in the profits. Both the (quasi-) equity situations and the non-businesslike loan concern an all-or-nothing approach. A partial reclassification of a loan into equity as now included in the TP Decree contradicts existing case law of the Dutch Supreme Court, where it remains to be seen whether the view of the State Secretary will hold before the court.

Furthermore, the TP Decree contains guidance on the treatment of intercompany guarantees. If the provision of such a guarantee enables the borrower to attract a higher amount of debt than it could in the absence of the guarantee, the State Secretary states that the additional amount of the loan must be treated as a loan to the guarantor followed by a capital contribution to the borrower. Again, with this statement the State Secretary deviates from the Supreme Court's case law, according to which, the civil law form of a provision of monetary funds is decisive for the classification for tax purposes (unless it is deemed to be a (quasi-) equity loan with reference to the above).

Financial service companies

The TP Decree further addresses the treatment of SCs. An SC is a company that predominantly (more than 70%) receives and pays on royalties, interest and lease payments within the group. The financial intermediary has limited risk either through the loan agreement or through a guarantee from the parent company.

The purpose of this new guidance is threefold:

- to limit the possibility of "artificial" treaty shopping;
- to challenge the limited remuneration for financial intermediaries based on "artificial" provisions on limited recourse; and
- to emphasise the preference for "full-fledged banks".

The State Secretary states that debt that can solely be attracted by means of a guarantee from a related entity should be considered as a capital contribution into the SC, in line with the guidance on the treatment of intercompany guarantees. In addition, the State Secretary stresses that the remuneration of SCs must be aligned with control over the credit risks and financial capacity to bear the potential negative consequences when such risks materialise.

The State Secretary distinguishes three situations in determining the remuneration of SCs in this respect:

- The SC has both full control over the credit risks and sufficient financial capacity, in which case an arm's length remuneration must be determined based on a comparability study performed for each individual intercompany transaction. For intercompany loans, the State Secretary considers the comparable uncontrolled price (CUP) method as the most appropriate transfer pricing method to determine an arm's length remuneration.
- The SC has no control over the credit risks and/or insufficient financial capacity, in which case, the arm's length remuneration of the SC must generally be based on its operational costs.
- The SC has shared control over the credit risks and has the corresponding financial

capacity, in which case it would make sense to allocate the upsides/downsides of the risks on a pro rata basis. The latter situation, in particular, gives rise to uncertainty, as it remains unclear when such fact pattern arises and what the resulting allocation should be.

Although not confirmed by the State Secretary, existing structures set up under the previous TP Decree could also be impacted by the new SCs' guidance. For both existing and new structures that involve Dutch SCs, taxpayers should therefore carefully assess the impact of the new TP Decree on a case-by-case basis. This will be especially relevant for SCs that rely on the application of Dutch tax treaties or the EU Interest Royalty Directive for the exemption (or reduction) of withholding taxes, where there are similarities between the assessment of control and beneficial ownership.

New Decree on Permanent Establishments

On 1 July 2022, the State Secretary also published the new Decree on the Attribution of Profits to Permanent Establishments (the "PE Decree"), which took effect as of 2 July 2022. Developments in the area of profit allocation to permanent establishments, including the results of the OECD's BEPS project, led to an update of the previous PE Decree, which dated from 2011. The main changes to the PE Decree focus on preventing double non-taxation.

The PE Decree underlines the State Secretary's preference for the "capital allocation approach" in combination with the "fungibility approach" with respect to the allocation of interest costs to a permanent establishment. The capital allocation approach assumes that the permanent establishment has a credit rating equal to that of the legal entity as a whole. Under the fungibility approach, the interest expense of the entity is allocated to the permanent establishment in proportion to the debt allocated to the permanent establishment, pursuant to the application of the capital allocation approach.

The new PE Decree establishes that existing OECD practices with respect to profit allocation to PEs are in accordance with the State Secretary's view.

Dispute Resolution and Prevention

In the Netherlands, the number of tax audits increased substantially in 2022. These tax audits often focus on applied interest rates and the transfer pricing policies of multinational enterprises (MNEs). Solid transfer pricing documentation is essential in these discussions, as recent case law in the Netherlands has also emphasised. Such transfer pricing documentation should preferably be prepared on or around the date of the transaction in order to keep the burden of proof with the DTA.

To avoid discussions, taxpayers may consider entering into a (bilateral) advance pricing agreement (APA). In view of some of the developments already mentioned, a bilateral APA is generally preferred over a unilateral APA. Although there is no obligation for the competent authorities to reach an agreement on a bilateral APA, successful outcomes are in most cases reached by the Dutch competent authority.

Furthermore, taxpayers could end up in discussions with auditors on the annual audit of the financial statements, including discussions on deferred tax assets and deferred tax liabilities. Auditors tend to have become more critical of the tax elements over the last years, so taxpayers should ensure they have sufficient substantiation and documentation of their transfer pricing prior to the start of the audit. With the upcoming

introduction of Pillar Two, more discussions with auditors are expected, given the increased relevance of financial statements to determine the potential Pillar Two tax liability.

Mutual agreement procedures

Internationally, discussions with tax auditors may necessarily lead to a MAP. The new EU Directive on Tax Dispute Resolution (the “Directive”) provides taxpayers with more safeguards to resolve disputes with tax authorities within the EU.

The number of MAPs is expected to continue to increase, as transfer pricing discussions arise more frequently and cross-border transactions remain under the scrutiny of tax authorities across the globe. MAPs remain an attractive cross-border mechanism to resolve double taxation that often results from a unilateral correction by a tax authority. The Dutch competent authority is very approachable and will try to reach a resolution for the taxpayer even if there is no mandatory binding arbitration under a tax treaty.

A MAP request in the Netherlands can generally be based on one of the following:

- the relevant tax treaty;
- the 1990 EU Arbitration Convention; or
- the domestic implementation of the Directive.

The latter two instruments can only be used for disputes within the EU. The Directive generally provides more safeguards to derive a mandatory and binding resolution of tax disputes arising within the EU in a timely manner. MAPs under the Directive can be requested for disputes that relate to fiscal years starting on or after 1 January 2018. With the Directive, taxpayers are in a better position to resolve their tax disputes. The Dutch tax authorities have indicated that going forward they prefer this new mandatory and binding tax dispute resolution mechanism.

Transfer Pricing Aspects of Pillar Two

Pillar Two seeks to enforce a global minimum corporate income tax at an effective rate of 15%, calculated on a jurisdiction-by-jurisdiction basis. It will apply to MNEs meeting the consolidated group revenue requirement of EUR750 million per year, according to OECD rules. If the minimum 15% effective tax rate is not met in each jurisdiction, a top-up tax will apply. Pillar Two is expected to come into force as of 1 January 2024. The Netherlands has already held a public consultation on the draft bill to implement Pillar Two.

Pillar Two includes a specific provision on arm’s length pricing that applies to in-scope MNE groups. This transfer pricing provision stipulates that transactions should be valued on at arm’s length prices, including transactions between foreign entities and between a permanent establishment and the head office. Where the new Dutch transfer pricing mismatch legislation already puts emphasis on consistent pricing within the group, this will become even more relevant once Pillar Two comes into force. Dutch taxpayers should therefore already account for these effects when they update their transfer pricing documentation and/or enter into (new) transactions.

Specific provisions are included in Pillar Two when adjustments in accordance with the arm’s length principle can be booked and which exclude such adjustments when they result in double non-taxation. Where possible, the practice of making year-end adjustments not accounted for in the previous year’s consolidated financial statements, and other adjustments in later years, should be avoided. Adjust-

ments that take place in a later year might have a potentially adverse Pillar Two effect due to the transaction not being correctly priced in the year of the review, resulting in a potential qualification as a low-taxed entity (either resulting in an additional levy or not allowing the adjustment to be processed) and a potential complex recalculation requirement. Year-end adjustments are quite common within various MNE groups, so internal systems should be adjusted during 2023 prior to Pillar Two coming into force.

Furthermore, it should be noted that the transition period for Pillar Two started on 30 November 2021. Under this transition rule, only the transferor's carrying value could be taken into account for the Pillar Two value at the level of the recipient. This is potentially problematic for any asset transfers that result in a step-up to fair market value, as it causes a difference in amortisation between the Pillar Two accounts and the (Dutch) tax accounts. For the years 2024, 2025 and 2026, a safe harbour has been introduced where taxpayers can use their country-by-country reporting, which should limit the initial impact of this rule. Also, the recent technical guidance released by the OECD in February 2023 does allow the acquiring entity to take a deferred tax asset into account to the extent that the disposing entity paid tax in respect of the transaction. Based on this guidance, most transactions where (exit) tax is levied at a rate above 15% would be out of scope. This clarification is very helpful in the Dutch context, as most (cross-border) taxable transfers of assets during the transition period should now no longer be affected by this transition rule.

Concluding Remarks

There were many important transfer pricing developments in the Netherlands in 2022. The new transfer pricing mismatch legislation is a focal point for Dutch taxpayers, especially where, for example, the potential impact of Article 8bd CITA in situations with disregarded US entities remains uncertain and needs to be closely monitored. With the new TP Decree and PE Decree the State Secretary has provided more alignment with the TPG. However, this has resulted in uncertainty as to how the statements of the State Secretary should be seen in the context of the case law of the Dutch Supreme Court. More discussions with both tax and external auditors on the applied transfer pricing policies of MNEs are expected, and this is also expected to increase the number of MAPs. Finally, the introduction of Pillar Two as of 2024 will make consistent pricing within the group and avoiding adjustments in later years more important.

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