The APA/ATR practice

Memorandum regarding the most frequent legal forms

Introduction
As you previously wrote in your letter of 1 December to the Dutch House of Representatives[1], in the past few months intensive work has been carried out at international level (within the OECD, EU and G20) on measures to counter aggressive tax planning by multinationals. You also indicated in that letter that companies operating at global level are able to influence the overall tax burden by taking advantage of the absence of a relationship between the various national legal systems. There are many companies in the Netherlands that operate at global level. Regarding the consequences thereof with regards to taxation in the Netherlands, certainty ex ante ("zekerheid vooraf") can be requested from the Dutch Tax and Customs Administration, more specifically from the APA/ATR team.

Nationally and internationally, there is a lot of attention for taxation and rulings in particular. In that regard, the Netherlands strives for transparency and the exchange of rulings. With a view to these developments, among others, this memorandum sets out the role of the APA/ATR team and the most frequent legal forms of the rulings issued by that team.

Your predecessors previously agreed to the issue of certainty ex ante in respect of the topics contained in this memorandum, for which certainty ex ante can be obtained.

Decision point
Will you agree to continue granting certainty ex ante regarding various legal forms of rulings set out below?

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1. The APA/ATR practice
Every taxpayer may request the Tax and Customs Administration for a tax ruling, i.e. submit a request to the Tax and Customs Administration to take a position regarding the tax interpretation of a proposed legal or other act, or of one that has previously taken place but has yet to be incorporated into a tax return. This can relate to simple tax questions, such as the depreciation period of assets or the valuation of stock (older or not), to more complex tax questions like the determination of the level of arm's length remuneration for cross-border, intra-group transactions.

Where reference is made to the "APA/ATR practice", this concerns the practice of issuing certainty ex ante, APAs (Advance Pricing Agreements) and ATRs (Advance Tax Ruling), by the APA/ATR team regarding the tax consequences of specific international situations. The practice arose in the post-WWII reconstruction period. Where the Ministry of Finance had originally been authorised to issue certainty ex ante, this power was transferred to the local tax inspectors in the 1970s. From 1991, the issue of rulings was centralised at one desk within the Tax and Customs Administration, specifically the Tax and Customs Administration, Rotterdam Office, the APA/ATR team. After international criticism, the old ruling practice was replaced per 1 April 2001 by current APA/ATR practice. Currently, some 75 individuals are employed within the APA/ATR team.

An APA or ATR relates to the explanation of the Dutch tax regulations for a specific body of facts and is therefore expressly not a favourable relaxation of the tax base or the tax rate for taxpayers. Via an ATR, certainty is obtained regarding the Dutch tax treatment in respect of a number of topics in connection with an international group structure. An APA distinguishes itself from issuing approval ex ante in the national context, as approval ex ante via an APA is issued regarding the determination of transfer prices at the international level. Therefore, the consequences of an APA are, generally speaking, not limited to the Dutch tax base.

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[1] Reference AFP/2014/1070

The agreements in the form of an APA or ATR are based on policy decisions determining the cases in which a binding recommendation of the APA/APR team is required for the issue of certainty ex ante. All agreements that are made are in line with legislation and regulations. In close consultation with the Director-General for the Tax and Customs Administration and the International Tax and Consumer Tax Directorate[2], the scope of the practice is coordinated. It is within this scope that the APA/ATR team issues certainty ex ante. Beyond this coordinated scope, certainty ex ante is refused. This means that the APA/ATR team is in many cases stricter than the law. The structures described in this memorandum can, therefore, also be implemented without any certainty ex ante. In those cases, the inspector arrives (after review or not) at the same tax treatment in the event of a settlement of the assessment as when certainty ex ante is issued. The greater the importance, however, the more value is attached to certainty ex ante.

An APA or ATR request must be addressed to the Tax Office to which the taxpayer reports. The Tax Office then presents the request to the APA/ATR team of the Tax and Customs Administration/Rijnmond office in Rotterdam for a binding recommendation. The request is reviewed by at least two persons. The APA/ATR team also coordinates with the various knowledge groups and coordination groups, including the Transfer Pricing Coordination Group[3], for the purpose of guaranteeing the uniformity of policy and execution.

In those situations involving an ATR request there is often a limited presence in the Netherlands. However, when the certainty ex ante is issued regarding transfer prices (APA) it concerns, generally speaking, an enterprise with a significant presence in the Netherlands (with the exception of so-called 'dienstverleningslichamen' or 'service entities'). The increasing national and international criticism regarding the role of the Netherlands relative to tax structures of multinationals relates to both situations.

Importance for the Dutch investment climate

It is particularly important that taxpayers are able to obtain certainty ex ante regarding tax consequences of planned legal acts. Especially if an investment decision is to be taken. The accessibility of the Dutch Tax and Customs Administration, including the possibility to obtain certainty ex ante, contributes to an attractive tax climate.

It is also the case that companies which receive dividends, interest or royalties and in turn pay them at the international group level are referred to as 'linking companies' ('schakelvennootschappen'). Special financial institutions, a term which is used by the Dutch central bank, De Nederlandsche Bank (DNB), and that comprises a larger group than 'linking companies', contribute, according to estimates, € 3 to € 3.4 billion per year to the Dutch economy in the form of taxes, labour costs and services that they insource from business service entities. A total of 2200 people are employed in the trust sector, which also provides its services to service entities ('dienstverleningslichamen').[4]

The most frequent legal forms of structures for which certainty ex ante is given in APAs and ATRs are set out below.

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[2] Note: this is a directorate within the Dutch Ministry of Finance.

[3] Note: This is a group within the Dutch Tax Autority that acts as an internal contact point for all matters related to transfer pricing.

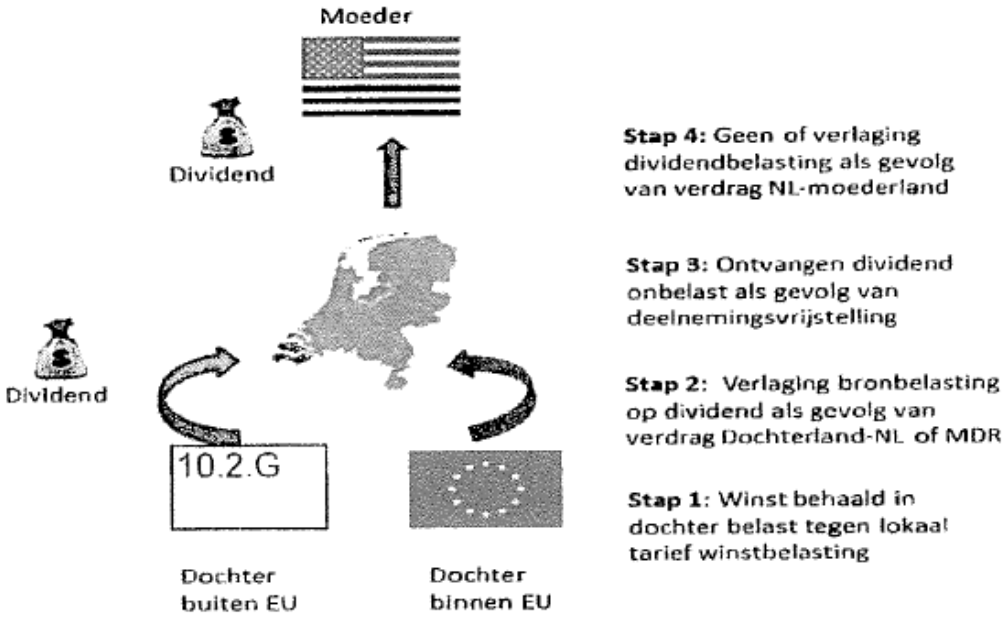
[4] Source: http://www.hollandquaestor.nl/nl/q-a/10-wat-betekenen-de-dienstverleners-voor-ondernemingen-voor-de-nederlandse-werkgelegenheid-economie

2. Intermediate holding company activities

2a. Description

If a foreign corporate group holds subsidiaries in third countries by means of a Dutch company, this is referred to as an intermediate holding company. In order to repatriate the profits of the subsidiaries without additional taxation to the country of the parent, the parties concerned desire to receive certainty regarding the application of the participation exemption and the exemption from the dividend withholding tax of the Netherlands pursuant to a tax treaty, the EU's Parent-Subsidiary Directive or national law.

2b Illustration



Translation of the notes in the illustration:
Parent ('Moeder')
Dividend
Subsidiary outside EU ('Dochter buiten EU')
Subsidiary within EU ('Dochter binnen EU')

Step 4: No dividend tax or reduction thereof due to treaty between Netherlands and home country
Step 3: Received dividend is untaxed due to participation exemption
Step 2: Reduction of dividend withholding tax due to treaty between subsidiary's country and Netherlands or PSD
Step 1: Profit earned in subsidiary taxed at local corporate tax rate

For legend of symbols used in this memorandum, see Appendix 1.

Application of the participation exemption means that corporation tax is not levied (once again) on profits that have been generated in the country of the subsidiary when dividends are paid to the Netherlands. This is in accordance with the body of thought applied by the Netherlands that enterprises must be able to operate on local markets at the tax rate in effect there. The statutory regulations of the participation exemption contain a number of anti-abuse stipulations that, in general, rule out the application of the participation exemption in the event the subsidiary does not conduct an active enterprise and is not subject to a real taxation in the country where it is established. Certainty ex ante regarding the application of the participation exemption requires, in addition, of course, to meeting the statutory requirements, that the holding company in the Netherlands meets certain substance requirements.

Often, requests to apply the participation exemptions are combined with requests for certainty regarding dividend tax. A holding-company structure does not, after all, benefit if the revenue stream on the incoming side is exempted (participation exemption), but is nonetheless levied on the outgoing side (dividend tax). In case there is an enterprise existing above the level of the Netherlands, this is in line with Dutch treaty policy that intends to ensure that additional (withholding) taxes do not have a disruptive effect within corporate structures. An enterprise above the level of the Netherlands also exists if a shell company above the level of the Netherlands acts as a "link" between an enterprise at or under the level of the Netherlands and one that directly or indirectly holds the shares in the company that acts as a "link".

Certainty is also requested in respect of the question as to whether profit distributions of a Cooperative ('Coöperatie') acting as intermediate holding company are subject to Dutch dividend tax. As a corollary thereof, certainty is requested in respect of the question as to whether the foreign participants are liable to pay tax in the Netherlands for their holding shares/membership rights in a Dutch company/Cooperative (see section 3 below).

Cooperatives, a special form of intermediate holding company
For a number of years, Dutch cooperatives have been used a lot as holding companies. Under certain conditions, a cooperative is not obliged to withhold dividend tax. That is why a cooperative can be an attractive alternative for a public or private limited company as an intermediate holding company within an international structure.

Needless to say, it is not intended that a cooperative is used as an intermediate holding company in those cases where the Netherlands would certainly want to levy a withholding tax. For that reason, an anti-abuse stipulation was incorporated into the Dividend Withholding Tax Act since 1 January 2012. As a result thereof, a cooperative is in principle made liable to withhold dividend tax in cases where a corporate structure does not exist. In addition, the scheme regarding non-resident tax liability is in effect as set out in section 3, for interests in a cooperative as well.

The fact that the cooperative in corporate structures can be used to prevent dividend tax from being withheld is in line with Dutch treaty policy that intends to ensure that additional (withholding) taxes do not have a disruptive effect in corporate structures.

2c. Importance for the Dutch investment climate
Many groups of companies operating at the international level make use of Dutch intermediate holding companies due to the extensive treaty network of the Netherlands and the application of the participation exemption. American groups of companies often use a Dutch holding company to hold non-US participations. For various foreign groups of companies, this has resulted in the fact that substantive European headquarters have been established in the Netherlands. This produces a "snowball effect": companies start with a small intermediate holding company in the Netherlands, but then also opt for the Netherlands to establish activities that generate jobs.

2d. What are the consequences of international developments?
Intermediate holding companies with little substance are criticised by some countries and certain sections of the Dutch Parliament. This is due, for instance, to the fact that they have little connection with the Netherlands and, in particular, damage the Netherlands' image abroad.

The effect of international developments might be such that the Netherlands loses its attractiveness as a location for holding companies. This applies not only to holding companies that have little substance, but also to holding company structures that have evolved into local head offices providing serious employment.

The extent to which this will be the case depends on the scope of anti-abuse stipulations that will be incorporated into bilateral tax treaties, in the EU's Parent-Subsidiary Directive or a possible multilateral instrument. In case of a broad application of the anti-abuse stipulations, source states can in an extreme case take the position that even holding shares by an active company with employees was inspired in whole or in part by tax motives and for that reason withholding tax may be applied. In other words, in case of a broad application of the anti-abuse stipulations, this will have consequences for the Dutch investment climate as well as employment.

Code 10-2-a[5]

3. Non-resident tax liability

3a. Description
Companies that are not established in the Netherlands could be liable to pay tax in the Netherlands in connection with certain activities that they perform in the Netherlands or specific revenues that they receive from the Netherlands. Companies often wish to receive confirmation that they are not liable to pay tax in the Netherlands for their Dutch activities or revenues. The most important two categories of non-resident tax liability are the presence of a permanent establishment and the income from a substantial interest in a company based in the Netherlands.

Permanent establishment
Foreign companies are liable to pay tax in the Netherlands for income generated with sustainable activities in the Netherlands which constitute a permanent establishment. If there is no permanent establishment in the Netherlands, it follows that there is also no tax liability. The facts and circumstances are used as the basis to test whether this is the case. It can be confirmed in an ATR that a permanent establishment does not exist.

Revenues from substantial interest
If a foreign company has an interest of at least 5% in a Dutch company, it has a substantial interest therein. The revenues from this substantial interest can be subject to Dutch corporation tax under certain circumstances. This concerns both the dividends received from the Netherlands and the profit generated when shares are sold.

The regulation for foreign companies having a substantial interest has an anti-abuse character. Liability to pay tax exists only if the substantial interest for the foreign shareholder is not part of the assets of an enterprise. In connection therewith, reference is made to section 2 of this memorandum. As set out in that section, the Netherlands does not see any cause to levy additional tax on dividends in connection with the profit of active operating companies and that are paid out to the active parent group of companies. If the direct or indirect holder of the substantial interest does not conduct an active enterprise, however, there is, in principle, no reason not to tax the dividend. If the foreign shareholder does not conduct an enterprise, but the substantial interest is not held to avoid tax, there is no tax liability either.

3b. Importance for the Dutch investment climate
The question regarding the taxability of a substantial interest in a Dutch entity is posed in practically all situations where a foreign group of companies invests in or via the Netherlands. The requests are broadly divided into two categories: the international groups of companies that hold their foreign operating companies in or via the Netherlands and private equity funds that keep their "target" via

[5] Note: This means that a part of the internal memo is blacked out. This applies to all sections in the text where it says code 10-2-a.

the Netherlands. Private-equity structures qualify, in principle, only for certainty ex ante if it relates to “active” funds, i.e. funds that invest in operational targets and are actively involved therein.

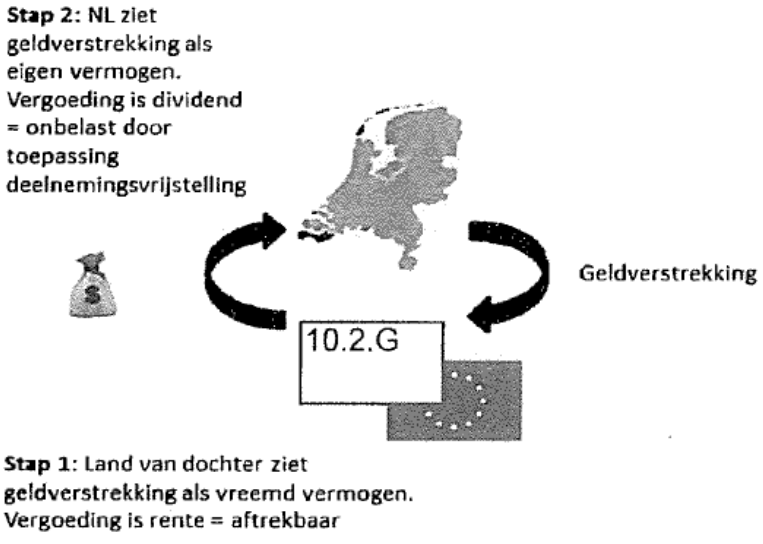
3c. What are the consequences of international developments?
The regulation relating to the income from substantial interest has, as previously mentioned, an anti-abuse character. Depending on the scope of anti-abuse stipulations that will be incorporated into bilateral tax treaties, in the EU’s Parent-Subsidiary Directive or a possible multilateral instrument, the Netherlands can thus apply its own anti-abuse stipulation in an earlier stage. In light, however, of the consequences of a broader application at the international level of anti-abuse measures for the Dutch investment climate and for employment in the Netherlands, this counts much less.

4. Qualification of hybrid financing structures and hybrid entities

4a Description of a hybrid form of financing
A hybrid financing structure has characteristics of both a loan and equity. In most cases it concerns hybrid loans. These are loans under civil law with characteristics such that they can be qualified as equity capital for tax purposes. Over the years criteria have developed in case law based on which it can be determined whether such a loan must be treated as a form of capital. If a loan is deemed to be equity for Dutch tax purposes, it ensues, in principle, therefrom that the compensation for such a loan is to be treated as dividend. This compensation cannot be deducted from the profit; in principle, dividend tax is to be withheld thereon and under certain circumstances the participation exemption can be applicable. These loans can be issued either *by* or *to* a Dutch legal entity.

Since each country applies its own criteria to qualifying forms of financing, it can occur in practice that a mismatch arises between the qualification in the Netherlands and the other country in the event equity is issued across borders. If the one country qualifies the compensation for the financing structure as interest and the other one as dividend, this can result in either double taxation (not deductible but subject to taxation) or double exemption (deductible but tax-exempt). The presence of a mismatch as such does not preclude issuing certainty ex ante regarding the characteristic of a loan. The mismatch ensues from a disparity between different tax regimes.

4b Illustration



Translation of the notes in the illustration:
Step 2: Netherlands deems lending funds as equity capital. Compensation is dividend = untaxed due to application of participation exemption

Lending funds

Step 1: Subsidiary's country deems lending funds as debt. Compensation is interest = deductible

4c. Importance for the Dutch investment climate

In practice, taxpayers take advantage of the differences between different tax regimes. The "mismatch" in the qualification can be seeked for the purpose of creating tax-deductible interest, without pick-up in the other country. It depends, of course, on the tax regime of the other country as to whether such a mismatch can be effected.
It also happens that taxpayers request certainty regarding the qualification of a financing structure in cases that do not result in a mismatch, because they want to have certainty regarding the fact that no double taxation will take place. There is a variety of taxpayers that make use of a possible mismatch. This ranges from companies that have little substance and substantive branches of foreign multinationals to Dutch multinationals.

4d. What are the consequences of international developments?

In the EU's Parent-Subsidiary Directive an amendment was recently incorporated on the basis of which the benefits of the Parent-Subsidiary Directive may no longer be allocated if a hybrid financing structure exists whose compensation is deductible in the other country. In that case the Netherlands will consequently no longer apply the participation exemption on the compensation received for the hybrid loan. In this way mismatches are avoided within the EU. The amended Parent-Subsidiary Directive will be implemented in the Dutch Law per 1 January 2016. Within the OECD as well, measures will more than likely be taken to prevent mismatches.

4e. Description of hybrid entities

Legal entities or collaborative partnerships incorporated under foreign law must be qualified as fiscally transparent or not transparent according to Dutch tax standards. If, according to Dutch standards, a transparent entity exists, the income is allocated directly to the participants. If a transparent entity does not exist, it is possible that it is a participation to which the participation exemption applies.
In addition, mismatches can occur in respect of the qualification of legal forms. A collaborative partnership can be judged to be transparent in one country and yet it is deemed as an entity liable to pay tax in another. For further treatment of hybrid entities, reference is made to section 5 below.

5. Limited partnership-private limited company structures ("CV/BV structuren")

5a. Description

Most European countries have a type of a participation exemption and, consequently, do not levy tax on the profits realised abroad. By contrast, the United States of America does not and, in principle, annually includes global profits of American companies in the tax levy/base.
In other words, foreign profits are subject to the additional American tax rate of 35% on foreign profits.

10.2.a.
10.2.a.

These regulations have the effect of deferring the additional tax to the United States, until payments to America actually take place. Consequently, American multinationals, subject to local requirements abroad, are still able to compete with local enterprises. The countries concerned outside of the US do, however, levy taxes directly on profits realised locally. As a result, no country other than the United States is losing out. It concerns, further, the deferment but not the cancellation of the additional American tax. This important nuance, deferment instead of cancellation, is often lost in both the public perception and the political arena. There is, however, no permanent mismatch; instead companies can in fact defer the additional tax for a very long period of time.

In case of a limited partnership-private limited company structure ("CV/BV structuur"), American groups of companies hold shares in a Dutch private limited company (BV) via a limited partnership (CV) not incorporated in the Netherlands.[67]A limited partnership is transparent for Dutch tax purposes, i.e. undisclosed for tax purposes. This means that payments to a limited partnership are directly allocated to its foreign members (the American groups of companies). On balance, the limited partnership is not liable to pay taxes in the Netherlands. The limited partnership is not transparent for American tax purposes, that is to say the limited partnership is regarded as an independent entity.[8] This ensures that payments which from a Dutch tax perspective are made directly to the United States, do not arrive in America but rather remain behind in the limited partnership from an American tax perspective. This is also referred to as the offshore asset ("moneybox-at-sea"). As soon as the limited partnership makes payments to the United States, additional tax will still be levied there according to the regular American tax rate. This temporary mismatch, the deferment of the additional tax, is caused by the difference in tax regimes previously mentioned.

5b. Illustration

Translation of the notes in the illustration:
"Offshore asset"
US sees an entity and does not act on payment

Netherlands see a transparent entity and, consequently, a payment to US

Netherlands: Limited partnership (CV) Transparent entity
US Limited partnership (CV) Opaque (entity)

[6] A limited partnership under Dutch law
[7] Instead of a limited partnership, a comparable hybrid foreign collaborative partnership (a British LP) can also be used or a legal entity often incorporated in a country with low corporate tax rates.
[8] Based on the previously mentioned American check-the-box rules.

5c. Importance for the Dutch investment climate
Limited partnership-private limited company structures occur a lot regarding US multinationals with activities in the Netherlands. The structure relates to Dutch intermediate holding activities (see section 2 above), financing and royalty activities (see section 8 below) and substantive principal activities (see section 7 below).

US multinationals can, in principle, start up hybrid or other structures similar to limited partnership-private limited company structures anywhere in the world. The Netherlands is therefore not unique. This is possible with hybrid entities, such as the limited partnership under Dutch law, or comparable foreign collaborative partnerships, as well as with legal entities which are often established in countries with low corporate tax rates.

If the subject of discussion is an American multinational's European head office or the establishment thereof in the Netherlands, it can be assumed that a limited partnership-private limited company structure or something similar is in place. In this regard, it concerns companies with a footprint in the Netherlands ranging from a few dozen or a few hundred to over a thousand employees. For the contact point of the International Investors' Desk (APBI) at the Dutch Tax and Customs Administration, this is one of the two most important structures which companies use when establishing real operational activities in the Netherlands. It concerns a core structure for the Dutch fiscal climate.

5d. What are the consequences of international developments?
The trend of increasing transparency that has already begun means that more European or other countries are becoming aware of the structures similar to limited partnership-private limited company structures. This can result in an extra critical view by foreign tax authorities of the compensation of the activities in their country. In addition, the risk exists that countries will unilaterally take anti-abuse measures against structures similar to limited partnership-private limited company structures, as a result of which they can include the profit or a part thereof of the limited partnership in their tax levy/base. Companies also weigh up the matter themselves regarding the structures which they wish to maintain within the context of transparency.

At the moment a State aid investigation into Starbucks is being conducted at the European Commission (EC). Starbucks has a variant on the limited partnership-private limited company structure described above. The EC is investigating whether the Dutch-based profit was in accordance with the arm's length principle. It relates, in particular, to transactions from the Netherlands with a foreign entity similar to a limited partnership entity and Switzerland.

10.2.a.
10.2.a.

The OECD has worked out draft measures to offset the effect of temporary or permanent mismatches caused by hybrid entities.

10.2.a.
10.2.a.
10.2.a.

[MISSING TEXT] the United States has submitted an alternative anti-abuse proposal to include entities similar to limited partnership structures, which are taxed at a rate of less than x% (around [10.2.a]), directly in the American tax levy/base. Whether this will become a reality remains to be seen, but it would largely remove the political pressure from the topic. All in all, there is a chance that structures similar to limited partnership-private limited company structures will still be

permitted (perhaps after some modification) in the new international tax scene after the BEPS project, but this is of yet uncertain.

10.2.a.

6. Informal capital/constructive dividend

6a. Description
In the Netherlands, arm's length remuneration for the functions performed, risks incurred and assets used must be taxed, on the basis of the arm's length principle. If a Dutch company is given an advantage merely on the basis of shareholder motives, i.e. without any consideration, then pursuant to established Supreme Court case law (since 1957), this non-arm's length element must be eliminated when fixing the taxable amount in the Netherlands. In other words, the taxable profit is set at a lower level than the commercial profit. In the sphere of certainty ex ante, it is considered whether there is awareness on the part of the supplier and recipient of the informal capital[9] (bilateral awareness criterion).

In practice, there are two basic forms of informal capital:

Re costs
For example an interest-free loan provided by an Irish group company to a Dutch company. In third-party business relationships, an interest rate would be stipulated on the loan. In tax terms, business interest on this loan can be offset annually by the Dutch company.

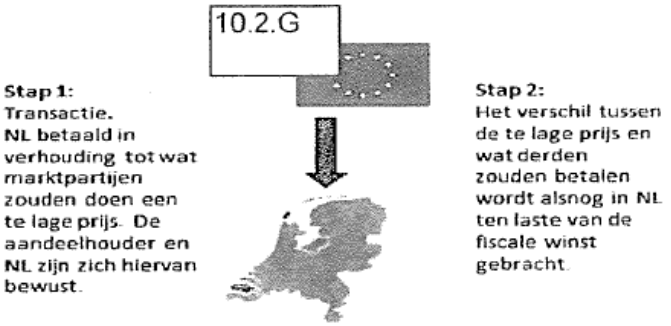
Re equity
If, on the basis of the shareholding relationship, intangible or tangible assets from abroad are transferred for no consideration or for a fee that is low or too low, then there will be a one-off contribution of informal capital. Despite the fact that too little or nothing has been paid for the transfer, the Dutch entity receives a potential tax depreciation over the economic value of the assets ('step-up').

The effect of an informal capital structure, is the creation of an international mismatch. With regard to the costs, the foreign country either does not or otherwise cannot include the tax deductible costs in the Netherlands in its own tax levy. With regard to equity, there is no settlement over the transfer of tangible or intangible assets (i.e. the price is contractually set at zero) whilst the Netherlands grants a step-up to the economic value (depreciation potential).

The Netherlands levies the amount to which it is entitled, whereas the foreign country does not (fully) levy what, from a Dutch tax perspective, it is entitled to. It goes without saying that creating international mismatches causes tension, especially if certainty about it is provided beforehand. After all, we see that informal deals are being done, and to date, we have not been informing the other tax authority about these deals. When asked, the taxpayer is obliged to provide the foreign country with this information. The Netherlands must also provide the foreign country with this information upon request.

[9] Informal capital exists if preferential treatment originates at the top of the group of companies. If the preferential treatment originates from the bottom of the group, a disguised dividend exists. Henceforth, although both variants are meant, reference will only be made to informal capital.

6b. Illustration



Translation of the notes in the illustration:
Step 1: Transaction. Netherlands underpays relative to what market parties would pay. The shareholder and the Netherlands are aware of this.
Step 2: The difference between the underpayment and what third parties would pay is nonetheless included in the taxable profit.

6c. Importance for the Dutch investment climate
The Dutch Tax and Customs Administration has been making informal capital deals with companies for decades. Historically, these agreements have mainly been made by the International Investors' Desk (APBI). These agreements usually involved substantial employment, ranging a few dozen to several hundred jobs per case. In addition, informal capital deals were made for financing and royalty activities, as discussed below in point 8.

In the appendix to your letter of 11 December 2002 to the Lower House "Tax aspects regarding the investment climate"[10], in response to concerns raised in the outside world about the tax climate in the Netherlands, you indicated:

For real investments in the Netherlands, it is still possible to conclude an APA in accordance with informal capital elements. The Netherlands charges tax over the actual profit attributable to the company on the basis of the arm's length principle. This is in accordance with the concept underlying overall profit. For the Dutch Tax and Customs Administration the effective tax rate is not a relevant factor.

Informal capital situations regularly occur without certainty ex ante, whereby the inspector arrives at the same tax treatment in the case of assessment as in the case of certainty ex ante, whether after inspection or not.
There are also other countries, including Belgium, that provide certainty ex ante on informal capital.[11]

6d. What are the consequences of international developments?
The various transparency initiatives, such as country-by-country reporting and exchange rulings, make informal capital situations visible to foreign tax authorities. The expectation is that fewer

[10] Dutch Lower House, 2002-2003 session year, 27 505, no. 5
[11] Newspaper article 12 December 2014: *Van Overveldt defends "Belgian tax deals"*
Brussels Finance Minister Johan van Overveldt (N-VA) believes that our country should not simply stop special tax measures such as the so-called excess profit rulings (addition by the Netherlands = informal capital) to tempt multinationals. "We are part of the monetary union and we have a limited enough number of policy tools available for us to intervene in our economy," he said in Parliament yesterday. "It is not advisable simply to give up a niche tax policy and in so doing surrender an additional tool of economic policy."

companies will request certainty ex ante if they know that these rulings are being actively shared with other countries. Moreover, it is still up to the other country as to whether or not it taxes the informal capital element. The exchange of informal capital or other rulings will have a negative impact on the attractiveness of the Dutch investment climate.

10.2.a

So-called informal capital deals are made as part of certainty ex ante. On the one hand, these deals create favourable conditions for establishing businesses but on the other hand they can raise international tensions. The Achilles heel of the informal capital deals was that the Netherlands did not actively share them with other countries. Assuming that future rulings of this kind will be shared with other countries, the tensions mentioned above will no longer play a part. As far as the Dutch government is concerned, the risk profile connected with making such deals is therefore considerably reduced.

7. Principal hub structures (European/EMEA head office)

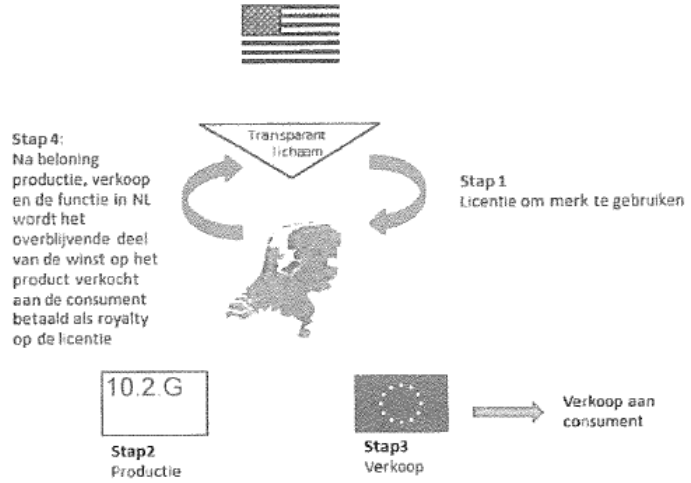
7a. Description

In recent decades, multinationals have evolved from locally run organisations, in which manufacturing, R&D, procurement and sales took place at the national level, into organisations in which such activities are bundled together and managed centrally. This central point, which, say, controls purchasing, sales, R&D and manufacturing in a large geographical area or time zone, is referred to as the "principal hub". It is at this principal hub that key officers control the business operations of a group of companies. The principal hub makes the business decisions, runs the risks associated therewith and ensures efficiency gains. The factories and the sales organisations have a limited functionality and a limited risk profile. Based on the arm's length principle, the principal hub has the right to the surplus profits as well as liability for the losses. Whereas the factories and sales organisations receive a limited, stable commercial payment.

Principal structures in combination with limited partnership-private limited liability company under Dutch law (IP outside of Netherlands)

With this structure, a foreign group of companies (often US) has placed part of its sales rights or other intangible assets into a hybrid limited partnership (see section 5 above) or low-tax, foreign entity. This entity grants the Netherlands the right to act as principal hub in a certain geographical area, e.g. Europe. The valuable intangible assets (IP) are therefore not in the Netherlands. The Netherlands often buys the products within the group of companies and sells them to local sales entities. These manufacturing/sales entities are compensated in separate countries with a (limited and stable) commercial payment. The European sales minus the corporate payment mentioned above are then declared in the Netherlands. If the Netherlands receives a higher income than the agreed corporate payment for the Dutch activities, most of it is issued as a royalty payment to the limited partnership or the low-tax entity as compensation for the right it granted to the Netherlands. Certainty ex ante is only given if actual manufacturing and sales activities (or the management thereof) are conducted in the Netherlands.

7b. Illustration



Translation of the notes in the illustration:

Step 1
Licence to use brand

Step 2
Production

Step 3
Sale
Sale to consumer

Step 4:
After remuneration for production, sale and the activities in Netherlands, the remaining part of the profit on the product is sold to the consumer, paid as royalty on the licence.

Principal structures in combination with informal capital (IP within Netherlands)
This involves relocating a substantive principal activity to the Netherlands for no consideration or at a price that is not in line with the arm's length principle. Since there is a price which is not at arm's length, there will be a contribution of informal capital. For further explanation of certainty ex ante in relation to informal capital, please refer to section 6 above.

7c. Importance for the Dutch investment climate
With principal structures it is all about substantial, high-quality employment in the Netherlands. It is about companies with a footprint in the Netherlands, ranging from a few dozen or a few hundred to over a thousand employees[12]. Principal structures are frequently set up by foreign and Dutch companies. For principal structures with intellectual property in the Netherlands, it is possible that under certain circumstances a part of the profit may qualify for applying the innovation box.

7d. What are the consequences of international developments?
Besides the international developments that have already been discussed in sections 5d and 6d above, there are three items in the OECD BEPS action plan that may have a particular impact on principal structures:

- Attribute more profit to the local countries and so less to the principal hub

[12] Based on data from the Netherlands Foreign Investment, there are 1100 head offices belonging to foreign groups of companies in the Netherlands. There are estimated to be around 86,000 employees.

- Sooner allow the local country to recognize a permanent establishment of a principal hub. This will result in the local country taxing a part of the principal hub's profit.
- Less qualified profit for applying the innovation box (nexus discussion).

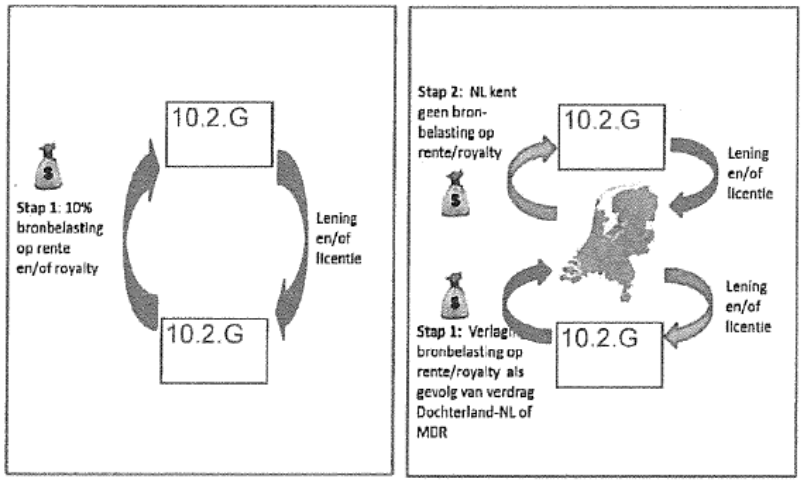
The general expectation is that even after BEPS, principal structures will remain among the options. As far as the Dutch investment climate is concerned, it is important whether the principal hub in conjunction with a limited partnership/private limited company or informal capital will remain an option (see sections 5d and 6d above).

8. Financing and royalty activities

8a. Description

Service entities ("dienstverleningslichamen") are linking companies whose activities predominantly consist of receiving and paying interest, royalties, rent or lease instalments within the group[13]. Using a Dutch Service Company as an intermediary makes it possible to avoid paying withholding taxes. The Netherlands does not have any withholding taxes so even when the Dutch Service Company routes through payments, no tax is owed at source. This is in line with the international treaty policy memorandum.

8b. Illustration



Translation of the notes in the illustration:
Step 1: 10% withholding tax on interest and/or royalty

Step 2: Netherlands does not have any interest/royalty withholding tax
Step 1: Reduction of interest/royalty withholding tax due to treaty between Subsidiary country and Netherlands or PSD

8c. Importance for the Dutch investment climate

Owing to the importance of an attractive fiscal investment climate, certainty ex ante is given about the tax implications for Dutch taxation. Among various foreign groups of companies, this has led to a "snowball effect": they start with financing and/or royalty activities of little substance, but then also opt for the Netherlands to establish activities that generate jobs. Furthermore, the number of employees at various service entities ranges from 5 to 80.

[13] The exact definition of the term "Service Company" is included in Section 3a, first paragraph of the International Assistance (Levying of Taxes) Act.

8d. What are the consequences of international developments?
Service entities that have little substance are criticised by some countries and certain sections of the Dutch Parliament. This is due, for instance, to the fact that they have little connection with the Netherlands and, in particular, damage the Netherlands' image abroad.

With a probability bordering on certainty, international developments also affect the service entities. The effect might be such that the Netherlands loses its attractiveness as a location for financing and royalty activities. This not only applies to companies with little substance, but also to structures that have grown into local head offices providing serious employment. The extent to which this will be the case depends on the scope of anti-abuse stipulations that will be incorporated into bilateral tax treaties, in the EU's Interest and Royalties Directive that is likely to be amended or a possible multilateral instrument. By introducing anti-abuse measures, source countries will sooner challenge the application of the treaty between the source country in question and the Netherlands, meaning the lowered rate of withholding tax cannot be applied.

Code 10-2-a

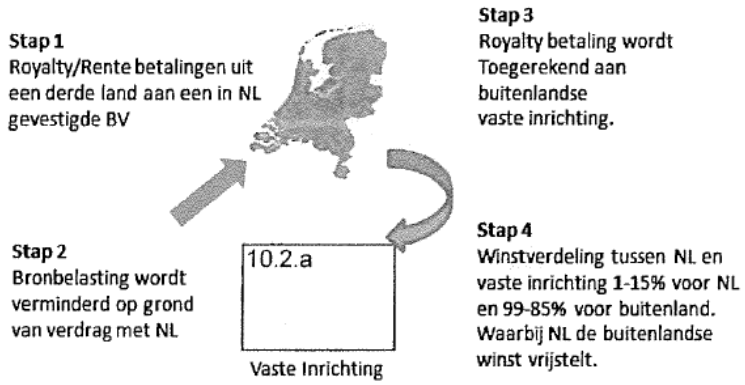
9. Profit allocation re head office - permanent establishment

9a. Description
A company based in the Netherlands has sustainable activities abroad which, for tax purposes, constitute a foreign permanent establishment through which economic activities are conducted. On the basis of tax treaties, the right to tax the profits earned by this permanent establishment is assigned to the country where the permanent establishment's activities take place. Since the Netherlands has to exempt this foreign profit, the company only pays tax in the Netherlands on its activities in the Netherlands. The foreign activities (the permanent establishment) are taxed under the foreign tax system.

By using a Dutch company for predominantly foreign activities, despite the fact that there are not necessarily many activities being carried out in the Netherlands, the Dutch treaty network is still applicable in relation to third countries. This may result in lower withholding taxes on interest and royalty payments to the Dutch company but they must be attributed to the permanent establishment in relation to the situation in which payments are being made to a local foreign legal entity based in the permanent establishment's country.

Certainty ex ante is not provided in these structures if doubt can be cast on the company's actual management in the Netherlands. For this reason, in such cases the involvement of the directors/employees present in the Netherlands in the activities of the permanent establishment is required. The payment for the Netherlands involves a weighting of the Dutch activities versus the foreign activities. We often see a Netherlands-Abroad profit distribution of between 1 - 15% for the Netherlands and 99% - 85% abroad. This profit distribution is technically underpinned in accordance with the OECD transfer pricing guidelines.

9b. Illustration



Translation of the notes in the illustration:
Step 1
Royalty/Interest payments from a third country to private limited company under Dutch law with its registered office in the Netherlands

Step 2
Withholding tax deducted by virtue of treaty with Netherlands

Step 3
Royalty payment allocated to foreign permanent establishment.

Step 4
Profit distribution between Netherlands and permanent establishment: 1-15% for Netherlands and 99-85% for foreign entity,whereby Netherlands exempts foreign profit.

10.2.a
Permanent establishment

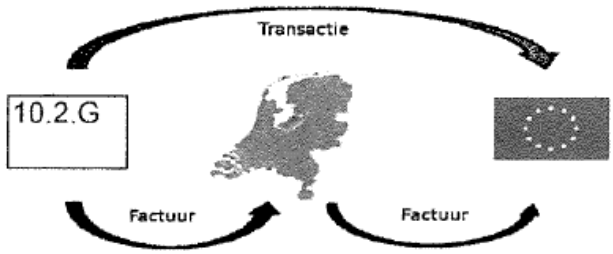
9c. Importance for the Dutch investment climate
Decades ago, the Netherlands started providing certainty ex ante on 10.2.a financing permanent establishments of Dutch companies. Thereafter, providing certainty ex ante was extended to other permanent establishments carrying out different activities. On average, the employment provided by each structure concerns a few workers. Almost all groups of companies that make use of such a head office-permanent establishment structure in the certainty ex ante also have other substantive activities in the Netherlands.

9d. What are the consequences of international developments?
In the BEPS project there is discussion about not granting treaty benefits by third states for permanent establishments with limited main house functionality. This would diminish the appeal of this structure.

10. Reinvoicing

10a. Description
Reinvoicing entities are companies whose activities consist of issuing invoices in the name of the reinvoicing entity for goods or services that are provided by other associated entities in the corporate group. The reasons for a corporate group to work with a reinvoicing entity may vary. For example, not mentioning the actual supplier on an invoice, avoiding trade barriers, reducing currency risk or avoiding currency valuations. As the contracts are concluded with the supplier and not with the reinvoicing entity, the buyer's country can know from which party the purchase is actually being made.

10b. Illustration



Translation of the notes in the illustration:
Transaction
10.2.G
Invoice
Invoice

10c. Importance for the Dutch investment climate
The actual employment associated with the reinvoicing is usually limited. However it is a legal possibility which corporate groups sometime use for reasons of their own. It is not the case that only companies of little substance use reinvoicing though. Companies that employ a lot of people also reinvoice, frequently due to IT reasons or to lighten the administrative workload.

In the realm of certainty ex ante, no prior assurance is given if reinvoicing to tax havens is practiced. Neither is certainty ex ante given if there is any concealment of the origins of goods in connection with an international boycott.

10d. What are the consequences of international developments?
Companies with little substance are criticised by some countries and parts of the Lower House. This is due, for instance, to the fact that they have little connection with the Netherlands and, in particular, damage the Netherlands' image abroad. Therefore, this general criticism also focuses on reinvoicing entities. Specific measures aimed at reinvoicing entities are not expected.

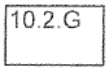
Appendix 1

Bijlage 1

Legenda

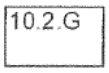
Nederlands lichaam, BV of coöperatie

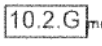
Buitenlandse moedermaatschappij, vaak USA



Buitenlandse hoog belaste dochtermaatschappij, buiten EU

Buitenlandse dochtermaatschappij, binnen EU





moedermaatschappij

Buitenlandse tussenhoudster in fiscaal vriendelijke omgeving

Legend

Dutch entity, private limited company (BV) or cooperative

Foreign parent company, often located in USA

Foreign subsidiary, heavily taxed, located outside of EU

Foreign subsidiary, located within EU

10.2.G parent company

Foreign intermediate holding company in tax-friendly environment