Introductory statement for public hearing

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"Case studies on member states national tax policies – the Netherlands: implemented national tax reforms and the combat against aggressive tax schemes"

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Summary

Dutch tax reforms provide an interesting case study. Over the past ten years, the Netherlands has taken many measures to address aggressive tax schemes. Key elements of the Dutch tax system that facilitated tax avoidance have been reformed, in part through EU Directives. The reforms reduced opportunities for tax avoidance, but not all measures were equally effective. The overall impact is difficult to assess. A lesson is that more uniform implementation of EU Directives may generate more impact and less complexity.

Overview

Historically, multinationals have used Dutch tax rules to avoid corporate tax on a large scale. Aggressive tax schemes were set up by foreign firms as well as Dutch firms.[1] Some opportunities for tax avoidance resulted from the international orientation of the Dutch tax system. Others were created on purpose.[2]

The Netherlands has changed course and undertaken reforms against aggressive tax schemes. Key measures include amending tax treaties, neutralising international mismatches, and introducing a conditional withholding tax on interest and royalties.[3] Moreover, the Netherlands currently has higher standards for tax rulings than other EU countries. It does not provide advance certainty for transactions with low-tax jurisdictions and publishes anonymized summaries.[4]

The overall impact is difficult to assess. Effects are not clearly visible in aggregate statistics and comprehensive data on individual companies is lacking. Moreover, it is hard to attribute impacts to reforms in one country, because many countries changed their tax rules. I will now zoom in on two Dutch reforms: the Controlled Foreign Corporation (CFC) rule and rules against international mismatches.

Controlled Foreign Corporation (CFC) rule against low-taxed foreign profits

The Netherlands introduced a CFC rule in 2019. CFC rules discourage profit shifting to low-taxed foreign subsidiaries and branches of a multinational. This measure targets Dutch firms that park profits in low-tax jurisdictions and foreign firms that own subsidiaries in low-tax jurisdictions via a Dutch holding.

It was introduced as a result of the first EU Anti-Tax Avoidance Directive (ATAD1). ATAD1 gives member states a choice between two types of CFC rules. The Netherlands already complied with type B, which basically

[1] See e.g. A. Lejour (2020). De Last van Onbelaste Winsten: Belastingontwijking in en door Nederland [*The burden of untaxed profits: tax avoidance in and through the Netherlands*]. Inaugural speech (link)
[2] For example the low-tax schemes enabled by the Dutch group financing activities regime that existed until 2011.
[3] See Advisory committee on conduit companies (2021). The road to acceptable conduit activities (link); Advisory committee on taxation of multinationals (2020). Op weg naar balans in de vennootschapsbelasting [*Striking a balance in corporate income tax*] (link)
[4] These summaries are available on two webpages, see link and link

means applying the latest transfer pricing standards to transactions with low-taxed entities. Type A, which forms the basis for the new Dutch CFC rule, mechanically includes certain low-taxed profits of foreign subsidiaries in the tax base of the parent company. This has the effect of topping up low foreign taxes to the domestic rate. Unlike type B, type A also helps to protect the tax base of other countries.

The Netherlands made two choices that severely limit the impact of its CFC rule. First, the Netherlands deviates from type A by looking at statutory tax rates instead of effective tax rates. Second, it exempts all low-tax foreign subsidiaries with payroll costs of at least 100.000 euro and a permanent office space.[5] This strongly reduces the scope of the rule. Other countries do not use such fixed thresholds; five member states do not apply any substance escape to subsidiaries outside the EU/EEA.[6] Overall, ATAD1 had been implemented in highly diverging ways. Only 16 member states have type A CFC rule. Twelve exclude subsidiaries with mainly active income, and seven exclude subsidiaries with low accounting profits or low profit margins.

By contrast, the Netherlands implements the interest limitation rule in a relatively strict way. That rule is another element of ATAD1 allowing many choices. The Netherlands adopted it without a so-called group escape, an exemption for standalone entities or an exemption for existing loans. Moreover, the Netherlands recently lowered the maximum ratio for allowable deductions to 20% of EBITDA, compared to 30% in most other countries.

International mismatches resulting in untaxed profits

Implementation of the second Anti-Tax Avoidance Directive (ATAD2) closed key tax avoidance routes via the Netherlands. Many firms used Dutch entities to created so-called hybrid mismatches, resulting in untaxed profits. These aggressive schemes have been effectively addressed, in part by ATAD2, which has been implemented more uniformly.[7] Dutch tax rules still enabled another type of mismatches, though, involving unilateral transfer pricing adjustments. Multinationals therefore continued to create new mismatch schemes.[8] This limited the impact of ATAD2.

Addressing other mismatches facilitated by the Dutch tax system required additional legislation. Since this year, the Netherlands no longer allows unilateral downward transfer pricing adjustments.[9] Closing this alternative tax avoidance route has been an important complement to ATAD2 and increased the overall impact of the reforms.

Conclusion

This shows that EU Directives and national reforms against tax avoidance interact in different ways. Leaving key choices to member states can lead to large differences in implementation, reducing effectiveness and increasing complexity. Implementation by the Netherlands shows a mixed picture. At the same time, the impact of EU legislation depends on specific national reforms that need to complement it. The Netherlands has already undertaken various such reforms.

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[5] For further background, see Report of the Ministry of Finance, 26 Oct 2018 (link)
[6] Report from the Commission on the implementation of ATAD1, 19 Aug 2020 (link)
[7] PwC, ATAD I and II implementation overview, July 2021 (link)
[8] These transfer pricing mismatches involve so-called informal capital situations with an international component. In 2016, 157 such situations were identified from tax returns. In 2017 and 2018, 13 rulings were provided for new situations. This increased to 6 in first half of 2019, before the reform of the tax ruling practice took effect. Ministry of Finance (1 Jul 2020). Answers to questions from parliament (link)
[9] Wet tegengaan mismatches bij toepassing zakelijkheidsbeginsel [*Law against mismatches in application of the arm's length principle*] (link). The new rule also applies to tax schemes resulting from mismatches in transactions that took place between mid-2019 and end-2021.