Dutch implementation proposal on EU anti-hybrid measures

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On July 2, 2019, the Dutch government published the legislative proposal implementing the EU Anti-Tax Avoidance Directive II (ATAD II) that was adopted on May 29, 2017. The ATAD II mandates EU Member States to implement rules that target hybrid mismatches by January 1, 2020 (specific sections by January 1, 2022).

With the implementation of ATAD II, the Dutch government will resolve the 2018 Decrees, which allows taxpayers to claim certain tax saving benefits under the United States - Netherlands tax treaty (US-NL Treaty) for CV/BV structures, dividend distributions from a Dutch entity - which is held by a reverse hybrid CV - to the US, will become subject to Dutch dividend withholding tax, unless a domestic withholding tax exemption is applied.

The final version of the legislative proposal differs slightly from the legislative proposal that was circulated for public consultation. For the legislative proposal circulated for public consultation, we refer to our previous Tax Alert.

General Principles of ATAD II

Under the legislative proposal, the Dutch tax effects of certain structures must be neutralized. The Dutch tax effect is the result of i) a mismatch outcome (a deduction/inclusion outcome (D/NI) or a double deduction outcome (DD)), or ii) caused by a hybrid mismatch element, such as the difference in tax treatment or qualification of financial instruments, legal entities or permanent establishments.

Primary and Defensive Rules for Mismatch Outcomes

The ATAD II deals with a number of specific situations that lead to a D/NI outcome:
- Payments made under hybrid financial instruments;
- Payments made to a hybrid entity;
- Branch mismatches;
- Payments made to a disregarded permanent establishment;
- Payments made by a hybrid entity;
- Dividend payments between a head office and a permanent establishment or between two or more permanent establishments.

Any D/NI outcome that results from one of the hybrid mismatches listed above is subject to a primary rule. If the primary rule does not apply because, for example, the state of residence of the payor does not have anti-hybrid rules (the "defensive rule"). The primary rule and the defensive rule function as follows:

- Primary rule: Where there is a D/NI outcome caused by one of the defined hybrid mismatches, the state of residence of the payor should deny the deduction.
- Defensive rule: Where there is a D/NI outcome caused by one of the defined hybrid mismatches, the state of residence of the recipient should include the income in its taxable base if the state of residence of the payor has not denied the deduction.

In contrast to the D/NI situations described above, the ATAD II and the Dutch implementation thereof does not list specific categories of DD situations. Any DD situation giving rise to a DD outcome is therefore covered by these rules. If, for example, there is an actual hybrid mismatch, any (imputed) deduction also falls under the scope of the anti-hybrid rules.

Similar situations giving rise to a DD outcome, any DD outcome is subject to a primary rule or, if the primary rule does not apply because, for example, the state of residence of the investor does not have anti-hybrid rules, a defensive rule. The primary rule and the defensive rule function as follows:

- Primary rule: Where there is a DD outcome, the state of residence of the investor should deny the deduction.
- Defensive rule: Where there is a DD outcome, the state of residence of the investor should deny the deduction if the state of residence of the investor has not denied the deduction.

There are a number of exceptions to these rules. These exceptions relate to the non-inclusions at the level of the recipient of the income, transfer pricing corrections and inclusions under Controlled Foreign Company (CFC) rules.

Nature of the non-inclusion

The anti-hybrid rules are not intended to target non-inclusion outcomes that arise from a different mechanism other than a hybrid mismatch. According to the explanatory memorandum to the legislative proposal, the hybrid mismatch rules do not apply if the income is not included in the taxable base of the state of residence of the recipient because the recipient of the income is exempt there. This guidance is in line with the recommendations in the OECD BEPS Action 2 Report.

Transfer pricing corrections

Similar to situations due to non-inclusion, mismatch outcomes arising solely from differences in the transfer pricing (transfer pricing corrections) do not fall within the scope of the anti-hybrid rules.

Inclusion under CFC rules

Unless certain conditions, inclusion of income under CFC rules may be deemed to be sufficient inclusion so as to not result in D/NI outcomes. The Explanatory Memorandum notes that the income is sufficiently taxed if the income is fully included under the laws of the relevant jurisdiction and is subject to tax at the full statutory rate (which is in line with the recommendations in the OECD BEPS Action 2 Report). Explicit reference is made to US CFC regime that does not qualify for full CFC regime treatment.

Imported Mismatches

Imported mismatches, where the hybrid mismatch occurs at a different level, are also targeted by the proposed anti-hybrid rules. For example, there is a hybrid financial instrument between C Co and B Co, and not between the BV and the B Co. Under the proposed rules, if State B does not deny deduction on the hybrid financial instrument and there is a "nuisance" between the payments under both financial instruments, the Netherlands will deny the interest paid on the non-hybrid loan.
The fact that payments are of an equal amount does not necessarily mean there is a nexus between the payments. However, back-to-back loans involving a hybrid financial instrument likely qualify as imported mismatches.

The above is an example of a direct imported mismatch. If the hybrid mismatch occurs further up the chain (if it takes place more than one level above the Netherlands), there may be an indirect imported mismatch, which is also caught by the proposed rules.

Reverse Hybrid-Specific Rule & Impact on CV/BV Structures

Pursuant to the ATAD II (and the Dutch implementation proposal), reverse hybrid entities will become subject to corporate income tax as of January 1, 2022 if there is a hybrid mismatch. CVs will fall under these rules.

Specifically, as of January 1, 2020, payments made to a reverse hybrid CV will no longer be deductible in the Netherlands. As of January 1, 2022, the reverse hybrid CVs will become subject to Dutch corporate income tax.

Due to the revocation of the 2005 Decree, dividends distributed will be subject to 15% Dutch dividend withholding tax as of January 1, 2020, as the Dutch domestic dividend withholding exemption will not apply in reverse hybrid structures.

Exception for collective investment vehicles

In contrast to the draft circulated for public consultation, the Netherlands has decided to implement the exception to the reverse hybrid rule for collective investment vehicles allowed by the ATAD II.

Administrative Requirements

The Explanatory Memorandum to the legislative proposal also notes that Dutch corporate taxpayers will need documentation substantiating the fact that there are no hybrid mismatches if they take this position in their annual corporate income tax return.

If that position is taken, taxpayers must have documentation substantiating the application of the hybrid mismatch rules. Examples of such documentation include worldwide structure charts, a tax analysis of the financial instruments, hybrid entities, or permanent establishments on the basis of Dutch tax law and the tax law of the other jurisdiction. A substantiated calculation of the extent of hybrid mismatch and the correct application of the hybrid mismatch rules are expected to be included.

Timing

The legislative proposal was published by the Dutch government on July 2, 2019. Now, the proposal will be discussed by the Dutch House of Representatives’ Finance Committee, after which it is voted upon in the House of Representatives. If the Dutch House of Representatives approves the bill, the bill will then go to the Finance Committee of the Dutch Senate, after which it will be sent to the Senate floor for a full vote. The Dutch House of Representatives can amend the draft bill, but the Dutch Senate cannot. If the Dutch Senate approves the bill, it will be signed by the King and the responsible minister (the Minister of Finance) in order to become law.

As also noted above, the law is expected to enter into force on January 1, 2020 (and a part is expected to enter into force on January 1, 2022).

Concluding Remarks

The Dutch government has announced its intention to find ways to keep the Dutch investment climate attractive, while also meeting its obligations under EU law. In this regard, the Dutch Ministry of Finance will meet with different organizations and will hold expert meetings to determine how to keep the Dutch investment climate attractive while combating so-called letterbox companies.

In addition, the Dutch government mentions in the Explanatory Memorandum that the rules for tax transparency will be reviewed in the future. As such, these rules may be amended in order to create fewer (unintentional) hybrid mismatches.

The Dutch government is also expected to publish a legislative proposal proposing a conditional withholding tax on interest and royalties paid to tax jurisdictions in certain abusive situations; this is not yet clear how the abusive situations will be defined other than a situation with an intermediate holding company that lacks substance and is interposed in order to avoid having to pay the conditionality withholding tax.

Please contact the authors if you have any questions concerning the above.

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