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Global Tax Alert

Netherlands issues Q&A notes as part of legislative process for mandatory disclosure regime

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Executive summary

The Dutch Government published, on 18 October 2019, further clarifications on the formal draft legislation, issued on 12 July 2019,[1] to implement the European Union (EU) Directive on the mandatory disclosure and exchange of cross-border tax arrangements (referred to as DAC6 or the Directive). Under DAC6, taxpayers and intermediaries are required to report cross-border reportable arrangements from 1 July 2020. However, reports will retrospectively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020.[2]

The Dutch draft legislation is currently subject to the formal legislative process, including debate in Parliament, and is likely to be amended before final enactment. Clarifications are provided in a question and answer (Q&A notes) type format that address questions raised by political parties in the House of Representatives and answered by the Dutch Secretary of State for Finance. It also contains some answers to questions from the Dutch association of tax advisors (NOB – acronym in Dutch). In summary, the newly issued Q&A notes provide clarity on the interpretation of the Dutch Mandatory Disclosure Rules (MDR) legislation and how the Dutch Government anticipates the reporting process to operate.

Key highlights of the newly issued Q&A notes are summarized below.

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Key highlights

Reportable arrangements

- The Q&A notes provide some corrections to the explanatory notes which accompanied the formal draft legislation issued in July 2019.
- It is now corrected and explicitly stated that all three triggering events for reporting apply to both marketable and bespoke arrangements. In the previously published explanatory notes, only the reporting triggering event of "made available for implementation" (the equivalent of Article 8ab(1)(a) of the Directive) was stated as applying to marketable arrangements. For bespoke arrangements, only the reporting triggering events of "ready for implementation" and "when the first step in the implementation (…) has been made" were stated as applying (the equivalent of Article 8ab(1)(b) and (c) of the Directive).
- It is now corrected and explicitly stated that an arrangement is "ready for implementation" when it **can** be implemented. Previously, it was assumed that an arrangement is "ready for implementation" if one or more specific relevant taxpayers (who will participate in the implementation) are identified and an agreement has been reached that this arrangement **will** be implemented. The Q&A notes clarify that the triggering event is now met when a cross-border arrangement is designed for and focused on a specific relevant taxpayer (and the reportable arrangement is capable of being implemented). This means that the reporting triggering events: "ready for implementation" and "made available for implementation" can occur before it is agreed with the relevant taxpayer that the arrangement will be implemented. Furthermore, the Q&A notes clarify that the term "do not reach the finish line" used in the explanatory notes means that only specific and detailed advice – and not all ideas that are briefly discussed as potential scenarios to solve a specific case – might trigger a reporting obligation.
- In the case of a marketable arrangement, the provision of information shall take place in phases. Due to the character of marketable arrangements, it will often not be possible to provide all the necessary information on a reportable arrangement at the time of the report (e.g., the details of the relevant taxpayer are not yet known). However, in the case of a bespoke arrangement, the relevant information must be provided at once.
- The Q&A notes confirm that there will neither be a "white list" of reportable cross-border arrangements that ultimately do not need to be reported, nor will there be a list of "negative hallmarks" produced (i.e., features of cross-border arrangements which do not present a potential risk of tax avoidance).
- In relation to what should be considered a "new" reportable cross-border arrangement, it is noted that any changes that trigger a new hallmark (compared to the initial hallmark triggered) results in a new reportable cross-border arrangement. If no new hallmark is triggered, which will likely be the case if an interest rate [regarding a loan agreement] is changed, it will not have to be reported.

Intermediaries

The definition of intermediaries is further clarified for in-house tax advisors of a relevant taxpayer.

In general, entities employing in-house tax advisors (in-house tax teams) that provide tax services to affiliated entities in relation to a cross-border arrangements to which they are not a party qualify as an intermediary (provided that all other MDR conditions are met).

An example to illustrate this concerns a multinational group with subsidiaries in several non-EU countries, that employs 200 in-house tax advisors who are involved in the creation and implementation of reportable cross-border arrangements of the group. Those 200 in-house tax advisors are employed by a separate group company that only provides tax services, but this group company is not a party to any of the reportable cross-border arrangements of the group. In that case, the group company employing the 200 in-house tax advisors should be regarded as the intermediary in relation to such reportable arrangements.

The same conclusion applies to a "private equity firm" with a separate entity employing in-house tax advisors that provides tax services to funds or subsidiaries of these funds (provided that this separate advising entity is not itself party to the reportable cross-border arrangement). Depending on the facts and circumstances, it can be the case that the related entity to which the in-house tax advisor provides its services, qualifies as a relevant taxpayer.

Lastly, it is explicitly clarified that an individual in-house tax advisor cannot qualify as an intermediary itself.

In relation to the question as to which (legal) person qualifies as the intermediary, it is noted as a rule of thumb that the relevant criterion is whether someone is acting on their own behalf, or on behalf of an organization/entity. For example, when a partner of a tax advisory firm provides advice in respect of a reportable cross-border arrangement in the name of this firm, this firm (and not the individual partner) will qualify as the intermediary.

An intermediary has no obligation to further investigate his reporting responsibility beyond advising about the arrangement based on the information available to him.

The definition of intermediaries is further clarified for the service provider type of intermediary (referred to as the "auxiliary intermediaries"). There is a reporting obligation for an auxiliary intermediary if, based on the information available and the expertise and understanding necessary to provide the respective services, this person knows or should reasonably have known that he/she has (directly or through other persons) committed to provide aid, assistance or advice. This knowledge threshold should be examined on an individual level, instead of at the level of the organization where the person works.

The Q&A notes indicate that an (auxiliary) intermediary cannot be a "participant" for the purposes of defining a cross-border arrangement. This statement is provided as a response to a NOB question regarding the following scenario: the relevant taxpayer resides in Belgium and the **only** cross-border element of the arrangement is that the (auxiliary) intermediary, or one of the (auxiliary) intermediaries, is established in the Netherlands.

The Q&A notes also provide some (non-exhaustive) examples of tax related work that does not result in the person undertaking that work qualifying as an (auxiliary) intermediary: tax audits, due diligence and drafting a "tax fact book." If, however, restructuring advice is given, in relation to these activities for example, then a reportable cross-border arrangement could still arise.

Relevant taxpayer

Further to the above clarification regarding in-house tax advisors, a question was raised to clarify the concept of relevant taxpayer to which the following illustrative example is provided:

> A tax advisory firm provides tax advice to an in-house tax advisor who is employed by group entity X of parent company A in respect of a reportable cross-border transaction for the benefit of group entity Y of parent company A. The tax advisory firm and the in-house tax advisor agreed that the advice was provided to the latter. It is stated that in this case, the relevant taxpayer is group entity Y, and not group entity X to whom the advice was provided. The reasoning is that only the entity that is affected by the arrangement, or who is a "subject" of the arrangement or the "user" of it qualifies as the relevant taxpayer. That means that, depending on the specific facts, parent company A can also qualify as the relevant taxpayer.
>
> If in a loaned-staff situation (i.e., an individual from a tax advisory firm is employed (temporarily) at the client's premises), it depends on the circumstances by whom (e.g., client or tax advisory firm) the individual is being managed. In the case that the individual is managed by the tax advisory firm, then this firm as intermediary has the obligation to file a reportable cross-border arrangement. When managed by the client, then it is the client as the relevant taxpayer who has the obligation to file a reportable cross-border arrangement. The substance of the situation and not the form of the situation is to be followed in these cases.

Hallmarks A-E of the Directive

In relation to hallmarks A-E included in DAC6 and the Dutch explanatory notes, the Q&A notes include minor additional clarifications.

Category B hallmarks

Hallmark B2 covers the conversion of income into capital, gifts or other categories of revenue which are taxed at a lower level or are exempt from tax. In this regard, a specific example of so-called switching from one "box" to another "box" in the Dutch *Personal Income Tax Act 2001* is said to be caught, because in this specific example income is "converted," resulting in a beneficial tax treatment. Nothing is stated in general about the conversion concept with respect to hallmark B2.

Category C hallmarks

The category C hallmarks cover specific hallmarks related to cross-border transactions.

It is clarified that payments as mentioned in hallmark C also cover "non-existing" payments that only have a tax effect (which are not reflected in commercial figures). An example is imputed interest, i.e., a tax deductible arm's length compensation as a result of an interest free loan from a parent entity to its subsidiary.

A minor clarification regarding the concept of "recipient" in respect of hallmark C1 is provided. If the person behind a (transparent) body (i.e., shareholders, participants) is directly and immediately taxed in respect of the payment, this person can be regarded as the recipient. However, this will not necessarily be the case if there are differences in whether the entity is treated as transparent or opaque in different jurisdictions. Therefore, this always needs to be assessed on a case-by-case basis.

With respect to hallmark C4 (arrangements that include the transfers of assets, where there is a material difference in the amount being treated as payable in consideration for the assets in those jurisdictions involved), it was clarified that, in the case of a transfer of assets between a head office and a permanent establishment, this hallmark will also apply if one party does not recognize the transfer. For the sake of completeness, this was already clear for the situation where the two respective countries recognize the transfer, but for a different tax value.

Category D hallmarks

Hallmark D1 captures arrangements which may have the effect of undermining the automatic exchange of financial account information. The Q&A notes indicate that in the event of a reorganization aimed at achieving a business objective that is not related to the exchange of information, this does not qualify as undermining the hallmark D1 reporting obligation. Furthermore, opening a bank account as part of such a reorganization with business rationale does not undermine the CRS reporting obligation and therefore does not trigger hallmark D1.

Category E hallmarks

The following example is given for unilateral safe harbors (hallmark E1): an entity in country X provides a loan to a Dutch group company with an arm's-length interest rate of 5%, (noting that under regulations in country X, the interest rate on inter-company loans is always considered to be at arm's length if this percentage is higher than 4% (safe harbor)). It is clarified that if the interest rate of 5% is at an arm's-length rate and that fact is supported by a transfer pricing study, the arrangement is not regarded as involving the use of a unilateral safe harbor rule such that hallmark E1 is not met.

It was also confirmed that the Dutch Tax Authority will follow the guidelines for "hard to value intangibles" set out in Chapter VI, paragraph D.4 of the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines in the cases of hard to value intangibles and this may, depending on the size of the transaction and the available capacity, lead to further questions for the taxpayer.

Regarding hallmark E3, (arrangements involving intragroup cross-border transfers of functions/risks/assets with significant earnings before interest and taxes (EBIT) impact), the Q&A notes provide no clarification on what should be considered as "EBIT." However, it is specifically mentioned that it should be the EBIT for commercial purposes and not for tax purposes. Also, the EBIT test must take place at a single entity level (and for example not as part of the fiscal unity/consolidated tax filing). Furthermore, transfers of subsidiaries within a group could fall within the scope of hallmark E3.

Main benefit test

The Dutch interpretation of the scope of the main benefit test (MBT) was criticized by academics (i.e., for being too narrow) after the publication of the draft explanatory notes of 12 July 2019. The Q&A notes clarify that the MBT should not be viewed as being met solely in situations where the (series of) arrangement(s) is(are) artificial in nature.

Based on the Dutch interpretation, the MBT is met in case of an arrangement or series of arrangements with an artificial character (or in any case partially artificial) that (at least partly) aims at obtaining a tax benefit. However, if there are valid business reasons for an arrangement, and no artificial elements are added, then it is assumed that the arrangement does not have the aim to obtain a tax benefit. As such, in cases where valid business reasons exist, it is important to determine whether the tax benefit is obtained by adding artificial elements or whether the tax benefit follows from the specific arrangement. In the latter case, the MBT is not considered to be met. Following this interpretation an amendment was granted on 14 November 2019 stating that the artificiality of the arrangement may be an indication of the MBT being met but is not a necessary condition. An important consequence of this amendment is that an intermediary or a relevant taxpayer cannot take the view that reporting of an otherwise reportable arrangement can be omitted because the arrangement does not contain an artificial element.

It was explicitly asked whether an arrangement involving the prevention of double taxation does not trigger the MBT. This has not been confirmed "in general," because it entirely depends on the nature of the double taxation being prevented (economic or legal) and the context of the case.

Reporting deadlines

In addition to the Q&A notes, a draft general administrative order was published by the Dutch Government on 31 October 2019 with more clarification on the reporting deadlines for auxiliary intermediaries. There are two categories of reporting triggering events which apply to auxiliary intermediaries:

I) The "main rule" in accordance with Article 8ab, Paragraph 1 of the Directive that applies to all intermediaries and requires a report to be made within 30 days on the earliest of: (a) the day after the reportable cross-border arrangement is made available for implementation; or (b) the day after the reportable cross-border arrangement is ready for implementation; or (c) when the first step (…) has been made.

II) An additional rule (as stated in the last sentence of Article 8ab, Paragraph 1 of the Directive) whereby auxiliary intermediaries are required to report within 30 days beginning on the day after they provided, directly or by means of other persons, aid, assistance or advice.

The administrative order indicates that, in practice, the additional rule is expected to be particularly relevant to situations where the auxiliary intermediary is involved in providing aid, assistance or advice after a reporting obligation has already been triggered for the general intermediary under the main rule. For example, in the context of services provided in relation to managing the implementation of an arrangement, the auxiliary intermediary may not provide aid, assistance or advice until after the arrangement has already triggered an earlier reporting obligation. If there is proof that a filing has already been made by a general intermediary, the auxiliary intermediary may be able to rely on this to exempt his own reporting obligation. Lastly, it is also clarified that in principle an auxiliary intermediary is not meant to have a reporting obligation earlier than the general intermediary.

Penalties

The Q&A notes clarify that a penalty will not be imposed where an arrangement should have been reported but it was "defendable" not to report a cross-border arrangement. The term "defendable" is not defined in legislation but derives from Dutch case law. Consequently, the "defendable" threshold depends on the relevant facts and circumstances of the case. Lastly, it was noted that the Government will not generally seek to impose penalties relating to the reporting obligations in the transition period.

A reason that might result in imposing penalties is the over-reporting of arrangements that are clearly not reportable under DAC6.

Next Steps

Determining if there is a reportable cross-border arrangement raises complex technical and procedural issues for taxpayers and intermediaries. Taxpayers and intermediaries who have operations in the Netherlands should review their policies and strategies for logging and reporting tax arrangements so that they are fully prepared for meeting these obligations.

Endnotes

1. See EY Global Tax Alert, *The Netherlands publishes draft proposal on Mandatory Disclosure Rules*, dated 26 July 2019.
2. See EY Global Tax Alert, *EU publishes Directive on new mandatory transparency rules for intermediaries and taxpayers*, dated 5 June 2018.

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