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Our reference

Your letter (reference)

Date

Re: Cabinet response Committee on Conduit companies

Dear President,

On 12 February 2021, I informed your House of representatives (House) about the establishment of the Committee on Conduit Companies (the Committee), chaired by Bernard Ter Haar. The committee has completed its investigation. I hereby present the report "The road to acceptable conduit activities" to your House, together with this government response. The committee investigated the activities of conduit companies, popularly known as letterbox companies. In the report, the committee discusses the phenomenon of conduit companies in a broad sense, including the nature, extent and cause of this phenomenon. In particular, it focuses on three main topics: the role of tax factors on the presence of conduit companies, the role of non-tax factors on it and the link between tax avoidance and money laundering. The latter is the investigation requested in the Snels/Groots motion.¹

The fight against tax avoidance is an important spearhead for this government. During this government's term of office, the government has shown, with a large number of measures against tax avoidance, that tackling tax avoidance is high on the agenda. Many of these measures have already entered into force or will do so in the near future. These measures, which are primarily aimed at combating tax avoidance, also broaden the tax base and ensure more balanced taxation of multinationals. The Netherlands is leading the way internationally with the recently introduced withholding tax on interest and royalties and the yet to be implemented extension to dividends to low-tax jurisdictions. The list of low-tax jurisdictions used by the Netherlands is stricter than the European list of non-cooperative jurisdictions. Even with the tightening of the earnings stripping measure - in line with the Hermans motion² - the Netherlands is considerably stricter than surrounding countries in limiting interest deductions. In addition, the Netherlands is putting maximum effort into exchanging information with other countries and transparency. And because the extent to which tax avoidance can be combated nationally has its limits, it is clear that further agreements need to be made

¹ Parliamentary Papers II 2019/20, 31 477, no. 46.

² Parliamentary Papers II 2021/22, 35925, no. 13

internationally in order to combat undesired conduit activities and tax avoidance. The Cabinet therefore looks forward to the European Commission's announced proposal for a directive to combat abuse with conduit companies³. The Netherlands also remains actively committed to the implementation of the agreements resulting from the recent agreement of the Inclusive Framework (IF) of the OECD⁴ for a more modern international tax system and a global minimum tax. The Netherlands has an active role in the realisation of these agreements.

The report is a follow-up to the work of the Advisory Committee on the Taxation of Multinationals, also headed by Bernard ter Haar. This government contributes to a more balanced taxation of multinationals and has therefore already adopted many of the recommendations of this committee. In some parts with stricter implementation than necessary. For example, as of 1 January 2022, loss settlement in the corporate income tax is restricted. This creates a lower limit in corporate tax for companies with profitable activities in the Netherlands. In addition, the government submitted a separate bill to your House on Budget day 2021 to combat mismatches that arise when countries apply the arm's-length principle differently. As a result, part of the profits of a group of companies can no longer remain untaxed. This measure will prevent double non-taxation and will bring the Netherlands more in line internationally. The government is also conducting further research into structurally loss-making companies, the importance of royalties in avoidance structures and the differences between tax and commercial profit determination on the effective tax burden of multinationals. The government expects the results of these studies later this year.

The government greatly appreciates the work and recommendations of the committee's report. The committee notes that many measures have already been taken at the national level to prevent conduit activities for tax reasons and mentions a certain degree of 'policy stacking'. It is still unclear how effective these measures are. This is partly due to statistics lagging behind and partly to the fact that some of these measures have yet to enter into force. Also, international developments are accelerating, so that the effects of international agreements are still unclear. This combined uncertainty can, according to the committee, legitimise restraint in the recommendation for new measures, but can also offer an opportunity to send a clear signal from the Netherlands as an important conduit jurisdiction. Because of its caretaker status, it will be up to a subsequent government to assess the recommendations in the report and possibly translate them into policy. In this Cabinet response, the findings of the report are therefore only briefly explained and viewed in the light of the measures already taken by this government.

³ Communication from the Commission to the European Parliament and the Council on company taxation in the 21st century, COM (2021) 251 final.

⁴ For the OECD statement of 8 October 2021, please see: <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm>. In my letter of 15 October 2021, I informed your House of the outcome of the IF meeting on 8 October 2021 (Parliamentary Papers II 2021/22, 25087, no. 284).

Content of the report

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Definition and scope

Our reference

The committee has investigated the possible definition of a 'conduit company', but finds that there is no clear and conclusive definition of the concept that does justice to this phenomenon in all its aspects. Therefore, according to the committee, the assessment of the existence of a conduit company should be made on the basis of a number of characteristics. These characteristics include the presence of an international structure, transactions with affiliated parties, limited real presence in the Netherlands, the presence of tax, financial or legal motives and large international cash flows or balance sheet positions. If several of these characteristics are present, one can speak of a 'conduit' or a 'conduit company'⁵.

The Netherlands still has a large number of conduit companies. Based on data from De Nederlandsche Bank (DNB), the committee finds that there are approximately 12,400 conduit companies (in 2019) with a balance sheet total of approximately EUR 4,500 billion in the Netherlands. That amount is equivalent to 550 per cent of the gross domestic product (GDP) at that time. The interest, royalty and dividend payments flowing through these conduit companies annually amount to an average of EUR 170 billion in the period 2015-2019. The fact that a relatively large proportion of these payments flowed from the Netherlands to low-tax jurisdictions (LTJs), while the ultimate parent company is based in the United States (US), points to tax motives, according to the committee.

Compared to their size, the importance of conduit companies for the Dutch economy is limited, both in terms of employment and tax remittance. Direct employment is estimated at three to four thousand jobs. The corporate income tax payments of conduit companies are estimated at around EUR 650 million in 2019, which is 0.2 per cent of total tax revenues. The committee concludes that this is disproportionate to the negative effects of conduit companies on other countries and thus the reputation of the Netherlands. The committee finds it difficult to say exactly how much tax revenue governments miss out on because of the conduit activities through the Netherlands, but it is assumed that developing countries are extra sensitive to tax avoidance via the Dutch treaty network.

The government emphasises that these statistics are from 2019. The vast majority of the measures have been implemented in recent years or have yet to come into force. The coming years will show whether the desired effect of the measures is also reflected in the figures. The government expects that the downward trend of unwanted conduit activities has now started.

Tax factors

The committee describes the relevant parts of the Dutch tax system that, at least until recently, have made the Netherlands attractive for conduit companies. These include the participation exemption, the extensive treaty network, the absence of withholding tax on interest and royalties and the ruling practice. The report describes examples of unintended use of each of these aspects of the Dutch tax

⁵ The exact characteristics used by the committee can be found on p. 24 of the report.

system. In combination with the well-organised financial advice and service sector, this has, according to the committee, led to a sizeable financial conduit. The Committee believes that the measures already taken are expected to put an end to part of the tax-driven interest and royalty conduit activities. This does not mean that the Netherlands can be expected to structurally lose its position as a country of establishment for empty holding companies, even though the Dutch tax system is no longer unique compared to other countries. According to the committee, there will still be a large group of (nearly) empty conduit companies that use the Dutch tax infrastructure, whose contribution to the economy is small. The committee therefore recommends further steps, but at the same time sees that far-reaching unilateral measures are not an immediate solution. First and foremost, the committee recommends a proactive attitude and a pioneering role in respect of international and European initiatives. These include the revision of the international tax system within the OECD's Inclusive Framework and the forthcoming EU directive proposal on conduit companies.⁶ The Netherlands should, according to the committee, advocate measures that focus both on targeted information exchange and on limiting the benefits of the Interest and Royalties Directive⁷ and the Parent-Subsidiary Directive⁸.

The committee's recommendations are in line with the path taken by this government. Tackling tax evasion is a priority for this government. The Netherlands has not only repeatedly shown itself to be in favour of international agreements, but has also taken on a pioneering role internationally. For example, the government has implemented the EU directives ATAD1 and ATAD2 in a strict and robust manner. A major next step in the international fight against tax evasion is the recent global agreement on the revision of the international tax system.⁹ Nederland is pleased with the progress and will continue to be proactive and constructive in the further elaboration of this agreement. I have previously commented favourably on the forthcoming EU directive to deal with conduit companies.¹⁰ The government is awaiting the European Commission's proposal for a directive with great interest.

The government has also taken measures at the national level to prevent the Netherlands from being used for conduit activities. Among other things, the government has introduced a conditional withholding tax on interest and royalties. As of this year, this withholding tax ensures that the Netherlands will levy 25% withholding tax on interest and royalties from the Netherlands to low-tax jurisdictions (and in abusive situations). The government expects this measure to

⁶ Communication from the Commission to the European Parliament and the Council on company taxation in the 21st century, COM (2021) 251 final.

⁷ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (*OJ 2003 L 157*).

⁸ Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (*OJ 2011 L 345*).

⁹ For the OECD statement of 8 October 2021, please see: <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm>.

¹⁰ See Annex 3 to Parliamentary Papers II 2020/21, 21112, no. 3148 ('fiche: *Communication/Recommendation Taxation of Enterprises in the 21st Century*').

virtually eliminate interest and royalty conduit activities to low-tax countries. Indeed, this measure directly tackles conduit companies that are used to avoid tax. In addition, on 30 September last, your House adopted the Bill on the Introduction of Conditional Withholding Tax on Dividends.¹¹ From 2024 onwards, this law will also tax dividend flows that, under the existing legislation, can be distributed untaxed within a group to entities established in low-tax jurisdictions. Furthermore, the introduction of the Principal Purpose Test (PPT) prevents the improper use of the extensive Dutch treaty network. If obtaining treaty benefits is one of the main purposes of a structure or transaction, the PPT prevents a treaty partner of the Netherlands from unduly limiting its taxing rights. Undesirable conduit structures are thus restricted. The government will monitor the effects of the anti-tax avoidance measures as closely as possible and report to your House.¹²

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Two of the committee's recommendations are about expanding the spontaneous exchange of information with other tax authorities. In the government's response to the findings of the study into the participation exemption, which was sent to the Lower House on Budgetday 2020, it was announced that further research would be carried out into whether it would be possible to introduce an information exchange as of 2022 for conduit companies that use the participation exemption and do not meet the substance conditions included in that letter.¹³ Research by the government has shown that the delineation of situations in which the exchange of information would be desirable is complicated. Due to aspects of EU law, it is not possible to design the measure in such a way that it does not affect unforeseen cases with a real presence in the Netherlands. A proposed Dutch amendment to the information exchange will therefore be included in the broad consideration of the final proposal for a directive on conduit companies from the European Commission. That proposal is expected by the end of this year.

Non-tax factors

The committee also identifies non-tax factors that contribute to the presence of conduit companies in the Netherlands. The flexible business law, legal services, good infrastructure and international orientation also play a role in establishing holding and finance companies in the Netherlands. The committee does not make recommendations in the area of company law because it does not consider its flexibility to be undesirable (per se) and possible measures could also affect bona fide companies. The Committee advises the government to work at the multilateral level to exclude conduit companies from investment protection agreements. Should this fail, the committee recommends renegotiating existing investment protection agreements. The committee makes two further recommendations in the area of accounting law. These relate to more extensive reporting requirements that should prevent conduit companies from making use of the exemptions intended for SMEs. It is a matter for a subsequent government to assess these recommendations.

¹¹ Parliamentary Papers II 2020-2021, 35779, no. 2.

¹² For a detailed description of how the effects of the measures will be monitored, please refer to the letter 'Monitoring the effects of the approach to tax avoidance' (Parliamentary Papers II 2019-2020, 25087, no. 259).

¹³ Parliamentary Papers II 2020/21, 31066, no. 699, p.9.

Money laundering

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In the report, the committee points out that elements related to or resulting from the Dutch tax and investment climate can attract criminal money flows and increase the risk of money laundering. The practice of conduit activities through companies makes our financial system vulnerable to use for money laundering or terrorist financing. The Committee also notes that the very existence of financial flows through conduit companies and the reliable reputation of the Netherlands can act as a cover. The use of structures with companies in different countries makes it difficult to trace the origin of the funds. At the same time, the committee notes that many measures have already been and are being taken in the Netherlands to prevent and combat money laundering and the financing of terrorism. The committee still sees scope for tightening up on service providers and for preventing the abuse of legal entities that can be used for concealment.

The committee makes a number of recommendations for additional policy measures. Some of these are already part of ongoing measures by the government. Three recommendations concern monitoring and detection. Firstly, this concerns addressing the capacity for tackling illegal trust services. The government endorses this. Recently, the Minister of Finance announced additional measures in response to an investigation into illegal trust services in the Netherlands, including entering into discussions with the Wwft Supervision Office and DNB about supervisory capacity.¹⁴ Secondly, the committee recommends that a follow-up study into the relationship between conduit companies, money laundering and tax evasion be carried out by the Financial Expertise Centre (FEC). The government supports this recommendation for a more in-depth study and includes it in the ongoing discussions with the partners to the FEC. Thirdly, the committee recommends that international cooperation should be used to tackle criminal conduit activities. The government endorses this; it is an ongoing point of attention.

The committee makes a further three recommendations regarding the transparency of legal entities. The Committee recommends that the Netherlands advocate public UBO registers for legal entities in an international context. The government is already committed to this. For example, the Netherlands is actively working on new standards in the Financial Action Task Force (FATF) on the transparency of UBO data for legal entities and the prescription of UBO registers at global level. The committee also makes two proposals concerning the UBO register for legal entities in the Netherlands. Firstly, this concerns a further clarification in the event that an investigation into the UBO of a legal entity does not reveal an actual UBO, but a pseudo-UBO, the management board. The Cabinet wishes to consider this point in relation to the new European legislative proposals, which the European Commission presented last July. The rules surrounding the determination of UBOs originate from European legislation and any adjustments are best made in that context. Secondly, the committee advocates making of the UBO register easier to search. The current design of the UBO register strikes a balance between the public nature of UBO data on the one hand and the protection of UBOs' privacy on the other. This relationship was established after an extensive and careful legislative process. During that debate, amendments on additional safeguards for the protection of the privacy of

¹⁴ Parliamentary Papers II 2020/21, 32545, no. 144.

UBOs and motions on monitoring the effectiveness and privacy implications of the register were adopted.¹⁵ The Cabinet will monitor these aspects and inform the House about them one year and four years after their introduction. This is in 2023 and in 2026. This recommendation by the committee will be taken into account in this monitoring and information provision to the House of Representatives.

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¹⁵ Parliamentary Papers II 2019/20, 35179, no. 12.

Conclusion

Tackling tax avoidance and conduit companies with no real economic contribution is an important spearhead of this government. The Cabinet therefore thanks the members of the committee for the important work they have done in this field. In line with the Committee's advice, the Netherlands is currently taking a proactive attitude in international forums to take further steps in the revision of the international tax system. It is a matter for a subsequent Cabinet to assess the committee's recommendations and possibly translate them into policy. The Cabinet emphasises that in the further elaboration of measures it is important to test the implementation consequences for the relevant implementing organisations, such as the Dutch Tax Authorities.

Yours sincerely,

The State Secretary for Finance - Taxation and Tax Administration,

J.A. Vijlbrief

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