

Policy letter on tackling tax avoidance and tax evasion

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1. Background

The Netherlands is a trading nation with an open economy. Foreign markets are very important for Dutch businesses. Our tax system reflects our economy's international orientation. It aims to minimise any obstacles to operating abroad for Dutch businesses. This is shown, for example, by elements aimed – at least in part – at avoiding double taxation of corporate profits, such as the participation exemption (substantial holding exemption), which ensures that Dutch businesses can compete on an equal footing abroad, and the extensive network of tax treaties, which is designed to avoid double taxation. The Netherlands wants to create a favourable environment for nationally and internationally operating businesses, as this ensures a buoyant economy and quality jobs. For example, the certainty in advance that the Tax and Customs Administration provides on the tax consequences of investments strengthens the Dutch investment climate. The government is taking steps to ensure that the Netherlands remains attractive for businesses already established here and to persuade other businesses to invest here. In my tax policy agenda I will provide further details of the tax measures aimed at contributing to an attractive investment climate.

The downside of a tax system that takes account of multinationals is that it may also be susceptible to arrangements that erode the tax base. This can undermine tax compliance and damage the Netherlands' reputation and therefore the investment climate. That is why support for arrangements favourable to multinationals has shrunk in recent years. As far as tax evasion is concerned, there is little room for debate. Taxpayers who evade the law should be met with a robust response. But I also want to tackle tax avoidance. If businesses use international tax avoidance arrangements to defer taxation or circumvent it altogether, they will not be helping to fund the cost of general services, which is borne by individuals and businesses that do pay their

taxes normally and on time. This is unjust, especially since those who avoid taxes still benefit from tax-funded facilities and services – in the form of good infrastructure and well-educated employees, for example.

What are the government's plans?

The government wants to tackle tax evasion and tax avoidance. I see this as a policy priority. I am also keen to overturn the Netherlands' image as a country that makes it easy for multinationals to avoid taxation. This stubborn image undermines the investment climate.

Appropriate measures therefore need to be taken. In the case of international measures, such as combating excessive interest deduction and treaty abuse, the government will go beyond the minimum standard. Another good example of government policy is that we are going to tax dividend, interest and royalty flows to low-tax jurisdictions to prevent the Netherlands from being used primarily to erode the tax base of other countries. In addition, businesses will have to meet stricter requirements regarding their presence in the Netherlands before they can obtain certainty in advance.

Where does the Netherlands currently stand?

Tax avoidance can only be tackled effectively at international level. This is because unilateral measures merely shift the problem of international tax avoidance elsewhere. In recent years, the Netherlands has actively joined in efforts to combat national and international tax avoidance and tax evasion. The previous government was a committed participant in the Addressing Base Erosion & Profit Shifting (BEPS) Project, which the OECD carried out at the G20's request.¹ Within Europe, the Netherlands has played a leading role. During the Dutch Presidency of the European Union, the first Anti-Tax Avoidance Directive was agreed,² and a decision was taken to introduce a second Anti-Tax Avoidance Directive, which has since been adopted.³ In addition, various directives have been adopted to improve transparency, and the Netherlands is very diligent when it comes to exchanging information with other OECD and EU countries. For an illustration of the situation regarding the implementation of all international and European agreements, see the appendix to this letter.

How this letter is structured

The policy outlined in this letter largely builds on international, European and national initiatives during the previous government's term of office. The government not only fleshes them out, but in certain respects goes beyond what is required under international and EU agreements. The parliamentary committee on tax avoidance schemes, which was convened in 2017 and whose report was published on 5 July 2017, yielded valuable insights and helped to determine the policy

¹ For a detailed overview of the results, see the letter from my predecessor presenting an assessment of the outcome of the BEPS Project and the outlook for the Dutch tax climate for businesses, 5 October 2015, IZV/2015/657 M.

² Council Directive (EU) 2016/1164 of 12 July 2016, OJ L 193/1. A rectification of this directive was published on 31 August 2016, OJ L 234/26.

³ Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (OJ L 144/1).

set out in this letter. This letter also constitutes the government's response to the report by that parliamentary committee.

Government policy on combating tax avoidance and tax evasion comprises two pillars:

- **protection of the tax base (section 2);**
- **measures on transparency and integrity (section 3).**

In addition, the Netherlands will keep pushing for an international approach, though the government wants to continue determining the tax base at national level (section 4).

When incorporating the measures proposed in this letter into legislation, the consequences in terms of implementation will of course be taken into account. As soon as the measures have taken on more concrete form, feasibility tests will be carried out to determine what demands they would place on the Tax and Customs Administration in terms of staff and resources.

2. Protecting the tax base

Within the first pillar of my approach, I will take measures to protect the tax base in the Netherlands and in other countries. First, I will take measures aimed mainly at preventing erosion of the Dutch tax base (section 2.1). Second, I will take measures to prevent taxpayers being able to avoid taxation by exploiting hybrid mismatches between the tax systems in the Netherlands and other countries (section 2.2). Third, I will take measures to prevent the Netherlands being used for conduit activities or abuse of our treaty network (section 2.3). Finally, the Transfer Pricing Decree will be brought into line with the OECD Transfer Pricing Guidelines, as amended in the light of the BEPS Project (section 2.4)

2.1 Tackling the erosion of the Dutch tax base

To protect the Dutch tax base, the government will start implementing the first EU Anti-Tax Avoidance Directive (ATAD1) in 2019. In certain respects, the government will go beyond the minimum standard set in the directive. The government will also respond to developments that could potentially erode the Dutch tax base. This involves urgent reparatory measures, operative with retrospective effect, now that the Court of Justice of the European Union has given broader effect to certain elements of the corporate income tax consolidation regime (fiscal unity) than was intended.⁴

A) First EU Anti-Tax Avoidance Directive (ATAD1)

In the first half of 2018 the government will submit a bill implementing ATAD1. This directive requires member states to introduce the following corporation tax measures from 2019:

⁴ See Parliamentary Papers, House of Representatives, 2017/18, 34 323, no. 20 and <https://www.rijksoverheid.nl/actueel/nieuws/2017/10/25/aankondiging-van-enkele-spoedreparatiemaatregelen-in-de-wet-op-de-vennootschapsbelasting-1969-en-de-wet-op-de-dividendbelasting-1965-inzake-de-fiscale-eenheid>.

- a general interest limitation rule (earnings stripping rule);
- a measure preventing profits being taxed in low-tax countries by shifting it to a low-taxed subsidiary controlled by a parent company (controlled foreign company (CFC));
- exit taxation to prevent a taxpayer avoiding tax by for example moving assets or its place of residence to another country;
- a general anti-abuse rule (GAAR) to enable abusive tax practices to be tackled where there is no legislative measure to this effect.

The Netherlands already levies exit taxes and it also already has a general anti-abuse rule in the form of the doctrine of *fraus legis*. These measures will not be explained in more detail in this letter. The first two measures and the options chosen by the government are explained below.

General interest limitation rule (earnings stripping rule)

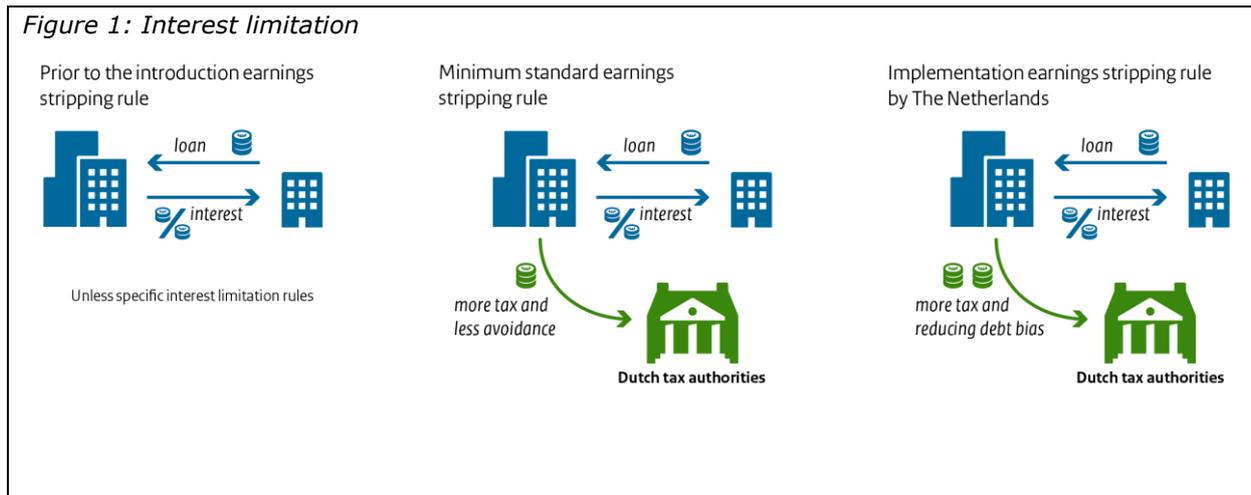
The interest paid by a business falls under operating costs, which are in principle deductible. As a rule, tax on interest income is paid by the recipient. In international groups in particular, this can lead to tax avoidance by structuring financial flows in such a way that interest paid is attributed to a group company in a high-tax country and interest received accrues to a group company in a low-tax country. ATAD1 creates a barrier against excessive interest payments on third-party and intra-group loans, and requires the introduction of an interest limitation rule in the form of an earnings stripping measure in order to combat tax base erosion.

The earnings stripping measure limits the deduction of net interest owed by a taxpayer on bank and intra-group loans. The deduction of the net interest owed is limited to a maximum of 30% of the gross operating result.⁵ In implementing this measure, the government is opting for a robust approach and will not only take action against tax base erosion but also seek more equal treatment of debt and equity for all corporation tax payers. The government will limit tax advantages of debt financing, thereby encouraging businesses to finance their activities from equity. This will create more stable companies and healthier economic conditions, especially in times of adversity.

For that reason, the government will not include a group exemption in the earnings stripping rule, although the EU directive allows it. This means that the Dutch earnings stripping measure will be stricter than the minimum standard in ATAD1. The proposed interest limitation rule will affect all taxpayers with too much debt, not only those financed with a relatively large amount of debt compared with the rest of the group. The interest limitation rule will be stricter than the minimum standard in ATAD1 because the threshold up to which net interest may always be deducted will be reduced from €3 million to €1 million. Finally, the proposed earnings stripping measure will take immediate effect. This means that no grandfathering rules will apply to existing loans. The difference between the current situation, the situation after implementing the minimum standard from ATAD1 and the situation created by the government's approach is illustrated below.

⁵ i.e. earnings before interest, taxes, depreciation and amortisation (EBITDA).

Figure 1: Interest limitation



The government wants the prevention of tax base erosion and the promotion of more equal treatment of debt and equity to apply to all sectors. That is why a minimum capital rule will be introduced for banks and insurers as from 2020. This will also implement the OECD's recommendation that each country should adopt an interest limitation rule specifically for banks and the insurance sector.⁶ The earnings stripping measure and the minimum capital rule together mean that the difference in the tax treatment of debt and equity will be reduced for all taxpayers. The House of Representatives has called for this several times.⁷

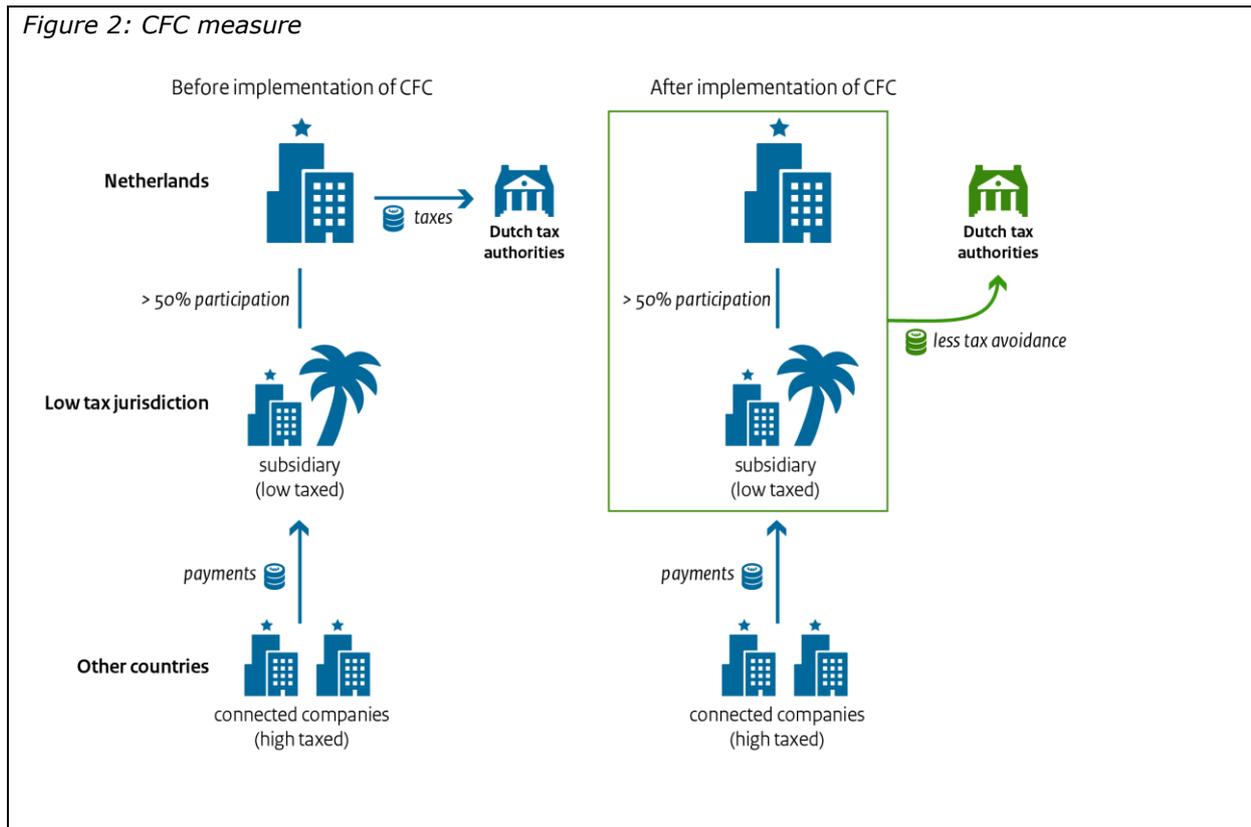
Tackling tax avoidance via controlled foreign companies (CFC measure)

If a taxpayer controls a low-taxed, foreign-based company (CFC), it is tempting to shift profits made with mobile assets to the CFC in the low-tax country in order to avoid taxation. ATAD1 requires implementation of a measure against low-taxed controlled foreign companies (CFC measure) in order to combat this form of tax avoidance. The following figure clarifies this.

⁶ OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2016 Update: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, Paris: OECD Publishing 2017.

⁷ Parliamentary Papers, House of Representatives, 2015/16, 34 300, no. 56 (Koolmees/Schouten motion), Parliamentary Papers, House of Representatives, 2015/16, 32 013, no. 121 (Koolmees/Nijboer motion) and Parliamentary Papers, House of Representatives, 2016/17, 25 087, no. 144 (Schouten/van Weyenberg motion).

Figure 2: CFC measure



The CFC measure set out in ATAD1 basically comprises three steps:

- The first step is to establish whether an entity is a CFC (step 1). This is the case if the Dutch taxpayer holds more than a 50% interest in the non-resident entity (step 1a: is the entity controlled?) and if the tax charged in the country where the CFC is established is less than half of the tax that would be charged in the Netherlands if it were established there (step 1b: is the entity low-taxed?). If the entity is a CFC, the taxpayer must include the CFC's undistributed profit, pro rata to its interest in the CFC, in the Dutch tax base.
- The second step is to determine how much of the CFC's income must be added to the Dutch tax base (step 2). ATAD1 offers member states two options for this purpose (model A or model B). Under model A the amount of income is determined on the basis of several specific categories of income (dividends, interest, financial leasing, royalties, etc.). Under model B the income is determined on the basis of the arm's length principle. This means that non-arm's length transactions within a group are adjusted as if they were transactions between independent parties. Because the Netherlands already applies the arm's length principle, further amendment of Dutch legislation is not strictly necessary for the Netherlands to fulfil its obligation for implementation in this regard.
- In model A, the third step involves checking whether the CFC carries on a 'substantive economic activity'. If it does, the CFC measure does not apply (step 3).

In implementing the CFC measure, the government wants to go further than is strictly necessary. In this regard, I will focus on tax avoidance through entities or permanent establishments in a country with a low statutory rate or a country on the EU list of non-cooperative countries. That is

why I have opted for model A.⁸ I am aware that this decision may raise questions about the impact on the participation exemption. I want to prevent any impact in respect of substantive activities. My aim is to tackle entities in the above-mentioned countries that do not carry on substantive economic activities. These are the cases targeted by this more far-reaching step. I will further define 'substantive economic activity' (step 3) and include it in the execution of step 1. A substantive economic activity will in any event be deemed to exist if the CFC satisfies the substance requirements introduced for the purposes of the dividend tax withholding exemption. They include a payroll of €100,000 and office space that is available for at least 24 months. This will meet as far as possible the concerns expressed by the business community during the online consultation. In addition, the government will consult the business community in order to establish a clearer picture of the administrative burden imposed by the government's decision and, if possible, further reduce it.

B) Urgent reparatory measures or the fiscal unity regime

To protect the Dutch tax base, the government earlier urgent reparatory measures regarding fiscal unities for corporate income tax purposes. This was in response to an opinion by the Advocate General at the Court of Justice of the European Union in two Dutch proceedings.⁹ Without these emergency urgent reparatory measures, multinationals would probably be able to erode the Dutch tax base relatively easily, leading to an estimated long-term loss of revenue of up to several hundred million euros per year. In addition, the level playing field between domestic companies and multinationals would be distorted to the detriment of domestic companies. The government is aware that the urgent reparatory measures may affect every existing fiscal unity and will have far-reaching consequences for the Tax and Customs Administration in terms of implementation. To protect the Dutch tax base, these measures with retrospective effect are unavoidable.

2.2 Tackling tax avoidance that exploits hybrid mismatches

Secondly, in order to counteract the erosion of the tax base, I will take measures to prevent taxpayers exploiting differences between tax jurisdictions in the characterisation of instruments or entities ('hybrid mismatches') in order to avoid tax in the Netherlands or another country. To this end the government will incorporate the second EU Anti-Tax Avoidance Directive into Dutch law in a timely manner and apply it from 1 January 2020.¹⁰ The government will also include a hybrid entity provision in treaties via the Multilateral Instrument (MLI) (see section 2.3).

Second EU Anti-Tax Avoidance Directive (ATAD2)

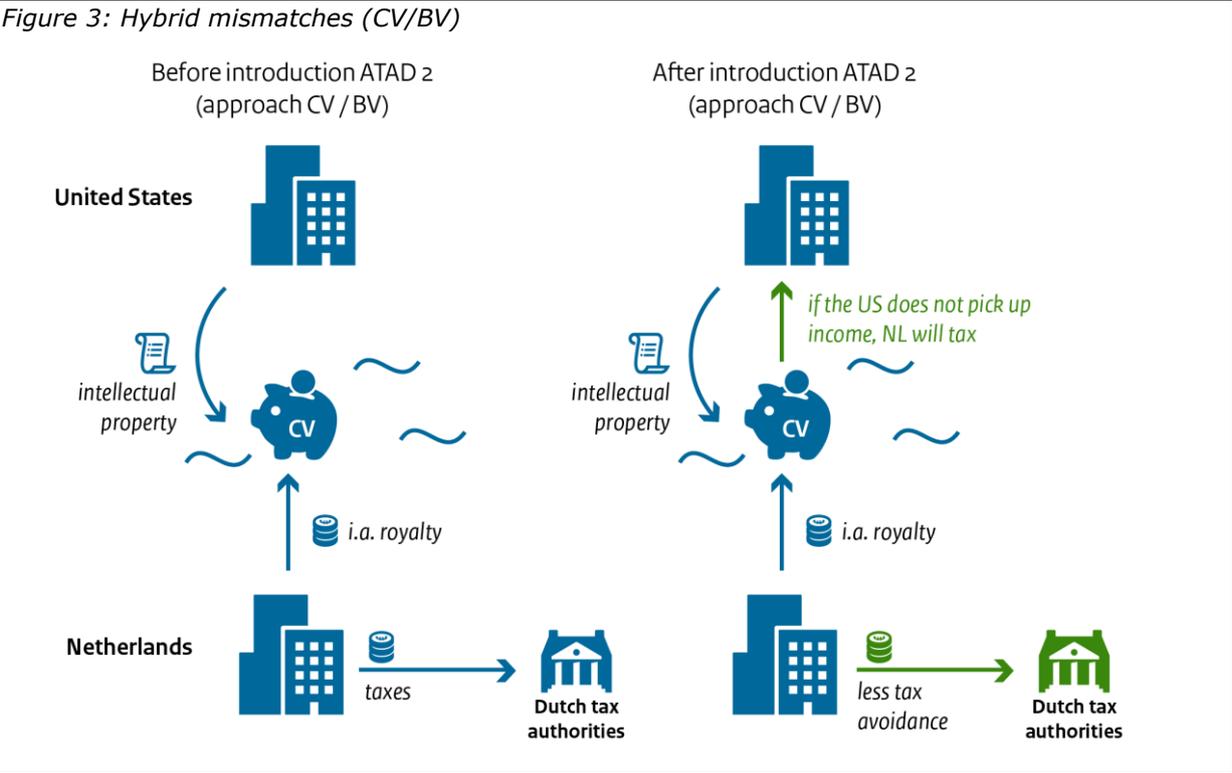
One possible effect of hybrid mismatches is that costs are deducted more than once (i.e. in two or more countries) or deducted in one country without any corresponding income being included in the tax base of another country. Implementation of the second Anti-Tax Avoidance Directive

⁸ This will also implement the Groot motion, Parliamentary Papers, House of Representatives, 2016/17, 34 552, no. 56.

⁹ HR 8 July 2016, no. 15/00878, ECLI:NL:HR:2016:1351 (foreign exchange loss on shareholding), HR 8 July 2016, no. 15/00194, ECLI:NL:HR:2016:1350 (section 10a of the Corporation Tax Act 1969).

¹⁰ Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries. The measures included in ATAD1 to tackle hybrid mismatches will be implemented at the same time.

(ATAD2) will entail the inclusion of rules in Dutch law to neutralise the tax advantages arising from hybrid mismatch arrangements. Among other things, implementation of ATAD2 will mean that tax avoidance arrangements involving a limited partnership (CV) and a private limited company (BV) will lose their attraction. In the package of tax reforms it recently adopted, the United States itself has already removed a number of incentives behind the prevalence of CV/BV tax avoidance arrangements. The Netherlands will also take necessary measures itself when it implements ATAD2. This is illustrated below.



The legislation designed to address the issue of hybrid mismatches is very complex because it concerns many different types of hybrid mismatches¹¹ and the interface between different legal systems. In the government's view, this complexity makes it necessary to hold an online consultation. The government will aim to launch this consultation as soon as possible in 2018. The government expects to be able to submit a bill to the House of Representatives at the start of 2019 so that enough time is available for parliament to debate it.

Hybrid mismatches in tax treaties (hybrid entity provision)

The Netherlands also combats hybrid mismatches by means of its treaty policy. It wants all tax treaties to include a provision that ensures that treaty benefits are only granted if a hybrid entity's income is taxed in the hands of the participants in that entity. If the use of the hybrid entity results in the income not being subject to tax, treaty benefits are not granted. This hybrid entity provision can apply by means of the MLI (see section 2.3) to existing treaties that do not yet include a provision of this kind.

¹¹They include hybrid financial instruments, hybrid transfers, hybrid entities, hybrid permanent establishments, imported hybrid mismatches, double deduction schemes and dual residence entities.

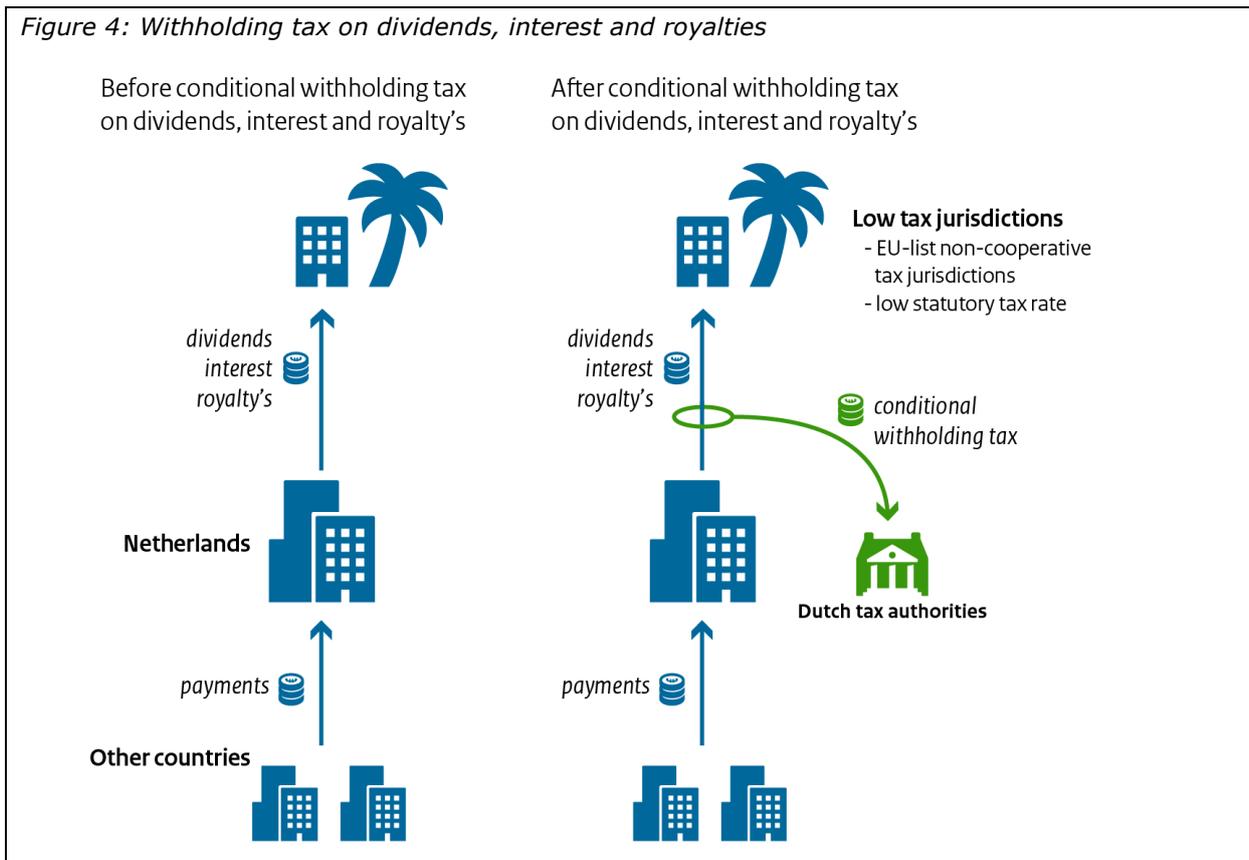
2.3 Combating abuse of our internationally oriented tax system

Thirdly, in order to counter base erosion, I intend to take measures that primarily prevent the internationally oriented Dutch tax system being used as a conduit to tax havens. The planned introduction of a system of withholding taxes on dividend, interest and royalty flows to low-tax jurisdictions and in the event of abusive tax arrangements is in keeping with this intention. The government also wishes to include, in all bilateral treaties, a provision to prevent treaty abuse. The MLI has an important role to play in this respect. Finally, I will take measures to tighten up the requirements concerning presence in the Netherlands for financial service entities and international holding companies in respect of information exchange and certainty in advance, without in so doing affecting real economic activities.

Conditional withholding taxes on dividends, interest and royalties

The government seeks to put an end to financial flows that are directed for tax reasons to low-tax or non-cooperative jurisdictions. This is why the government maintains a withholding tax on dividends paid to low-tax or non-cooperative countries and is introducing a withholding tax on interest and royalty payments to these countries. The figure on the next page illustrates how these withholding taxes work.

Figure 4: Withholding tax on dividends, interest and royalties



The new withholding taxes will be levied on entities established in the Netherlands that pay dividends, interest or royalties to a group entity if that group entity is established in a country with a low statutory rate or a country on the EU list of non-cooperative countries. This is why the

withholding tax is referred to as 'conditional'. Effective and workable arrangements will be made to counter abuses in relation to these conditional withholding taxes. An example of an abusive transaction is a payment that is not made directly to a low-tax or non-cooperative jurisdiction but is channelled to such a jurisdiction circuitously by employing a contrived mechanism.

By introducing withholding taxes the Netherlands is anticipating a discussion within the EU on possible measures against non-cooperative countries (see section 3.5). Withholding taxes are currently on the list of optional countermeasures.

The government sees these conditional withholding taxes as a serious step to prevent the Netherlands being used as a conduit country in tax-saving group structures. It also views them as a way to stop the shifting of profits to low-tax or non-cooperative countries at the expense of the Dutch tax base. This measure will have an impact on the size of the legal, financial and consultancy sectors that provide advice to their clients on conduit arrangements.

If the Netherlands has concluded a treaty with a country that applies a low statutory rate or appears on the EU list of non-cooperative countries, that treaty may limit or preclude the Netherlands' ability to levy the withholding taxes. It goes without saying that this is undesirable. I will examine ways of revising our treaty policy and look into how and when the treaty partners in question could be approached with a view to preventing this situation as much as possible. I will send the House a separate letter in which I will address more broadly the changes in the tax treaty policy since the publication of the Tax Treaty Policy Memorandum 2011. In that letter I will also deal at greater length with the relationship between the envisaged conditional withholding taxes and treaties. I will also respond in that letter to the Groot/Schouten motion,¹² which requests that tax treaties with countries on the EU list of non-cooperative countries be reconsidered. I expect to be able to submit this letter to you in the second half of this year.

The coalition agreement sets out plans to abolish dividend tax and introduce the conditional withholding taxes on dividends, interest and royalties. The introduction of the conditional withholding tax on dividends will coincide with the abolition of dividend tax as of 1 January 2020. When the coalition agreement was drawn up, the introduction of the conditional withholding taxes on interest and royalties in 2020 did not seem feasible. It is now clear, however, that the introduction of conditional withholding taxes on interest and royalties can be achieved in 2021. I will therefore present a bill to introduce the conditional withholding taxes on interest and royalties to the House in 2019.

Preventing the abuse of Dutch tax treaties (Multilateral Instrument)

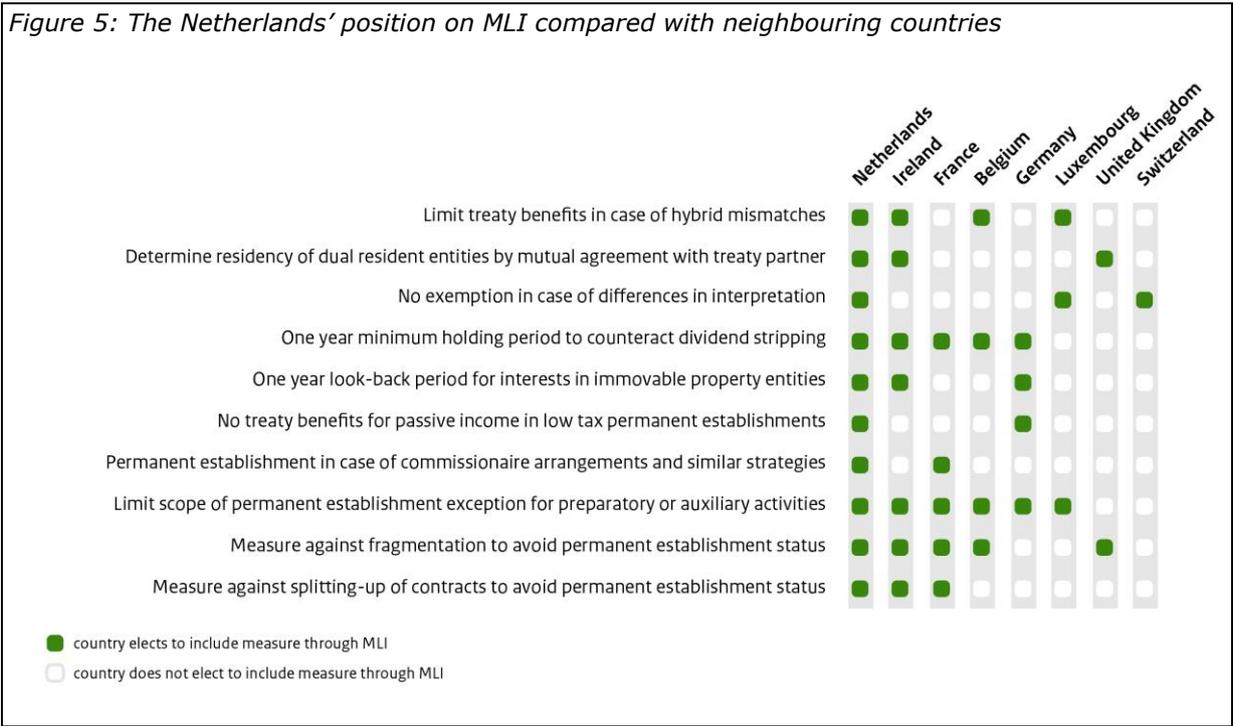
The government presented a bill to the House on 20 December 2017 to approve the Multilateral Instrument (MLI).¹³ It enables all Dutch tax treaties to be brought into line with the anti-abuse provisions developed in the BEPS Project if our treaty partners agree. The government wishes to

¹² Parliamentary Papers, House of Representatives 2015/16, 25 087, no. 122 (Schouten/Groot motion).

¹³ Letter setting out a proposal to implement BEPS measures against tax avoidance in Dutch tax treaties, 20 December 2017, 2017-0000237466.

equip both the Netherlands and its treaty partners – including developing countries¹⁴ – with effective tools to combat tax avoidance. This can prevent the Netherlands’ extensive network of tax treaties being used improperly. The choices the Netherlands has made in signing the MLI against tax avoidance will result in substantial amendments to our tax treaties to avoid double taxation. It is apparent from the provisional choices made, however, that not all countries have the same level of ambition as the Netherlands. A large number of OECD countries have indicated that they wish to implement fewer specific anti-abuse provisions by means of the MLI than the Netherlands. This is illustrated in the figure below. It shows that each country is carefully considering its own position and that the Netherlands is playing a pioneering role internationally.

Figure 5: The Netherlands’ position on MLI compared with neighbouring countries



The principal purpose test (PPT) is however accepted by all treaty partners that are ratifying the MLI. The PPT prevents improper use being made of the Netherlands’ extensive treaty network by examining whether obtaining a treaty benefit was one of the principal purposes of an arrangement or transaction. If so, the PPT prevents the Netherlands’ treaty partner’s taxing rights being wrongly limited. The PPT thus helps makes the Netherlands unattractive for undesirable conduit arrangements.

Tightening up (relevant) substance requirements

In the motion submitted by MPs Leijten and Bruins,¹⁵ the House asked me to indicate the approach the government wishes to take concerning substance requirements to counter letterbox companies. I intend to meet the concerns expressed in this motion by tightening up requirements regarding a

¹⁴ In recent years the inclusion of anti-abuse provisions has already been agreed bilaterally with several developing countries.

¹⁵ Parliamentary Papers, House of Representatives, 2017/18, 34 785, no. 50.

company's presence in the Netherlands so that information will be exchanged with other countries more frequently. I will also set stricter conditions for providing certainty in advance. These two policy options are taken from the letter sent to the House by my predecessor on 4 November 2016.¹⁶

The first measure, which aims to increase the number of cases where information is exchanged with the source country if a Dutch company does not satisfy certain substance requirements, has two parts and concerns firstly extending the group of taxpayers about which information is exchanged to include international holding companies (part a). The introduction of this measure will mean the 'source country' is informed more often of substance in the Netherlands, so that country is in a better position to assess whether it should grant treaty benefits. I also intend to draw up stricter requirements for exchanging information and bring them in line with the requirements for relevant substance introduced by the Holding Cooperative Withholding Obligation and Withholding Exemption Extension Act (part b),¹⁷ namely a payroll of €100,000 and office space that is available for at least 24 months. As a result, the Netherlands will share information more readily with the source country. Both measures together necessitate amendment of the International Assistance Implementation Decree.¹⁸ The second measure I will take is to also draw up more demanding substance requirements, in the same way, for obtaining certainty in advance¹⁹ (see also section 3.3). The government aims to implement both these measures without delay, subject to a feasibility test to be carried out by the Tax and Customs Administration.

A third policy option was outlined by my predecessor in the letter of 4 November 2016. This option concerns tightening up section 8c of the Corporation Tax Act 1969. This provision is intended to discourage interest and royalty conduit entities without real substance from setting up in the Netherlands. I intend to assess the need for this measure from a policy perspective in conjunction with the planned withholding taxes on interest and royalties. As indicated above, the presentation of a bill on withholding tax on interest and royalties is scheduled for 2019.

In this connection I intend to examine whether the participation exemption can be modified in such a way that it need no longer be applied in cases where the presence of a group in the Netherlands is limited to one or more (interim) holding companies that have practically no substance. I expect to have the opportunity to examine this question in the course of 2020.

2.4 Transfer prices

The OECD Transfer Pricing Guidelines have been revised to combat tax avoidance as part of the BEPS Project. The aim is to prevent the pricing of transactions being used as a way to shift profits to countries where the value is not created. The new OECD guidelines set out a method for analysing and modifying risk allocation in respect of intra-group transactions. This makes it

¹⁶ Parliamentary Papers, House of Representatives, 2016/17, 25 087, no. 136.

¹⁷ Parliamentary Papers, House of Representatives, 2017/18, 34 788, no. 3, p. 19.

¹⁸ In the 165 cases in which information has been exchanged with other countries since 2014 on the basis of the current substance requirements, 12 cases concerned developing countries.

¹⁹ See Order DGB 2014/3099 and Order DGB 2014/3101.

possible to prevent profits being shifted to countries without relevant functions by allocating risks arbitrarily. The revised text also provides far more detailed guidance on determining the entity within a group to which the income generated by activities involving valuable intangible assets such as patents should be allocated. As a rule this will not be the legal owner of the intangible asset if it has carried out few, if any, value-adding activities. Profits should be allocated to and taxed in the countries where the important functions have been or are being performed. I intend to amend the Transfer Pricing Decree this year to ensure its wording is also in line with the new OECD guidelines.

The issue of the need to tax profit in the country where the corresponding value is created is often linked to the digitalisation of the economy, but that question is a broader one. Please refer to my letter on the tax policy agenda for the Netherlands' position on this matter.

Investigation of the arm's length principle

On the basis of the arm's length principle, related companies are assumed for tax purposes to enter into transactions with each other in the same way that independent parties would do in comparable circumstances. Application of the arm's length principle can lead to taxable profits being adjusted upward or downward. The latter in particular can potentially conflict with the government's ambitions to combat tax avoidance. It is mainly this impact of the arm's length principle on corporation tax that prompted me to examine whether the principle should be modified.

3. Transparency and integrity

The second pillar of my approach to combating tax avoidance and tax evasion begins with measures to promote transparency. They concern *inter alia* transparency between taxpayers and the Dutch Tax and Customs Administration (section 3.1), transparency between tax authorities (sections 3.2 and 3.5), transparency in the European Union on tax remitted by large multinationals, and transparency about the way different countries contribute to efforts to combat tax avoidance and tax evasion (sections 3.5 and 3.6). My approach to tax avoidance and tax evasion also includes measures to promote ethical conduct among tax intermediaries and in financial markets (sections 3.1 and 3.4).

3.1. National policy on promoting transparency

In its letter of 17 January 2017 in response to the Panama Papers, the previous government underlined the importance of transparency in tackling tax evasion and announced a number of domestic statutory measures in the fight against tax evasion, tax avoidance and undesirable arrangements preventing tax collection.²⁰ The government will continue to pursue this policy. Consultation on the collection measures set out in the letter is now complete and the measures will be included in the 2019 tax plan.

Clarifying the right of non-disclosure in tax matters

The parliamentary committee on tax avoidance schemes states in its report of 5 July 2017 that the engagement of the services of tax consultants and trusts or company service providers sometimes creates a reality that exists only on paper. This makes it more difficult for regulators and the Tax and Customs Administration to see what is really going on, complicating the enforcement of the rules and increasing the risk of tax avoidance and tax evasion. The parliamentary committee's findings also reveal the highly interconnected nature of a sector in which established partnerships of trusts or company service providers, tax advisers and civil-law notaries work together to devise tax avoidance arrangements. Each participant in this process only considers their responsibility for their own role, but nobody takes responsibility for the negative side effects of the arrangement as a whole. This can result in tax evasion or tax avoidance by exploiting differences between tax jurisdictions.²¹

The findings of the parliamentary committee on tax avoidance schemes reinforce the government's conviction that the Tax and Customs Administration must be enabled to gain access to the facts that are relevant to taxation. This is also why, in the coalition agreement, the government identifies the need in the light of the Panama Papers to ensure that the Tax and Customs Administration has better access to information and to increase transparency. The announcement that the right of non-disclosure in tax matters would be clarified should also be viewed against this backdrop.

Publicising the imposition of fines on tax intermediaries for culpable negligence

In view of the role that tax intermediaries play in making tax avoidance arrangements, the Tax and Customs Administration must not only be able to remove and fine the 'rotten apples', it should also be able to bring them to the public's attention. Greater transparency in this regard will be brought about by publicising fines for culpable negligence imposed by the Tax and Customs Administration on financial intermediaries who are a party to a finable offence.

The length of tax proceedings

During the expert meeting on tax avoidance arrangements on 6 October 2016 and in response to questioning by the parliamentary committee on tax avoidance schemes, members of the Tax and

²⁰ Parliamentary Papers, House of Representatives, 2016/17, 25 087, no. 138.

²¹ Report by the parliamentary committee on tax avoidance schemes, Parliamentary Papers, House of Representatives 2016/17, 34 566, no. 3, pp. 18 and 19.

Customs Administration's team coordinating efforts to combat such arrangements spoke about proceedings concerning cases where taxpayers were suspected of concealing their wealth. They explained that proceedings relating to a tax assessment were sometimes very prolonged due to a succession of different legal proceedings and the way they are currently designed. These delays can also be caused by successive proceedings: firstly an appeal against 'information decisions' and secondly an appeal against tax assessments. Information decisions offer taxpayers and potential taxpayers legal protection in a dispute as to whether the tax inspector's questions are justified. An evaluation report on the functioning of information decisions provides a nuanced picture. I intend to assess whether it is possible to take measures to address lengthy tax proceedings while at the same time safeguarding the desired level of legal protection.

Wealth concealed abroad

Tax evasion measures also extend to wealth concealed abroad. International schemes are used to evade taxation and hide the proceeds of other criminal activities such as corruption and money laundering. Tackling assets concealed abroad provides a framework for addressing such forms of cross-border tax evasion. This issue is one of the Tax and Customs Administration's priorities. For both taxation and investigation (FIOD) purposes, substantial capacity is currently being deployed to improve access to information and detect and prevent concealed wealth. The House has been informed about this on previous occasions.

During the parliamentary committee meeting regarding the Tax and Customs Administration on 14 December 2017, the House also considered the Nijboer motion. This motion calls for an investigation to determine what investments the Administration can make to increase tax revenue. In the past, it has proved impossible to establish a direct link, either ex ante or ex post, between a given investment and higher tax revenue. The Nijboer motion therefore suggests that a wider look be taken at the Administration's use of capacity and its impact on tax revenue. The relevant considerations are described in detail in the 2018 enforcement letter, which the House received last December. The Administration will have to develop its enforcement strategy further in the years ahead.

More specifically, the coalition agreement *Confidence in the Future* states that, in the light of the Panama Papers, the government will ensure that the Tax and Customs Administration has better access to information and greater investigative capacity. The coalition agreement calls for a business case to be drawn up to this end. This is a concrete example of the suggestion made in the Nijboer motion. As noted, a lot of concealed wealth has been detected and declared in recent years. The Tax and Customs Administration will continue this work in 2018. I am currently investigating the extent to which an additional investment in this area will benefit both tax revenue and the Administration's enforcement strategy. I am aware that no direct link has ever been established between a given investment and higher tax revenue. Another benefit of tackling concealed wealth might be the societal impact. High-profile action to tackle undesirable arrangements has a preventive effect and can improve taxpayer compliance.

3.2. Certainty in advance in international situations

Prior consultation and the provision of certainty in advance are key elements in the supervision exercised by the Tax and Customs Administration. The provision of certainty in advance in the form of a ruling is also an important feature of our business climate. A further benefit is that the exchange of information on rulings creates transparency for foreign tax authorities. Certainty in advance can only be given within the framework of legislation, policy and case law. The government therefore remains a firm advocate of providing clarity at an early stage and settling discussions between taxpayers and the Tax and Customs Administration 'up front'.

The letter of 18 February 2018²² explained that the government is taking additional measures to further enhance the quality and robustness of the Netherlands' ruling practice. Both the procedural aspects and the content of advance tax rulings will be reviewed. In order to help shape the review of the ruling practice, I will set up an external advisory group of independent experts to act as a sounding board. Wider consultations will also be held during the review process. My ambition is to have the revised tax ruling practice in place by 1 January 2019. Key elements that I believe should be taken into account are the forthcoming legislative changes and social, economic and practical considerations.

Transparency

As part of this process, the current policy on transparency towards both foreign tax authorities and the House will be continued. Transparency towards other tax authorities will be achieved by exchanging information on rulings and answering any subsequent questions they may have. As at 31 December 2017, the Netherlands had shared information on 4,462 'past' rulings.

I will also keep the House informed of developments in the ruling practice. In the past, information was provided by means of the memorandum on the APA/ATR practice which included the common forms and illustrative examples of APAs²³ and ATRs.²⁵ The House is also informed through the publication of policy decree's and the APA/ATR team's annual report setting out developments in a given year. These initiatives help to meet the recommendations on transparency made by the EU Code of Conduct Group. In order to confirm this view, I have asked the independent committee that is examining APAs and ATRs to review whether, in its view, the published documents on the APA/ATR practice provide a sufficiently transparent picture of APAs and ATRs as they are issued.

Relevant substance and certainty in advance

In my letter of 18 February 2018 referred to above, I undertook to study whether the provision of certainty in advance on tax issues was still appropriate in all situations. I can now announce the first step in this respect: the current criteria regarding the minimum presence in the Netherlands

²² <https://www.rijksoverheid.nl/ministeries/ministerie-van-financien/documenten/kamerstukken/2018/02/18/kamerbrief-onderzoek-rulings-met-internationaal-karakter>.

²³ APA: Advance Pricing Agreements. Providing certainty in advance about international transfer prices (including financial service entities).

²⁴ ATR: Advance Tax Rulings. Providing certainty in advance about the tax treatment and consequences of transactions in international structures.

²⁵ Which are considered in the letter of 23 May 2017.

(substance requirements) necessary to obtain certainty in advance will be made stricter.²⁶ They will match the relevant substance requirements introduced in the Holding Cooperative Withholding Obligation and Withholding Exemption Extension Act,²⁷ that is to say a payroll of €100,000 and office space that is available for at least 24 months.

3.3. Strengthening the integrity of financial markets

To strengthen the integrity of the financial markets, the government is drafting legislation to establish a register for ultimate beneficial owners (UBO register). Existing legislation on trusts or company service providers will also be tightened up.

UBO register

Under the Fourth EU Anti-Money Laundering Directive, EU member states must keep a central register of ultimate beneficial owners. The Fourth Anti-Money Laundering Directive is designed to prevent the financial system being used for the purposes of money laundering and terrorist financing.

Disguising the origin of criminal proceeds enables perpetrators to keep out of sight of the authorities and enjoy their ill-gotten gains unhindered. The money can also be used to prepare terrorist attacks. It is of great importance to society that the perpetrators of such crimes cannot hide their identity behind a corporate structure. The purpose of the register the Netherlands must keep pursuant to the directive is to disclose the ultimate beneficial owners of enterprises and legal persons established in this country. It will make an important contribution to enhancing transparency with a view to protecting the integrity of the financial system from money laundering, terrorism financing and related offences such as corruption, tax crimes – including tax evasion – and fraud. The government is currently drafting a bill to implement the UBO register.

Legislation on trusts or company service providers (TCSPs)

The government is tightening up the legislation on TCSPs in order to strengthen their integrity and professionalism, raise the requirements applicable to services in order better to control integrity risks, and increase the Dutch central bank's powers of enforcement. As indicated in the letter to the House of 24 October 2017²⁸ in response to the report issued by the parliamentary committee on tax avoidance schemes, the sector fails to adequately comply with either the letter or the spirit of the law. This is one of the reasons to tighten up the legislation. TCSPs are the gatekeepers of the Dutch financial system: they must prevent the system being used for money laundering, terrorist financing and other socially undesirable behaviour, including tax avoidance. The TCSPs themselves must ensure that their services are not used for money laundering, terrorist financing and other socially undesirable behaviour. Improving the sector's integrity and professionalism and setting stricter requirements on its services should reduce the financial markets' vulnerability to

²⁶ Parliamentary Papers, House of Representatives, 2016/17, 25 087, no. 136.

²⁷ Parliamentary Papers, House of Representatives, 2017/18, 34 788, no. 3, p. 19.

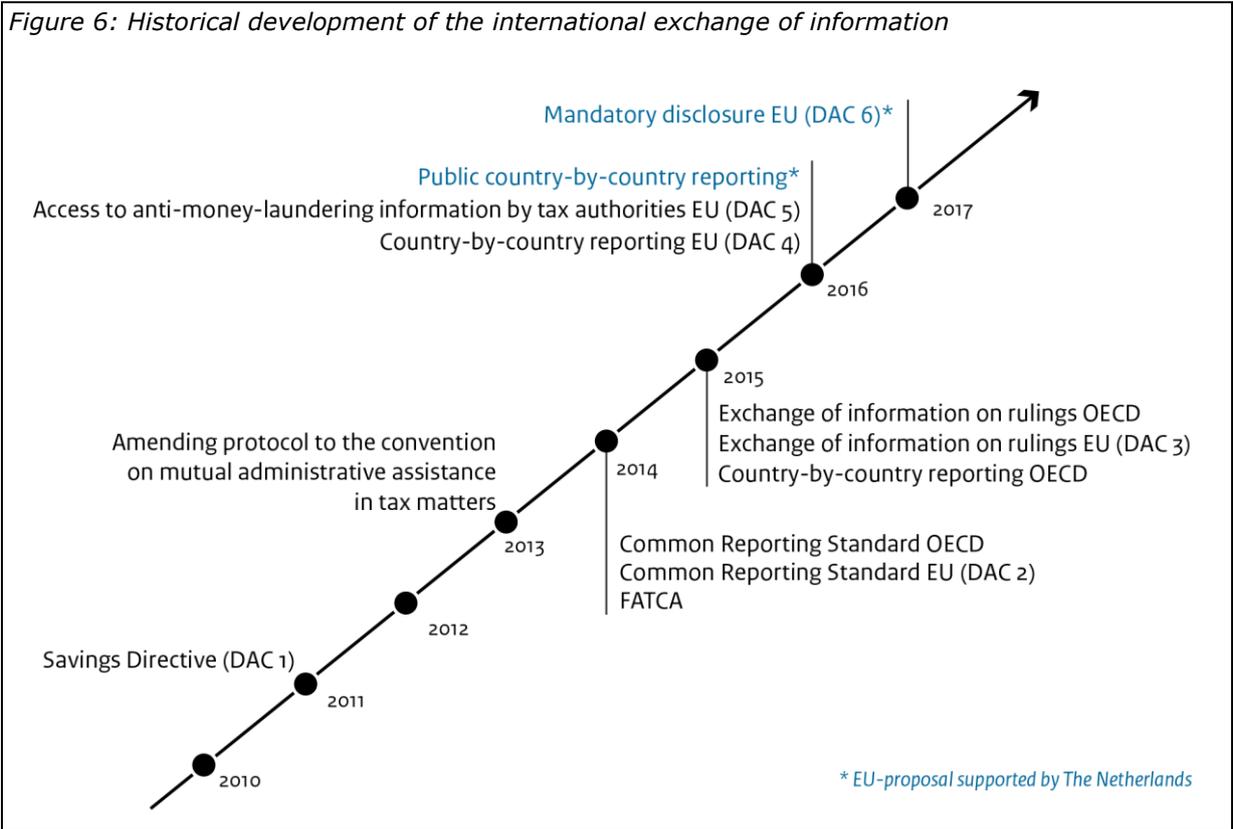
²⁸ <https://www.rijksoverheid.nl/documenten/kamerstukken/2017/10/24/kamerbrief-over-trustkantoren>.

integrity risks. This can in turn also help combat tax avoidance and tax evasion. The government will submit a bill to the House of Representatives in the first half of 2018.

3.4. EU policy on promoting transparency

In the government’s opinion, a cultural change is also necessary to combat tax avoidance effectively. In this respect, the EU has proposed that financial intermediaries must be obliged to notify the tax authorities of potentially aggressive tax planning schemes. The EU is also proposing that the public should be made aware of how multinationals fulfil their tax obligations in the EU. These measures are essential to bring about the necessary cultural change with regard to tax avoidance.

These measures build on the important steps taken previously, such as the Common Reporting Standard (CRS), country-by-country reporting (CbCR) and the exchange of information on rulings. By sharing this information, tax authorities are better positioned to detect potential risks of tax avoidance and evasion. See the figure below for an illustration of the historical development of the international exchange of information. The Netherlands satisfies all international standards regarding the exchange of information.



Exchange of information on potentially aggressive tax planning schemes (mandatory disclosure)
As already noted, the government supports the Commission’s proposal for a directive regarding mandatory disclosure. The proposal would oblige financial intermediaries (e.g. tax advisors,

lawyers, civil-law notaries and TCSPs) to notify the tax authorities of potentially aggressive cross-border tax planning schemes. If, owing to the right of non-disclosure or other reasons, an intermediary cannot fulfil the obligation, it is assumed by the taxpayer. The tax authority then forwards the information to a central database managed by the Commission, which is open to the tax authorities of all other member states. The proposal offers tax authorities a better insight into tax planning schemes that taxpayers employ on the advice of their intermediaries. When the proposal is worked out in greater detail, the government will make further proposals at EU level to make it more effective and more practicable. The current expectation is that agreement can be reached within the EU in the first half of 2018.

Public country-by-country reporting

The government supports the EU initiative to make agreements on public country-by-country reporting in respect of major multinationals. The proposal would require multinationals with global annual turnover of more than €750 million to publish information on the nature of their activities, number of employees, net turnover, profit or loss before tax, corporation tax obligations, corporation tax paid and accumulated profit. This information would be broken down by EU member state and by third country on the list of non-cooperative tax jurisdictions, and aggregated in respect of other countries. The Netherlands has been an active participant with a view to reaching an agreement in Brussels. Mindful of the House's wishes,²⁹ the government suggested during the negotiations that information from third countries should also be specified by country rather than aggregated. The negotiations are currently at an impasse because a small group of member states think the matter should be treated as a tax proposal (where voting must be unanimous) and not as an accounting proposal (where voting is by qualified majority).

EU Code of Conduct Group

The EU Code of Conduct Group is examining tax measures in EU member states and third countries that constitute potentially harmful tax competition. Measures of this kind are therefore subject to the EU Code of Conduct for business taxation. It is also developing guidelines (soft law) that build on the Code of Conduct. These guidelines will also serve to combat tax avoidance. The government greatly appreciates the Code of Conduct Group's work. At the request of the Ecofin Council, the Code of Conduct Group compiled the list of non-cooperative jurisdictions. This is a list of countries that do not satisfy the minimum standards set by the member states. As I noted in my letter of 12 December 2017,³⁰ the Netherlands recently again called for greater transparency in the Code of Conduct Group. I am trying to garner support for this within the EU. The government will maintain its efforts to increase the transparency of the Code of Conduct Group and to this end will advocate the preparation and publication of reports of meetings.

²⁹ Parliamentary Papers, House of Representatives, 2015/16, 21 501-07, no. 1364.

³⁰ <https://www.rijksoverheid.nl/ministeries/ministerie-van-financien/documenten/kamerstukken/2017/12/12/brief-naar-aanleiding-van-berichtgeving-in-de-media-dat-nederland-dwarsligt-bij-de-eu-aanpak-van-belastingontwijking>.

3.5. Compliance with international and EU standards

Combatting international tax avoidance requires not only the Netherlands to comply with international and EU standards. It is also vital that other countries to do so, too. Only then will efforts to tackle international tax avoidance be effective.

EU list of non-cooperative countries

The finance ministers adopted the EU list of non-cooperative jurisdictions (or 'blacklist') for tax purposes at the Ecofin Council of 5 December 2017. The Netherlands actively participated in the list's compilation. A list of non-cooperative countries is an important tool in the fight against tax avoidance. I believe it will encourage more countries to comply with the same tax standards. Although the list itself will facilitate a cultural change, its impact can be magnified by means of defensive measures. EU member states have committed themselves to applying or introducing at least one of the three agreed administrative defensive measures. They are:

- (i) Reinforced monitoring of certain transactions; ,
- (ii) Increased audit risks for taxpayers benefiting from the regimes at stake; , (iii) Increased audit risks for taxpayers using structures or arrangements involving these jurisdictions..

The member states themselves can select the defensive measures that are the most appropriate to them.

The Tax and Customs Administration is devoting attention to the EU list and checks on certain transactions. In addition, the government is maintaining a withholding tax on dividends in respect of dividend payments to jurisdictions with a low statutory tax rate and jurisdictions included in the EU list of non-cooperative countries, and it is introducing a withholding tax on interest and royalty payments to these countries. In so doing the government is introducing a defensive measure of legislative nature against countries on the EU list, and also an additional administrative defensive measure through the exercise of supervision of these new withholding taxes. The Tax and Customs Administration is also examining whether an additional administrative measure can be introduced.

During 2018 the EU Code of Conduct Group will determine whether countries that have committed to comply in full with the EU standards by 1 January 2019, and have therefore so far not been included in the EU list, have indeed kept their commitments. The Netherlands is of the opinion that it is vital to the credibility of the EU list that their compliance is very carefully assessed. Countries that do not keep their commitments must be included in the EU list. The list's credibility would be increased if the Code of Conduct Group, and specifically the process concerning the blacklist, were more transparent. The Netherlands is actively calling for this.

Inclusive Framework and Global Forum

Compliance with the agreed standards is also overseen at a wider international level. Hence the Netherlands is a member of and active contributor to the Inclusive Framework on BEPS (Inclusive Framework) and the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum).

More than a hundred countries are currently members of the Inclusive Framework, including a large number of developing countries and emerging economies that have committed themselves to the minimum standards of the BEPS Project. The Inclusive Framework reviews and reports on the member countries' implementation of the BEPS measures. It also facilitates the implementation processes of the member countries (including developing countries). The Global Forum performs a similar role with regard to international agreements on the exchange of information. The Netherlands is a member of both the Inclusive Framework and the Global Forum.

The implementation of the minimum BEPS standards is checked by means of peer review. On 4 December 2017 I informed the House of the outcomes of the peer review of the exchange of information on rulings.³¹ The exchange of information on rulings will be peer reviewed again this year and the exchange of information on request will also be subject to peer review. A peer review will be started of the implementation of the minimum standards of measures to combat treaty abuse. The Netherlands will continue to make an active contribution to the peer reviews and I will of course share the outcomes relevant to the Netherlands with the House when they become available.

Continuation of technical cooperation with developing countries

Multilateral agreements against tax avoidance also prevent tax avoidance eroding the tax bases of developing countries. To help them protect their tax bases themselves, the government will continue its technical cooperation with developing countries with respect to taxation. Further efforts to build the capacity of tax authorities and finance ministries in developing countries is crucial for this. Anti-misuse provisions in treaties will give developing countries the right, for example, to deny enterprises treaty benefits if those treaties are abused. But this requires capacity and knowledge. The same applies to the exchange of information. The countries concerned often do not have sufficient capacity and knowledge regarding tax audits and transfer pricing. The Netherlands is cooperating bilaterally with around a dozen countries to address this shortfall by sharing the knowledge of the experts at the Dutch Tax and Customs Administration and the International Bureau of Fiscal Documentation. The Ministry of Foreign Affairs also supports IMF, OECD and UN programmes that cover many countries. Support provided to the African Tax Administration Forum has also contributed to knowledge sharing and knowledge building among African tax authorities. In accordance with the undertakings given in the context of the Addis Tax Initiative, the Netherlands is working to double its technical cooperation in the field of domestic resource mobilisation/taxation.

4. Race to the bottom, tax base harmonisation and minimum rate

As already noted, tax avoidance can be tackled effectively only at international level. Unilateral measures merely displace the problem of international tax avoidance. A point often raised in the

³¹ <https://www.rijksoverheid.nl/documenten/kamerstukken/2017/10/24/kamerbrief-over-trustkantoren>.

discussion of tax avoidance is the race to the bottom and the need to harmonise tax bases and rates.

Race to the bottom

International coordination is important in part because of the tension that exists between the desire for an internationally attractive tax regime and the prevention of a race to the bottom. The Ploumen motion³² called on the government to work internationally in the context of the Brexit negotiations to prevent a race to the bottom in corporation tax rates. Mr Van der Lee asked me how, in the light of the American tax reform, we could avoid getting involved in tax competition with the USA. The amended Leijten and Van den Hul motion also called on the government to endeavour to ensure that Brexit did not lead to tax avoidance.

It is a fact that countries compete to attract multinationals and the tax regime plays a role. This is where the prisoner's dilemma can come into play. In the short term, individual countries can be tempted to compete against each other to attract mobile businesses, but this may trigger a race to the bottom that ultimately weakens all countries. In accordance with the amended Leijten and Van den Hul motion,³³ the government is seeking to prevent Brexit leading to tax avoidance. In the negotiations on Brexit, the EU aims to reach agreements with the United Kingdom that preclude harmful tax competition and tax avoidance.

I agree with the motions' proposers that countries have a common interest in preventing harmful tax competition. However, an attractive tax regime is important to ensure high quality jobs and investment in the Netherlands. The government has tried to strike a balance by lowering statutory corporation tax rates to levels similar to those in Scandinavia and around the EU average, but it has financed this on a structural basis mainly by widening the tax base. The regime is therefore less economically disruptive while the government's measures do not promote harmful corporation tax competition.

Dutch policy on the innovation box also strikes a balance. The innovation box is an example of a tax incentive that makes the Netherlands an attractive location for innovative enterprises. To prevent such incentives leading to harmful tax competition, international agreements have been reached as part of the BEPS Project and within the EU regarding the minimum conditions that an innovation box must satisfy. The Netherlands has already adapted its innovation box on these points, making it an internationally accepted feature of an attractive international tax regime.

The OECD and EU are still discussing various international tax issues, such as the digital economy, intra-group profit allocation and further harmonisation. Good agreements on international tax issues also contribute to a climate in which countries do not engage in harmful tax competition with each other.

³² Parliamentary Papers, House of Representatives, 21 501-20 European Council, No. 1277.

³³ Parliamentary Papers, House of Representatives, 2016/17, 21 501-20, no. 1224.

European tax base and rate harmonisation (CCTB, CCCTB and minimum rate)

A race to the bottom could also be prevented, it is claimed, by further tax base harmonisation in the EU (CCTB³⁴ and CCCTB³⁵) and the introduction of a minimum EU corporation tax rate. Combating tax avoidance and preventing harmful tax competition, however, need not lead to countries having to renounce their sovereignty. The Netherlands is participating in the EU discussion of base harmonisation in accordance with the position taken in the assessment by the Working Group for the Assessment of New Commission Proposals (BNC). It goes without saying that the House and the Senate's yellow cards regarding subsidiarity and proportionality will be taken seriously. The Commission thinks the CCTB will combat tax avoidance. Most member states, including the Netherlands, however, are not sufficiently convinced this is the case.

The adoption of a minimum corporation tax rate in the EU is sometimes seen as a solution to prevent a race to the bottom. This view has not, however, gone unchallenged within the EU. Several member states have consistently opposed a minimum corporation tax rate, even if it were to be lower than their own rate. These countries believe that member states must retain their sovereignty in terms of setting their own tax rates. There is currently no EU proposal for a minimum rate on the table.

5. Closing remarks

Cooperation is essential to prevent tax avoidance effectively. The Netherlands cannot act in isolation and Dutch politicians cannot combat tax avoidance on their own. In the same way that we have joined hands internationally with a range of partners, I reach out to all sections of society to contribute to the development and implementation of Dutch policy. I intend to actively seek out their input. In mid-April, I will ask various stakeholders for their written and oral response to this letter. I will, of course keep the House informed of the outcomes of these consultations.

³⁴ Common Corporate Tax Base (CCTB)

³⁵ Common Consolidated Corporate Tax Base (CCCTB)

Appendix

Implementation status of the BEPS actions

Key word	MS ¹	Status	Expected effective date
1 Digital economy		Ongoing discussions at OECD and EU level	-
2 Hybrids		Will be implemented as part of ATAD 2	1-1-2020
3 CFC		Will be implemented as part of ATAD 1	1-1-2019
4 Interest deductions		Will be implemented as part of ATAD 1	1-1-2019
5a Exchange of rulings	●	In progress in line with OECD and EU guidelines	1-1-2017
5b Nexus approach	●	Innovation box has been amended	1-1-2017
6 Treaty abuse	●	Included in NL treaty policy and MLI	asap, 1-1-2020
7 Permanent establishments		Included in NL treaty policy and MLI	asap, 1-1-2020
8 TP, intangibles		Included in TPG ² and being included in NL transfer pricing Decree	July 2017, summer 2018
9 TP, risk & capital			
10 TP, high-risk transactions			
11 Data analysis		Ongoing process	-
12 Disclosure		In consideration	-
13 CbC reporting	●	Implemented	1-1-2017
14 Dispute resolution	●	Included in MLI and Ad Hoc Group	various
15 Multilateral instrument		Legislative proposal in Parliament	asap, 1-1-2020

¹MS = minimum standard to which OECD / Inclusive Framework members have committed

²TPG = OESO Transfer Pricing Guidelines