SUBSTANCE DEVELOPMENTS

TAXPERIENCE

Taxperience - Netherlands substance requirements

- Tax treaty developments, case law of the European Court of Justice (“ECJ”), and unilateral rules introduced by countries, all reflect that maintaining an adequate level of substance is crucial to be able to (continue to) benefit from a jurisdiction’s tax system, tax treaties and eligibility to EU Directives.

- The Netherlands applies minimum substance requirements in various Dutch anti-abuse rules. In the context of these rules the minimum substance requirements focus on the substance position at the level of the (lower-tier) subsidiary of the Dutch group company (Dutch CFC rules) or at the level of the (direct) shareholder of the Dutch group company (domestic exemption from Dutch dividend withholding tax, Dutch non-resident taxation rules, 2021 Dutch Withholding Tax Act on interest and royalties directly or indirectly due to low-tax jurisdictions).

- Within the Netherlands itself the following Dutch minimum substance requirements apply to a so-called ‘financial services entity’ (“FSC”). An FSC is defined as a Dutch resident company whose activities in a year predominantly (for 70% or more) consist of directly or indirectly receiving and on-paying interest, royalties, rent or lease amounts to and from group companies outside the Netherlands.
  a. At least half of the aggregate number of statutory and decision-competent board members of the taxpayer live or effectively reside in the Netherlands.
  b. The board members living or residing in the Netherlands have adequate professional knowledge and skills to properly conduct their duties with respect to transactions involving the Dutch company and the implementation thereof.
  c. The Dutch company should have qualified personnel at its disposal for the adequate execution and registration of the transactions entered into by that company.
  d. The management decisions are taken in the Netherlands.
  e. The main bank accounts of the company are held and maintained in the Netherlands (can be a non-Dutch bank account, but does need to be managed and controlled from the Netherlands)
  f. The bookkeeping of the company needs to be performed in the Netherlands.
  g. Abolished per 1.1.2021 - the office address of the company needs to be located in the Netherlands.
  h. Abolished per 1.1.2021 - The Dutch company should - to the best of its knowledge - not be considered a tax resident in another jurisdiction.
  i. The Dutch company runs a genuine economic risk (as defined in Article 8c of the Dutch Corporate Income Tax Act) with respect to its intra-group financing / leasing activities.
  k. The Dutch company should have a sufficient amount of equity that is adequate in relation to the above genuine economic risk.
  l. Newly introduced per 1.1.2021 - The Dutch company incurs at least € 100,000 of wage costs for activities performed in relation to the intra-group financing or leasing activities.
    - The personnel does not need to be employed with the Dutch entity itself and it is therefore also possible to hire personnel within the group, provided that such personnel performs relevant activities.
    - Likely this wage-cost criterion will need to be satisfied at the level of each individual Dutch group company (not only (combined) at Dutch group level).

  m. Newly introduced per 1.1.2021 - The Dutch company has office space (with adequate facilities for its activities) available in the Netherlands for a period of at least 24 months from which the company also actually performs its activities.

- If an FSC does not meet these substance requirements during the entire year in which the benefits of a tax treaty or EU Directive are claimed, the Dutch tax authorities will spontaneously exchange information on the non-compliance with these requirements with local source countries, which may use this information to disallow tax treaty or EU Directive benefits.

- Other potentially relevant developments with respect to substance in the Netherlands include the following items.
  a. As of July 1, 2019, the Dutch tax authorities no longer issue rulings to taxpayers with insufficient “economic nexus” in the Netherlands. Both the group and the Dutch company pursuing the ruling need to be engaged in operational business activities in the Netherlands.
  b. If adopted, the Netherlands (as well as other EU Member States) will need to implement the EU Directive aimed at preventing the misuse of shell entities (ATAD 3) effective as of 1 January 2024. We refer to the next slides for more information on this proposed EU Directive.

- Contact your Taxperience tax advisor for more information to manage and prepare for these substance developments to ensure a sustainable and tax-efficient structure for the future!

Taxperience - EU substance requirements (ATAD 3)

- On December 22, 2021, the European Commission published a proposal ("Proposal") for EU Anti Tax Avoidance Tax Directive 3 ("ATAD 3") laying down rules to prevent the misuse of shell entities for tax purposes.

- The Proposal does not seek to replace existing national and international rules to combat shell entity tax abuse in the EU. It aims to reinforce and complement existing measures by providing objective substance criteria to prevent tax abuse in a cross-border context. National rules shall thus continue to apply to identify shell entities not captured by this Directive.

- The Directive lays down a "substance test" to facilitate Member States to identify manifest cases of shell entities misused for tax purposes in a coordinated manner across the EU. Subject to certain upfront carve outs and subject to counter-evidence provisions, it is proposed to apply to all undertakings that are considered tax resident and are eligible to receive a tax residency certificate in a Member State (without any threshold based on revenues and regardless of the entity's legal form).

- The relevant criteria that set up the gateways aim to distinguish as at risk those undertakings that seemingly engage with cross-border activities which are geographically mobile and in addition rely on other undertakings for their own administration (in particular professional third party service providers or equivalents). While it is recognized that different activities may require a different level or type of resources, a common minimum level of resources would be expected under all circumstances.

- The scope of the Directive covers EU resident undertakings meeting the following criteria:

  a) more than 75% of the revenues accruing to the undertaking in the preceding two tax years is relevant income;

     - Relevant income includes 'mobile income' such as income from financial assets, royalties, income from shareholdings, income from financial leasing, income from immovable property and certain movable property, income from insurance, banking and other financial activities, income from services which the undertaking has outsourced to other associated enterprises.

     - Undertakings whose book value of assets consist for more than 75% of immovable property, certain movable property, or shares, respectively, are deemed to meet this criterion.

  b) the undertaking is engaged in cross-border activity on any of the following grounds:

     (i) more than 60% of the book value of the undertaking's assets that fall within the scope of Article 4, points (e) (immovable property) and (f) (certain movable property), of the Directive, was located outside the Member State of the undertaking in the preceding two tax years;

     (ii) at least 60% of the undertaking's relevant income is earned or paid out via cross-border transactions;

  c) in the preceding two tax years, the undertaking outsourced the administration of day-to-day operations and the decision-making on significant functions.

- Carve-outs from the Directive apply to (i) (certain) listed companies, (ii) (certain) regulated financial undertakings (defined in the Directive), (iii) undertakings that have the main activity of holding shares in operational businesses in the same Member State while their beneficial owners are also resident for tax purposes in the same Member State; (iv) undertakings with holding activities that are resident for tax purposes in the same Member State as the undertaking's shareholder(s) or the ultimate parent entity, (v) undertakings with at least five own full-time equivalent employees or members of staff exclusively carrying out the activities generating the relevant income.

- Undertakings fulfilling above criteria are to annually declare in their tax return whether they meet the following indicators of minimum substance:

  a) the undertaking has own premises in the Member State, or premises for its exclusive use;
  b) the undertaking has at least one own and active bank account in the Union;
  c) one of the following indicators:

     i. One or more directors of the undertaking:

        1. are resident for tax purposes in the Member State of the undertaking, or at no greater distance from that Member State insofar as such distance is compatible with the proper performance of their duties;

Taxperience - EU substance requirements (ATAD 3)

2. are qualified and authorized to take decisions in relation to the activities that generate relevant income for the undertaking or in relation to the undertaking's assets;
3. actively and independently use the authorization referred to in point (2) on a regular basis;
4. are not employees of an enterprise that is not an associated enterprise and do not perform the function of director or equivalent of other enterprises that are not associated enterprises;

ii. the majority of the full-time equivalent employees of the undertaking are resident for tax purposes in the Member State of the undertaking, or at no greater distance from that Member State insofar as such distance is compatible with the proper performance of their duties, and such employees are qualified to carry out the activities that generate relevant income for the undertaking.

- Undertakings which are held to annually declare in their tax return whether they meet the substance test shall also provide documentary evidence, as specified in the Directive. This documentary evidence is to be attached to the tax return. All Member States will have access to this information, at any time and without a need for recourse to request for information (automatic exchange of information).

- Counter-evidence provisions and/or an upfront exemption may - under conditions and subject to exchange of information - be invoked by relevant undertakings which do not meet the substance test and/or which are used for genuine business activities without creating a tax benefit for itself, the group of companies of which it is part or for the ultimate beneficial owner. If the tax administration is satisfied that an undertaking rebuts the presumption that it is a shell for the purposes of the Directive and/or the interposition of a specific undertaking within the group does not impact on the tax liability of the group, it should be able to certify that the undertaking is not at risk of being found a 'shell' under this Directive for a tax year. To reduce administrative burdens, it will be possible to extend the validity of the rebuttal for another 5 years (i.e. for a total maximum of 6 years), after the relevant tax year, provided that the legal and factual circumstances evidenced by the undertaking do not change.

- Once an undertaking is presumed to be a shell for purposes of the Directive, and does not rebut such presumption, tax consequences kick in which are aimed at disallowing any tax advantages which have been obtained, or could be obtained, through the undertaking in accordance with agreements or conventions in force in the Member State of the undertaking or relevant EU Directives.

- Disallowing tax advantages also includes income becoming taxable in the Member State where the undertaking's shareholder(s) reside for tax purposes, as if it were paid directly to such shareholder(s). To prevent the risk of double taxation, tax paid on such income in the Member State of the undertaking, if any, should be taken into account and deducted from the tax payable at the Member State of the undertaking's shareholder(s). If the undertaking's shareholders do not reside for tax purposes in a Member State, such income should be taxable in the jurisdiction of residence for tax purposes of the payer, as if it were paid straight to the undertaking's shareholder(s). Scenarios where shell undertakings are resident outside the EU fall outside the scope of the Directive.

- Given that to obtain tax treaty and/or EU Directive advantages, an undertaking normally needs to provide a certificate of residence for tax purposes, in order to accommodate for an efficient process, the Member State of tax residence of the shell undertaking will either not issue a tax residence certificate at all or will issue a certificate with a warning statement.

- Non-compliance with reporting obligations will be subject to penalties.

- This proposal, once adopted as a Directive, is aimed to be transposed into Member States' national law by 30 June 2023 and come into effect as of 1 January 2024.