Algemene Rekenkamer

Tax avoidance

An in-depth audit of tax avoidance in relation to the tax rules and treaty network

2015

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The original report *Belastingontwijking; Een verdiepend onderzoek naar belastingontwijking in relatie tot de fiscale regels en het verdragen-netwerk* was adopted on 1 December 2014 and presented to the Dutch House of Representatives on 5 December 2014. After publication we found some errors in the report. We have sent an erratum to the Dutch House of Representatives on the 26th of February 2015. In this translation we have corrected the errors. The corrections have no influence on the conclusions.

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Executive summary

At the request of the House of Representatives, the Netherlands Court of Audit has carried out an in-depth audit of tax avoidance in relation to the tax rules and the Dutch tax treaty network. The House’s questions and our answers are summarised in the table at the end of this chapter.

Tax avoidance

Controversial but not illegal

Different countries have different tax regimes. The differences are due not only to a country’s tax laws but also to the tax treaties it concludes with other countries. Multinational enterprises generally seek to organise their activities in a way that lowers their tax burden, while remaining within the bounds of the law. This is known as *tax planning* or *tax avoidance*. Both tax planning and tax avoidance are legal. A strict distinction must be made between tax avoidance and *tax evasion*. Tax evasion is illegal. Multinationals do not locate their activities in particular countries solely for tax purposes. Other factors include the presence of an educated workforce, socioeconomic stability and investment protection schemes.

If multinationals are able to continually reduce the tax they pay on their profits, there is a corresponding impact on the tax burden borne by other persons and organisations in all the countries concerned. Small and medium-sized enterprises that operate nationally may be at a competitive disadvantage compared to multinationals. Partly thanks to tax treaties, multinationals – unlike companies that operate only nationally – can exploit differences in national corporation tax rates, tax bases and withholding tax rates.

The United Nations Conference on Trade and Development (UNCTAD) has observed a growing need for an international strategy on taxation. ‘*Unsustainable levels of public deficits and sovereign debt have made governments far more sensitive to tax avoidance, manipulative transfer pricing, tax havens and similar options available to multinational firms to unduly reduce their tax obligations in host and home countries.’* In its Base Erosion and Profit Shifting Project, the Organisation for Economic

Co-operation and Development (OECD) also seeks to combat tax avoidance, in part by obliging multinationals to be open about the taxes they pay in a particular country so that other countries can see where profits and losses are recognised. They are not obliged to do so at present.

Audit structure

The House of Representatives asked us to carry out an in-depth audit of the practice of tax avoidance in relation to the tax treaty network, paying particular attention to Special Financial Institutions (SFIs) registered in the Netherlands. SFIs transfer dividends, interest and royalties from a company in a foreign country to a company in another foreign country. The House also asked us to determine how multinationals allocate their assets and liabilities (profit shifting).

Dutch legislation

The Netherlands has a favourable tax climate for multinationals, but the legislation as such is not significantly different from that in neighbouring countries.

For multinationals, individual tax schemes in the Dutch tax system do not differ substantially from those in comparable European countries such as the United Kingdom, Switzerland and Luxembourg. However, schemes directed principally at the avoidance of double taxation do offer some advantages to multinationals, for example:

- income earned by foreign holdings is not taxed twice;
- tax is not withheld from interest and royalty payments;
- lower withholding tax rates in tax treaties on incoming dividends, interest and royalties.

Multinational groups take advantage of these treaties by establishing companies in the Netherlands that receive dividends, interest and royalties and then transfer them to other group companies established elsewhere.

Furthermore, multinationals can agree advance tax rulings with the Dutch Tax and Customs Administration to give them assurance on the taxes they pay. The rulings must always comply with Dutch law.

Figure 1 **provides facts and figures on tax rates and tax treaties**

Corporation tax rate

Netherlands 25%
Low, e.g. Bulgaria 10%
High, e.g. France 33.3%

Outgoing dividend withholding tax rate

Netherlands 15%
Low, e.g. United Kingdom 0%
High, e.g. Switzerland 35%

Outgoing interest withholding tax rate

Netherlands 0%
The same, e.g. France and Germany 0%
High, e.g. Portugal 25 %

Outgoing royalty withholding tax rate

Netherlands 0%
The same, e.g. Luxembourg and Switzerland 0%
High, e.g. Denmark and Portugal 25%

Number of tax treaties

Netherlands 94
Iceland 39
France 126

Number of companies

12,500
Conduit companies

1,750
companies are engaged principally in transferring interest and royalties

	IN	OUT
Average dividend payment in milliards of euros 2008 to 2012	78.6	58.2
Average royalty payment in milliards of euros 2008 to 2012	26.0	14.5
Average interest payment in milliards of euros 2007 to 2011	12.2	10.0

Dutch tax treaty policy

We found that the Netherlands negotiated tax treaties are in accordance with the principles laid down in the Tax Treaty Policy Memorandum 2011, which is in turn based on the model convention of the Organisation for Economic Co-operation and Development (OECD).

The principles of the tax treaties concluded by the Netherlands are laid down in the Tax Treaty Policy Memorandum 2011, which is in turn based on the OECD model convention. We would note that some of the OECD principles are controversial, such as those on the arm's length pricing of intangible assets.

On the basis of six recent negotiation dossiers, we investigated whether the State Secretary for Finance had applied the principles of the tax treaty policy, in so far as they were relevant to the dossiers. That proved to be the case.

We found from information submitted by entrepreneurs to the Dutch central bank (DNB) that substantial dividend, interest and royalty payments passed through the Netherlands, but we have no benchmark to draw further conclusions. We also found that the dividend, interest and royalty payments had increased sharply in the past 10 years.

Tax planning in practice

No fixed patterns but some examples

Tax planning is tailored to take advantage of differences in tax rates and the tax treatment of entities and transactions. As there is no fixed pattern we cannot say how prevalent a particular arrangement is. An arrangement's attractiveness depends on a combination of many factors such as corporation tax rates and tax base, withholding tax rates, options to set off tax withheld in another country, anti-abuse provisions in national legislation or tax treaties, and the presence of an investment protection treaty. By itself, a tax treaty is not an essential condition for an international tax avoidance arrangement; differences in international tax rates can provide sufficient incentive to set up such an arrangement. In many cases, however, a tax treaty offers the taxpayer additional tax savings or additional certainty on the country of taxation.

Examples of structures found in practice include:

- goods flows are organised in such a way that manufacturing, sourcing, distribution and sales are located in different countries. Tax considerations may influence the choices made in the logistics chain;

- the exploitation of tax treaties to minimise tax on profits from holdings;
- the organisation of royalty payments, for example by means of the Double Irish Dutch Sandwich,[1] to locate activities in several countries, e.g. Ireland, the Netherlands, the United States and Bermuda, in order to minimise or defer withholding and profit tax on royalties.

Review of transfer prices

We concluded from the files we reviewed that the Tax and Customs Administration's supervision of the (internal) transfer prices set by multinationals was sound and thorough.

The Tax and Customs Administration's supervision of the internal transfer prices set by multinationals is sound and thorough. We drew this conclusion from our reviews of the Administration's reports, reviews of files of requests by multinationals for advance pricing agreements and the Administration's audit files on the arm's length prices set where advance pricing agreements had not been made.

Review of advance rulings

The Tax and Customs Administration reviews and clears advance rulings conscientiously and consistently and in line with procedures.

In the 24 files we reviewed, the Tax and Customs Administration assessed and cleared requests by multinationals for advance rulings in accordance with applicable legislation, policy and case law. The conditions governing advance rulings are clearly laid down in tax legislation and administrative rules. The Administration requests and assesses relevant information and has more than one expert check the ruling before approving it.

Checks of substance requirements stepped up in 2014

Before 1 January 2014, the Tax and Customs Administration checked substance requirements chiefly when deciding whether to issue an in advance ruling. Since 2014, supervision of compliance with substance requirements has been stepped up and more attention has been paid to ex post checks at companies that already have an advance ruling. The Administration has also paid more attention to companies that do not request advance rulings. The Administration made preparations to step up its supervision and carried out its first checks during our audit. It is currently too early to report on the initial results of the increased

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[1] The Irish government announced on 14 October 2014 that this practice would be terminated.

supervision. We concluded that supervision of substance requirements still needs to be further implemented.

In practice, substance requirements can usually be satisfied simply through the use of a trust office. There need not be a visible presence with its own personnel in the Netherlands; all the required activities can be performed by a trust office.

Provision of information to the House of Representatives

Information provided to the House of Representatives is correct but has limitations

The State Secretary for Finance gives parliament information chiefly during the negotiation of a tax treaty or when the House asks questions about current events. The information is consistent with that presented in our report. We would note, however, that the State Secretary is not free to provide unlimited information. Information that can be traced back to an individual company may not be made public. We would also note that the House does not have a complete picture of Dutch policy to improve the tax climate for international businesses and its relationship with international tax planning. Although policy information is provided in the Tax Treaty Policy Memorandum 2011 (NFV 2011) and when treaties are concluded or renewed, little clear-cut information is available on the results of the policy and related capital flows. Systematic, periodic reports are not issued.

Recommendations

Tax avoidance is an international phenomenon. Dutch measures alone cannot prevent companies following tax routes that lead to the lowest possible tax burden. Countries actually compete with each other to offer the most advantageous tax arrangements. Because international tax avoidance can undermine the sustainability of public finances and a fair distribution of the tax burden, we recommend that the Netherlands support or initiate international measures to prevent unintended effects and enhance transparency. Initiatives by international organisations such as the OECD, G20, European Union and United Nations that actively combat arrangements that are contrary to the spirit of the rules, and are set up to minimise tax, therefore deserve the sustained and active support of the Netherlands.

We recommend that the responsible members of the government:

1) when submitting new or revised treaties, inform parliament of the measures taken to prevent their misuse or unintended use;

2) step up cooperation with treaty partners, giving greater priority to the conclusion and application of tax treaties that:
a. improve the exchange of information;
b. prevent legal uncertainty for companies wishing to use a treaty (e.g. by explaining how provisions to prevent misuse will be applied);
c. actively assist the Tax and Customs Administration and the tax authority of the treaty partner where necessary;
3) improve the information provided to the House by issuing a periodic monitoring report on the tax climate for international companies and the use made of it, the amount of money involved, and the impact of measures to combat improper use of tax rules and tax treaties.[2]

If the House of Representatives wishes to receive reliable cumulative information on the size of dividend, interest and royalty payments, the State Secretary for Finance could be asked to collect this information and present it in a monitoring report.

Response of the State Secretary for Finance

The State Secretary was pleased with our conclusion that the Dutch tax climate was attractive to international businesses without being out of step with that in other European countries. He noted that retaining an attractive business climate, in which taxation was just one factor, had the government's constant attention. In pursuing this aim the government's focus was on rules that were consistent with international guidelines and on combating tax avoidance. He also agreed with our other conclusions.

The State Secretary referred to the concerns we expressed in our report about the consequences of international tax avoidance for the sustainability of public finances and for an even distribution of the tax burden, and the associated recommendation to support international initiatives and measures to manage the situation. He thought our conclusion significantly supported the government's policy.

The State Secretary made several comments on our recommendation to improve the information provided to the House by issuing a periodic monitoring report on the tax climate for international companies and the use made of that climate, the amount of money involved, and the impact of measures to combat improper use of tax rules and tax treaties.

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[2] We previously highlighted the importance of collecting and analysing quantitative and qualitative information on the payments channelled through the Netherlands, sharing information with the parties combating money laundering and providing adequate information to the House of Representatives in our report Combating Money Laundering: State in 2013 (Court of Audit, 2014a).

In our report Combating Money Laundering: State in 2013 (Netherlands Court of Audit, 2014a), we referred to the importance of collecting and analysing quantitative and qualitative information on financial flows through the Netherlands, the sharing of information between the parties engaged in combating money laundering, and providing adequate information on these matters to the House of Representatives.

The State Secretary wrote that wherever possible he already informed the House as fully as possible about the quantitative impact of proposed and existing measures and treaties. He could not deny, though, that it was often impossible to make reliable quantitative analyses. In his opinion, so many factors influenced the tax climate for international businesses and the potential for misuse that it would rarely be possible to measure the impact of an individual measure. Certain aspects of our recommendation were therefore a matter of concern. Periodic reports giving an overview of the tax climate could be issued but the impact of anti-misuse measures was, he thought, difficult to measure. It could not be determined, for example, how taxpayers would have behaved if the measures had not been introduced. Another problem was that even if a measure's impact could be quantified it would take some time before it fed through into the tax figures.

The State Secretary observed that the size of incoming and outgoing dividend, interest and royalty payments to and from the Netherlands was already known from data published by De Nederlandsche Bank (the Dutch central bank) and Statistics Netherlands. The data could be stripped of the influence of Special Financial Institutions to give an indication of the attractiveness of the Dutch investment climate. He suggested conducting a pilot project over the next five years to improve the provision of information to the House, involving a short annual review of developments in the tax climate.

Court of Audit's afterword

We note that the State Secretary's response indicated approval for our recommendations. He considered our concern about the consequences of international tax competition and the associated recommendation to support international initiatives and measures significantly supported the government's policy. We therefore assume that the State Secretary will address this concern in consultation with parliament, partly on the basis of our recommendations. Since one of the recommendations relates to the provision of comprehensive information on this complex matter to the House of Representatives and the State Secretary has proposed that

an annual reporting system be established to do so, we suggest that the House consult the State Secretary to discuss how he can best meet its information requirement.

Questions from the House of Representatives and summary answers

The audit questions and related findings are summarised in the table below.

Question from the House of Representatives	Summary answer
1a) Can the Court of Audit carry out an in-depth audit of the tax avoidance arrangements found in practice and their relationship with the tax treaty network?	**Yes**. We provide examples of the tax avoidance arrangements found in practice at various places in this report and, where relevant, explain the relationship with treaties. It cannot be said how often a particular arrangement occurs in practice because tax planning is tailored to specific circumstances and the arrangement can differ from one company to another. In general, tax treaties are one of the instruments used in tax planning but are not essential for tax avoidance. The substance and scope of the Dutch treaty network are not exceptional in comparison with neighbouring countries.
1b) Can the Court of Audit carry out an in-depth audit of the legislation that enables tax avoidance?	**Yes**. Tax planning is enabled by international differences in tax legislation and the existence of tax treaties. This report considers such aspects as differences in corporation tax rates and bases, the levying of withholding taxes and different setoff methods in relation to Dutch treaty policy.
1c) Can the Court of Audit carry out an in-depth audit of ruling practice in the Netherlands?	**Yes.** Further to our audit of the legislation (see question 1b) we obtained information from the Tax and Customs Administration on its assessment process (ex ante) and supervision (ex post) of compliance with the relevant requirements, including substance requirements. We held interviews and studied files. We concluded that supervision is organised effectively. About 15% of the qualifying companies opted to conclude advance pricing agreements (APAs) or advance tax rulings (ATRs) with the Tax and Customs Administration. Until 1 January 2014, the Administration checked substance requirements when deciding whether to issue an advance ruling. This ex ante supervision was conscientious and consistent. Since 2014, supervision of compliance with the substantive requirements has been stepped up and the Administration has paid more attention to companies that do not conclude advance rulings. It carries out its checks on risk-based samples. We were unable to determine the effect of the stricter supervision owing to its recent introduction.
1d) Can the Court of Audit investigate how account is rendered on the above (questions 1a-1c) to the government and parliament?	**Yes**. Rendering account to the government is principally an internal matter for the State Secretary, policy departments and the Tax and Customs Administration. Our audit found no reason to question the information provided by the Administration to the State Secretary for Finance. The members of the government responsible for the Finance, Foreign Affairs, and Foreign Trade and Development Cooperation portfolios provide information to parliament on many occasions, when negotiating tax treaties and in response to

	questions in the House following press publications and the publication of reports. Nevertheless, because of the 'tailor-made' approach which is inherent in both tax planning and treaty negotiations and due to the absence of data on payments at aggregate level, the government does not have a complete picture of the Dutch tax climate for international companies and its relationship with international tax planning. Systematic, comprehensive, periodic reports are not published. Account is rendered to parliament principally in response to questions in the House or on the submission of new treaties or legislation.
1a-1d) Can the Court of Audit consider as many arrangements as possible, not only special financial institutions (SFIs), or letterbox companies, but also, for example, how multinationals allocate their assets and liabilities (transfer pricing and profit shifting)?	**To a limited extent**. Arrangements are tailored to specific circumstances. We restricted ourselves to the commonest categories, i.e. arrangements centring on transfer pricing and dividend, interest and royalty payments. We also considered hybrid legal forms. Our report uses the term SFIs only where information is available from the Dutch central bank (DNB). Otherwise we use the same term as the Tax and Customs Administration, conduit companies.
2a) Can the Court of Audit investigate the extent to which SFIs satisfy the substance requirements, how supervision is organised and how substance requirements are enforced?	**Not completely.** DNB knew of about 12,000 active SFIs in 2012. The Tax and Customs Administration, which supervises compliance with the substance requirements, uses the term conduit companies instead of SFI, and knew of about 12,500. The 12,500 conduit companies together constitute about 10,000 taxpayers. About 1,750 of them are financial service entities. Financial service entities are taxpayers whose activities consist principally of receiving and paying interest and royalties. They have long had to comply with the substance requirements. The other conduit companies, which act chiefly as holding companies, have had to comply with the substance requirements since 1 January 2014, but only if they wish to conclude an APA/ATR with the Administration. Before the adoption of a new inspection plan in 2014, the Administration checked a financial service entity's request for an APA/ATR chiefly in advance. A plan for ex post supervision was introduced in 2014. As the plan was only recently introduced, very few results are known and we cannot state the extent to which substance requirements are satisfied in practice.
2b) Can the Court of Audit make a better estimate of the revenue raised from dividend tax?	**No.** We cannot make a better estimate than what the House already has. We can determine from the Minister of Finance's central government annual financial report only the total revenue raised from dividend tax in the Netherlands. The figure was €2.2 billion in 2013. The impact of tax treaties and non-resident groups on the size of this revenue cannot be determined. The Administration does not keep overarching information on dividends paid by multinationals and their relationship with dividend tax or exemption from dividend

	tax. It can provide information, however, from the APA/ATR team of the Large Companies Local Tax Office in Rotterdam, which is responsible chiefly for conduit companies. Furthermore, many multinationals registered in the Netherlands carry out a wide range of activities here and, apart from concluding advance rulings, do not fall under the competence of the APA/ATR team. The information from the APA/ATR team indicates that multinationals, in so far as they do fall under the team's competence, apply the treaties and European legislation to minimise their dividend tax payments (to less than 1% instead of 15%).
3a) Can the Court of Audit outline the size of dividend tax exemption, and interest and royalty payments?	**Partially.** The Tax and Customs Administration does not generate comprehensive information on dividend, interest and royalty payments declared in multinationals' corporation tax returns. Nor does the Administration have information on dividend tax or dividend tax exemption based on tax treaties. We received information from DNB on incoming and outgoing dividend, interest and royalty payments, in so far as they could not be traced to individual companies. We found that the volume of dividend and royalty payments in particular had increased sharply in the past 10 years.
3b) Can the Court of Audit provide an insight into the rules on dividend tax exemption, and interest and royalty payments?	**Yes.** Anti-misuse provisions in treaties and international agreements are also relevant in this context. They regulate access to treaty benefits and are directly related to the substance requirements.
3c) Can the Court of Audit provide an insight into the supervision of the rules on dividend tax exemption, and interest and royalty payments?	**Yes.** We provide an insight into how supervision is regulated and express an opinion on how the Tax and Customs Administration performs this task. Supervision covers transfer pricing, compliance with APA/ATR conditions and ex post supervision of the companies that fall under the competence of the APA/ATR team. In the cases we reviewed, the supervision was satisfactory.

1 Introduction

1.1 Request from the House of Representatives

Different countries have different tax regimes. The differences are due not only to a country's tax laws but also to the tax treaties it concludes with other states. Multinational enterprises organise their activities within the bounds of the law so as to lower their tax burdens. This is known as *tax planning* or *tax avoidance*. Both tax planning and tax avoidance are legal. A strict distinction should be made between tax avoidance and *tax evasion*. Tax evasion is illegal. Multinationals do not locate their activities in a particular country solely for tax purposes. Other factors include the presence of an educated workforce, socioeconomic stability and investment protection agreements.

Countries usually seek a fair division of tax among individuals and businesses but also a tax climate that attracts business and encourages economic activity. This by itself leads to tax competition in the form of ever-lower international corporation tax rates. Tax facilities for, for example, innovative companies, such as the 'innovation box' in the Netherlands, further reduce the tax base on which corporation tax is calculated. Furthermore, countries lower the withholding taxes they levy on outgoing dividend, interest and royalty payments.

Tax competition enables multinational enterprises to organise their activities across many countries so as to minimise the corporation and withholding taxes they pay. Multinationals' paying ever less tax on their profits has an impact on the tax burden borne by other persons and enterprises in all the countries concerned. Small and medium-sized enterprises have fewer opportunities for tax planning or tax avoidance because they are usually active in only one country and therefore face a competitive disadvantage in the form of higher taxes on their operating profits. Developing countries are also at a disadvantage if they conclude tax treaties with a lower withholding tax rate on outgoing dividend, interest and royalty payments and therefore collect less tax. Such outgoing payments usually flow from developing to developed countries. Developing countries, however, are usually more reliant than developed countries on withholding tax, which is easier to compute and collect than

corporation tax. Others argue that this disadvantage is offset by the increased economic activity and consequent higher tax revenue brought about by tax treaties.

The House of Representatives asked the Court of Audit by letter of 3 December 2013 (House of Representatives, 2013) to carry out an in-depth audit of tax avoidance arrangements in relation to the tax treaty network. We informed the President of the House that we would honour the request by letter of 18 February 2014 (Court of Audit, 2014b). Table 1 lists the audit questions and refers to the chapters in this report where they are answered.

Table 1 **Audit questions and reference to relevant chapter**

Question from the House of Representatives	**Reference to relevant chapter in this report**
1a) Can the Court of Audit carry out an in-depth audit of the tax avoidance arrangements found in practice and their relationship with the tax treaty network?	We describe several arrangements in chapter 4.
1b) Can the Court of Audit carry out an in-depth audit of the legislation that enables tax avoidance?	We discuss these aspects and their relationship with each other in chapters 2 and 3.
1c) Can the Court of Audit carry out an in-depth audit of ruling practice in the Netherlands?	We explain the ruling practice and consider the numbers and types of rulings and their supervision in chapter 6.
1d) Can the Court of Audit investigate how account is rendered on the above (questions 1a-1c) to the government and parliament?	We describe how the politicians with primary responsibility (the State Secretary for Finance, the Minister of Finance, the Minister of Foreign Affairs and the Minister for Foreign Trade and Development Cooperation) render account to parliament in chapter 7.
1a-1d) Can the Court of Audit consider as many arrangements as possible, not only the use of special financial institutions (SFIs), or letterbox companies, but also, for example, how multinationals allocate their assets and liabilities (transfer pricing and profit shifting)?	We describe the various arrangements in chapters 4 and 5.
2a) Can the Court of Audit investigate the extent to which SFIs comply with substance requirements, how compliance is supervised and how substance requirements are enforced?	We consider substance requirements and their supervision by the Tax and Customs Administration in chapter 6. Chapter 6 also explains the difference between SFIs and conduit companies.
2b) Can the Court of Audit make a better estimate of the revenue raised from dividend tax?	We consider this in chapter 3.
3a) Can the Court of Audit outline the size of dividend exemption, interest and royalty payments?	We present the size of the various dividend, interest and royalty flows in chapter 3 and annexe 4.
3b) Can the Court of Audit provide an insight into the rules on dividend tax exemption, interest and royalty payments?	We consider these rules in relation to the various forms of tax planning and anti-misuse provisions in chapters 2, 3 and 4.

3c) Can the Court of Audit provide an insight into the supervision of rules on dividend tax exemption, interest and royalty payments?	We discuss the rules and their supervision in chapters 5 and 6.

We confined our audit to the avoidance of corporation tax and withholding tax; we did not consider avoidance of other taxes, such as VAT. To limit the size of this report, we consider national provisions to prevent misuse in broad lines only; provisions to prevent unintended use of the participation exemption (an exemption on substantial holdings) or interest payments are detailed and technically complex and their significance differs from one arrangement to another. For the same reason, the examples of tax avoidance arrangements we give in chapter 4 pay little if any attention to the various legal forms that can be used, such as cooperatives, permanent establishments, limited partnerships, non-resident hybrid entities and other legal forms. This is partly because virtually every arrangement is tailored specifically to the company concerned.

1.2 Structure of this report

The audit questions asked by the House of Representatives are successively answered in the light of the legislation, the resultant permitted arrangements, transfer pricing standards and their supervision, the organisation and operation of ruling practice, the supervision of substance requirements imposed on financial service entities and the provision of information to parliament. Chapter 2 considers relevant aspects of tax legislation. Chapter 3 looks at the tax treaty network and payment flows. Chapter 4 looks at tax planning in practice and chapter 5 at transfer pricing and profit shifting and the supervision exercised by the Tax and Customs Administration. Chapter 6 discusses the Tax and Customs Administration’s ruling practice, including advance pricing agreements, the substance requirements and their supervision. Chapter 7, finally, looks at how account for the matters discussed in this report is rendered to the House of Representatives. Annexe 1 lists the withholding tax rates in the EU. Annexe 2 presents the tax treaties concluded by the Netherlands and the applicable withholding tax rates. Annexe 3 presents the number of tax treaties concluded by European countries and the corporation tax rate applicable in those countries. Annexe 4 presents the size of dividend, interest and royalty flows into and out of the Netherlands. Annexe 5 expands upon one of the examples given in chapter 4.

2 Tax legislation

2.1 Introduction

Multinational enterprises can organise their activities so as to take advantage of differences in international tax regimes and the tax treaty network. Other factors that influence a decision to locate in the Netherlands include socioeconomic stability, the Dutch trading tradition and the availability of about 100 investment protection agreements (for a list of countries with which the Netherlands has concluded an investment protection agreement, see http://www.rijksoverheid.nl/documenten-en-publicaties/rapporten/2010/02/22/ibo-landenlijst.html (in Dutch only)).

This chapter considers tax legislation in the Netherlands in relation to foreign legislation.

2.2 Tax legislation

Corporation tax

One of the factors that influence tax planning is the difference in corporation tax rates between countries. In the Netherlands, companies pay 20% tax on profits of up to €200,000 and 25% on profits above €200,000. The corporation tax rate in the Netherlands is lower than that in, for example, Belgium, Germany and France, but higher than that in the United Kingdom, Ireland and most East European countries. Corporation tax rates in the EU range from 10% in Bulgaria to 35% in Malta.[3] Some countries, such as Bermuda and the Bahamas, do not levy corporation tax at all. The US, by contrast, charges 35% on a group's worldwide income if it is distributed to a holding company in the US. To avoid the high US tax rate, many US companies set up holding company arrangements that incorporate a company in the Netherlands. Many countries have lowered their corporation tax rates in recent years. The Netherlands has lowered its rate in steps from 48% in 1983 to the current 20-25% in 2011.

[3] However, the effective tax rate on Malta, after application of exceptions and deductions, is just 5%. The rate in France is 33.3% – one of the highest in Europe.

Figure 2 **presents corporation tax rates in Europe**

Bulgaria 10%
Cyprus
Ireland
Lithuania
Ukraine
Romania
Slovenia
Hungary
Poland
Czech Republic
Finland
Iceland
Croatia
Russia
Turkey
Estonia
United Kingdom
Slovakia
Sweden
Latvia
Denmark
Netherlands 25%
Austria
Switzerland
Greece
Norway
Portugal
Luxembourg
Spain
Italy
France
Germany
Belgium
Malta 35%

0 5 10 15 20 25 30 35

It should be noted that the actual tax paid is determined not only by the tax rate but also by the tax base. The tax rate in Belgium, for example, is relatively high, but the tax base is relatively small on account of the available tax deductions and exemptions.

Differences in corporation tax rates encourage companies to recognise profits in a low-tax country and declare expenses in a high-tax country (a practice known as profit shifting). There are limits, however, to this practice. Tax authorities have a duty to stop multinationals shifting profits unreasonably by using transfer prices that are not set at arm's length. An arm's length price is one that independent parties would use. We consider transfer pricing and advance pricing agreements in more detail in chapters 5 and 6.

Innovation box

Tax planning is driven by both the corporation tax rate and the tax base. The innovation box is a tax facility that reduces the tax base in the Netherlands. If the Netherlands Enterprise Agency of the Ministry of Economic Affairs has issued a Research and Development Declaration, only 20% of the profit generated by a patent or research and development work is taxed and the company concerned enjoys a reduction in its salaries tax and national insurance remittances. Other countries, including the United Kingdom, Belgium, China, France, Ireland, Spain and Switzerland, have similar facilities. The UK patent box, for example, covers a wider range of activities than the Dutch innovation box and the standard rate of corporation tax is reduced from 21% to 10%. In the Netherlands, however, it is reduced from 20-25% to an effective rate of 4-5%.

Avoidance of double taxation: exemption or tax credit

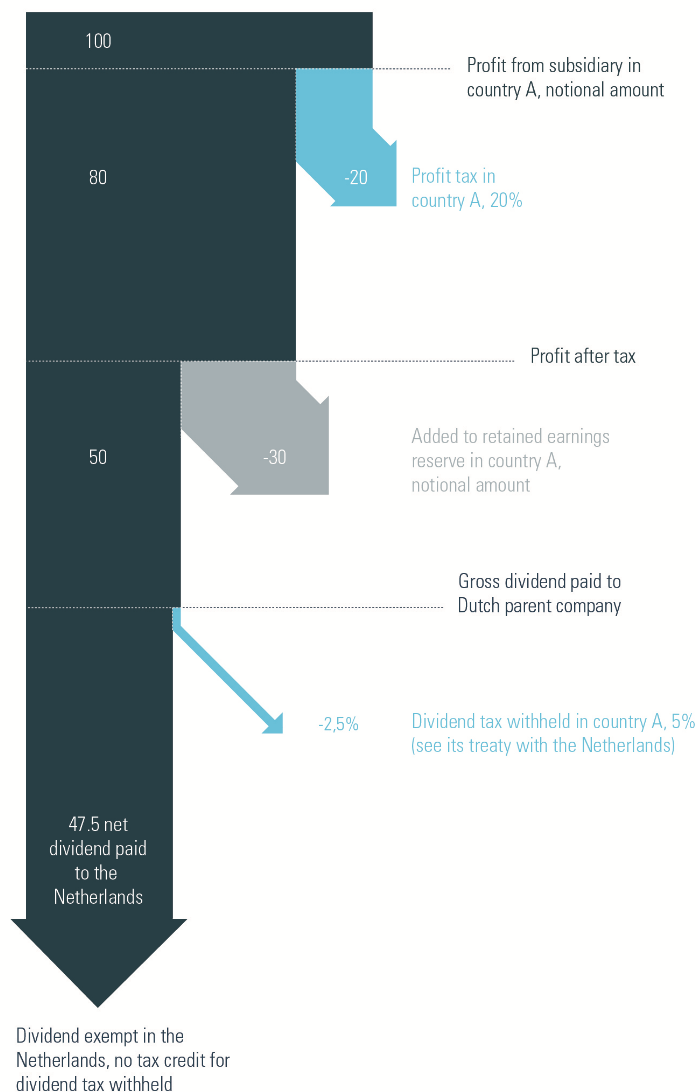
Double taxation can be avoided if the recipient country grants an exemption or a tax credit in respect of taxes withheld abroad. The way in which income from a subsidiary is taxed in the hands of the parent company also influences tax planning. Under the Dutch participation exemption scheme, income received by a parent company from a subsidiary is free of corporation tax in the Netherlands. The participation exemption scheme is laid down in the Corporation Tax Act 1969; the State Secretary for Finance's stance on the scheme is set out in a ministerial order (Ministry of Finance, 2010). The scheme prevents profit that has already been taxed in the hands of the subsidiary being taxed again in the hands of the parent. 'Profit' includes not only profit on ordinary activities (dividends) but also capital gains on the disposal of business activities or assets. As profits from substantial holdings are not

taxed, losses, with the exception of liquidation losses, are not deductible. A substantial holding is an equity holding of at least 5%.

Most EU countries also exempt dividend payments received on substantial holdings from profit tax. The scope of the exemption, however, differs from country to country. The Netherlands, for example, does not tax profits earned on the sale of a substantial holding. The other way to avoid double taxation is to grant a tax credit. Dividends received from a foreign subsidiary are taxed but the profit and withholding taxes paid abroad are credited against tax payable in the recipient country. There are various ways to credit the tax.

Figure 3 below illustrates the tax consequences of the Dutch participation exemption scheme.

Figure 3 **Example of the participation exemption scheme (in thousands of euros)**



The example shows that, under the participation exemption scheme, profit already taxed in country A is not taxed again in the Netherlands. The tax withheld in country A does not qualify for a tax credit in the Netherlands because the Netherlands does not tax the dividend, and the tax withheld cannot be credited against Dutch corporation tax levied on the Dutch parent company's profits on other activities.

Withholding tax

Tax planning is also influenced by differences in the withholding tax countries levy on outgoing dividend, interest and royalty payments in combination with the provisions of a tax treaty. A royalty is a payment for the use of a licence, trademark, etc. The Ministry of Finance has agreed that the definition of royalty should be 'that which is customary in the country concerned'. Royalties include licence fees for the use of patents, copyrights in books and music recordings, management fees, various consultancy fees, technical service fees, payments for the transfer of know-how, operating lease fees and rental payments for movable assets. Within the EU, interest and royalties paid to an associated company are exempt from withholding tax (EC, 2003) if the recipient company holds at least 25% of the paying company's share capital. Dividend payments within a *group* are also exempt in the EU if the parent company holds at least 10% of the subsidiary's share capital. The subsidiary then need not withhold dividend tax (EEC, 1990). Dividend, royalty and interest payments to non-associated companies or countries outside the EU, however, may be subject to withholding tax.

Most EU countries levy withholding tax on dividend, interest and royalty payments. The rate varies from 5% to 35%. The Netherlands levies withholding tax, at 15%, on dividends only, not on royalties or interest. The dividend tax rate was lowered from 25% to the current 15% on 1 January 2007. Other countries have also lowered their withholding tax rates in recent years. Dividend tax raised €2.2 billion in the Netherlands in 2013. Figure 4 shows the withholding tax rates on dividends, interest and royalties in the 28 EU member states.

Figure **4 Withholding tax rates in the European Union (without treaty)**

	Dividend	Interest	Royalties
Austria	25	0	20
Belgium	25	25	25
Bulgaria	5	10	10
Czech Republic	15	15	15
Croatia	12	20	20
Cyprus	0	0	10
Denmark	27	25	25
Estonia	0	0	10
Finland	20	0	20
France	30	0	33.33
Germany	25	0	15
Greece	10	15	20
Hungary	0	0	0
Ireland	20	20	20
Italy	26	26	22.5
Latvia	0	0	0
Lithuania	15	10	10
Luxembourg	15	0	0
Malta	0	0	0
Netherlands	15	0	0
Poland	19	20	20
Portugal	35	35	25
Romania	16	16	16
Slovakia	0	35	35
Slovenia	15	15	15
Spain	21	21	24.75
Sweden	30	0	0
United Kingdom	0	20	20
Number of countries without withholding tax	7	12	6

0 5 10 15 20 25 30 35

The figure shows that 14 countries levy withholding tax on dividends, royalties and interest, six have two kinds of withholding tax, five have one kind and three have no withholding tax.

It also shows that of the Netherlands' neighbours, Luxembourg does not levy withholding tax on royalties and interest and the United Kingdom is one of the few large European countries not to levy withholding tax on dividends. France does not levy withholding tax on interest payments. Switzerland, which is not shown in the figure, does not levy withholding tax on royalties.

The Netherlands takes the stance that interest and royalties are taxable in the country in which the recipient (the legal or natural person that owns the shares) is resident or registered. This is known as the state of residence principle. Tax withheld from interest and royalty payments abroad can be credited against Dutch corporation tax if permitted by the applicable tax treaty or if the tax is withheld by a developing country. The credit is limited to the lower of the tax withheld abroad and the corporation tax payable on the same income in the Netherlands. If the participation exemption scheme is applicable, foreign dividend payments are exempt in the Netherlands and no tax credit is available for foreign dividend tax. The principle that interest and royalties should be taxed in the recipient's state of residence is included in the tax treaties the Netherlands concludes. Treaty partners often agree to lower their withholding tax rates, on condition that the Netherlands lowers its withholding tax on dividends.

The absence of withholding tax on interest and royalty payments in combination with lower treaty-based withholding tax rates (such as the lower dividend withholding tax rate in the Netherlands) makes the Netherlands an attractive location for companies whose activities consist chiefly of receiving and paying interest, royalties and rental or lease instalments from and to group companies outside the Netherlands. Such companies are known as financial service entities. In some cases, the withholding tax levied in the treaty country is reduced to as low as zero and the Netherlands does not levy withholding tax on outgoing interest and royalties. Where tax is withheld, it can be credited subject to conditions against corporation tax payable in the Netherlands. As a result, the Netherlands might levy less or even no tax. An example of this, the Double Irish Dutch Sandwich, is given in chapter 4. Another example is shown in figure 5 below.

The example in figure 5 shows that the royalty payment reduces the profit in Indonesia. Corporation tax is payable on the profit at 25%. Furthermore, under the tax treaty, Indonesia withholds 10% tax on royalties paid to Dutch group companies. Without a treaty the rate would be 20%. The royalties received from Indonesia (€100,000) are taxed in the Netherlands net of the licence fee (royalty) paid to the group company in a third country. We do not consider the profit tax payable on the royalty in the third country (€75,000) further. The withholding tax levied in Indonesia (€6,250) can be deducted from the corporation tax payable in the Netherlands up to the maximum amount of corporation tax payable in the Netherlands. As a result, no tax is payable. This ceiling does not entirely eliminate double taxation. The Netherlands does not withhold tax from the royalties paid to the group company in a third country because it believes royalties should be taxed in the country of receipt. As a result of the tax treaty between the Netherlands and Indonesia and the Dutch tax credit in respect of Indonesian withholding tax, the interposition of a Dutch company in this example produces a net saving of €10,000. No tax is paid in the Netherlands in this example.

The Netherlands is not the only country in the EU that does not levy withholding tax on royalties; neither do Hungary, Latvia, Luxembourg, Malta and Sweden.

Figure 5 **Calculation of withholding tax on royalties (in thousands of euros)**

Indonesia
Tax in Indonesia
Netherlands
Tax in the Netherlands

120
Group company result in Indonesia before royalty payment, notional amount

100
20
Group company result in Indonesia

-5
Profit tax, 25% of 20

15
Net group company result in Indonesia

Royalty payable to group company in the Netherlands

-10
Withholding tax on royalty paid to the Netherlands (100), 10% under treaty

90
Net royalty received by group company in the Netherlands

15
-75
Licence fee payable to group company in another country. The Netherlands does not levy withholding tax on royalties

Gross group company result in the Netherlands

-6.25
Corporation tax in the Netherlands, 25% of 100-75 = 6.25

+6.25
Credit in respect of Indonesian withholding tax

Corporation tax in the Netherlands 0

Advance tax rulings and advance pricing agreements
Companies can make agreements with the Dutch Tax and Customs Administration on the taxation of certain activities (see chapter 6). This makes the Netherlands a more attractive business location.

2.3 Conclusion

For multinationals, individual tax schemes in the Dutch tax system do not differ substantially from those in comparable European countries such as the United Kingdom, Switzerland and Luxembourg. However, schemes directed principally at the avoidance of double taxation do offer some advantages to multinationals, for example:

- income earned by foreign holdings is not taxed twice;
- tax is not withheld from interest and royalty payments;
- withholding tax rates on incoming dividend, interest and royalty payments are lower.

Furthermore, under Dutch law multinationals can agree advance tax rulings and advance pricing agreements with the Dutch Tax and Customs Administration to give them certainty on how their activities will be taxed. However, the steady decline in corporation and withholding tax rates and the resultant reduction in the corporation tax paid by multinationals have focused growing worldwide attention on international tax competition in recent years.

3 Tax treaties and payment flows

This chapter looks at Dutch tax treaty policy and the reasons for it. It pays particular attention to policy on developing countries. It also considers international developments and the amount of dividend, interest and royalty flows, including licence income, that pass through the Netherlands.

Not only Dutch tax legislation but also tax legislation in other countries and treaties for the avoidance of double taxation are of importance for multinationals.

A tax treaty is an agreement between two countries laying down which one has the right to tax which income. One country will have the right of taxation and the other will grant the taxpayer a tax credit or exemption. Most tax treaties also provide for lower withholding tax rates on dividend, interest and royalty payments.

3.1 Number of tax treaties concluded

Like most other European countries, the Netherlands has concluded many tax treaties. Figure 6 shows the number of tax treaties concluded by European countries.

Figure 6 **European countries ranked by number of tax treaties**

France 126
United Kingdom
Switzerland
Germany
Netherlands 94
Italy
Belgium
Romania
Norway
Spain
Austria
Sweden
Poland
Czech Republic
Russia
Turkey
Denmark
Finland
Hungary
Ireland
Ukraine
Bulgaria
Luxembourg
Malta
Slovakia
Portugal
Croatia
Latvia
Estonia
Slovenia
Greece
Lithuania
Cyprus
Iceland 39

0 30 60 90 120 150

Figure 6 shows that the Netherlands ranks fifth. Many of its treaty partners are countries with highly developed economies. The Netherlands has concluded treaties with nearly all countries in Europe (Cyprus is an exception), and with all OECD countries barring Chile. Most of the treaties with the former Soviet countries are a continuation of the treaty with the Soviet Union. They are gradually being replaced with new bilateral treaties.

With the aid of the Deloitte International Tax Summaries website (https://dits.deloitte.com), we determined the reduced dividend, interest and royalty withholding tax rates agreed by EU member states in their tax treaties. In general, they do not differ from those agreed by the Netherlands. Apparently negligible differences in agreed withholding tax rates, however, can produce significant tax savings if substantial dividend, interest and royalty payments are made through a low-tax country.

Improper use of the tax treaties can be prevented by the inclusion of anti-misuse provisions in the treaties or in national tax law (see sections 6.3.1 and 6.3.2).

3.2 European legislation

Within the EU, the levying of withholding tax on dividend payments to holding companies was abolished, subject to certain conditions, by the Parent-Subsidiary Directive and the levying of withholding tax on interest and royalty payments to group companies by the Interest and Royalties Directive. EU countries have therefore relinquished their right to tax outgoing payments. In most of the treaties concluded by the Netherlands the country of residence principle has been reinstated and withholding tax is low if not zero. The country of residence principle adopted by the Netherlands means that income is taxable in the country in which the ultimate beneficiary (the legal or natural person that holds the shares) is resident. Developing countries, which, like the Netherlands in the 1950s and 1960s, are usually home to operating companies rather than holding companies, often attach greater weight to withholding tax. The Netherlands allows for this in the treaties it concludes with them.

3.3 Principles for concluding a tax treaty

The Netherlands has an open economy with large transit ports for ocean shipping and a major airport, a relatively small domestic market and a huge foreign market. It is therefore in its interest to remove obstacles to international trade, such as double taxation. Tax treaties are a means to avoid double taxation and eliminate tax gaps. The treaties the Netherlands has concluded in recent years have given greater weight to transparency and the exchange of information in tax matters. A growing number also include anti-misuse provisions. Furthermore, there have been significant changes in Dutch tax legislation, partly on account of international developments. In response, the government has issued an updated memorandum on Dutch tax treaty policy: the Tax Treaty Policy Memorandum 2011 (NFV 2011) (Ministry of Finance, 2011).

Pursuant to the NFV 2011, the Netherlands concludes tax treaties in order to:

- avoid double taxation and double non-taxation;
- strengthen bilateral economic ties and promote mutual economic development;
- eliminate the competitive disadvantage of Dutch companies relative to other domestic and foreign investors in a future treaty country;
- remove obstacles to mutual investments. To this end, investment protection agreements are concluded as well as tax treaties. An investment protection agreement is a bilateral treaty that provides assurance that investments in the territory of one of the countries will be protected.

The letter accompanying the NFV 2011 outlined the nature of recent treaties. The main categories are:

- Tax Information Exchange Agreements (TIEAs), concluded with countries that do not yet qualify for a general tax treaty;
- renewed treaties with established partners;
- tax treaties with states with limited domestic taxation, including a number of developing countries.

The Netherlands prefers to base its treaty negotiations on the OECD model convention (OECD, 2012) but potential treaty partners do not always wish to do so if their interests diverge from the convention’s intentions, such as a higher withholding tax for a country that barely taxes profits if at all. This, together with the diversity of the intended treaty partners, means the treaties have to be tailored to each country. Any enlargement of the current tax treaty network will be due almost

solely to the conclusion of new treaties with non-OECD member states. Treaties have already been concluded with most OECD countries.

Treaties with low-tax states harbour the risk of double non-taxation. In other words, the Netherlands could relinquish its right of taxation even if the treaty partner levies little if any profit tax. Treaties with such countries therefore pay extra attention to preventing undesirable avoidance arrangements. A treaty can also be restricted, however, to the exchange of information or may be incomplete. The treaty with Bermuda is an example.

The Netherlands accepts more departures from the OECD model convention in its treaty negotiations with developing countries than in its negotiations with 'richer' countries. The departures, such as higher permitted withholding tax rates, draw chiefly on the model convention of the United Nations, which is intended specifically for treaties between rich and poor countries (UN, 2011).

The Netherlands uses its membership of international organisations to advocate more efficient taxation in developing countries. It is active, for example, in the OECD's Task Force on Tax and Development, which was set up to strengthen the tax authorities of developing countries. The Dutch government announced on 30 August 2013 that the Netherlands would offer the 23 developing countries with which it had or was negotiating a tax treaty the option of including anti-misuse measures in the treaty (Ministry of Finance/Ministry for Foreign Trade and Development Cooperation, 2013). The countries concerned are Bangladesh, Egypt, Ethiopia, Georgia, Ghana, India, Indonesia, Kenya, Kyrgyzstan, Malawi, Moldova, Mongolia, Morocco, Nigeria, Pakistan, the Philippines, Sri Lanka, Uganda, Ukraine, Uzbekistan, Vietnam, Zambia and Zimbabwe. A news report issued by the Ministry of Finance on 11 July 2014 announced that contact would be established with these countries before the end of 2014.

3.4 The Dutch approach to developing countries

Several sections of the NFV 2011 deal with the different tax positions of developing countries and rich countries. It also highlights the importance of efficient tax authorities and effective taxation, and the assistance the Netherlands can provide to establish an efficient tax system through multinational ties, development cooperation and the exchange of information.

More specifically, the memorandum notes that the Netherlands is willing to depart from a number of principles in its treaties with developing countries, particularly regarding the definition of 'permanent establishment' and the levying of withholding taxes. The Netherlands favours a strict definition of permanent establishment and thinks that an activity performed elsewhere should not automatically be defined as a permanent establishment. The main reason for this is to limit the administrative burden on the taxpayer. If there is a permanent establishment, tax is levied where the permanent establishment is located. If there is no permanent establishment, it is levied in the home country of the company performing the foreign activity.

The Netherlands therefore agrees with the OECD model convention that building and construction work is performed by a permanent establishment only after 12 months' activity. Many developing countries prefer the approach taken in the UN model convention. It has a minimum term of six months for building work and defines more activities and services during a given period as permanent establishments. This model gives the right of taxation more often and more generously to the country in question. The Netherlands is willing to include more elements of the UN model in its treaties with developing countries.

Regarding withholding tax on interest and royalty payments, the Netherlands seeks only state of residence taxation in its treaties but is willing to make concessions in treaties with developing countries.

3.5 Audit of negotiation files

We studied the definition of permanent establishment and the withholding tax rates agreed in six recent negotiation files. We selected the six files chiefly because the negotiations had been completed in the past three years. The selection includes three countries that are classified as developing countries by the Minister for Foreign Trade and Development Cooperation or by large non-governmental organisations such as Cordaid and Oxfam-Novib (Ethiopia, Uganda and Ghana), two former Soviet republics (Kazakhstan and Azerbaijan) and a prosperous country (Japan). Apart from specific considerations relating to a negotiating partner's status as a developing country or specific requirements a country sets regarding anti-misuse provisions, the files reveal no significant differences in the negotiations. Each treaty is self-contained and both parties pursued their own economic interests during

the negotiations. The Netherlands, for example, wanted to remain an attractive European distribution centre for Japanese companies. The negotiations with Japan gave high priority to anti-misuse provisions.

Example treaty negotiations and anti-misuse provisions
If the majority of a Dutch company's shareholders are not Dutch residents, the company cannot benefit from the treaty with Japan unless at least 75% of the foreign shareholders are resident or registered in a country that has concluded an equally favourable treaty with Japan. Furthermore, treaty benefits cannot be enjoyed if the Dutch company transfers more than 50% of the income it receives from Japan in the form of deductible payments to natural or legal persons in countries that have a less favourable or no tax treaty with Japan. Regardless of the above, a taxpayer can benefit from the treaty if it carries on a business in the Netherlands or acts as the head office of an international company (the conditions are laid down in the treaty). The treaty stipulates that the lower rates of withholding tax on dividend, interest and royalty payments apply only if the company that receives the dividend has been the beneficial owner in the six months prior to the dividend payment and holds at least 50% of the voting rights in the company paying the dividend. The treaty also states that there is no beneficial ownership if the resident of a third state uses a Dutch conduit company but is subject to a less favourable tax rate under the treaty between that third state and Japan.

Under the NFV 2011, the Netherlands agrees higher withholding tax rates with developing countries than with other countries. This can be seen in Annexe 2, which lists the tax treaties and the withholding tax rates concluded by the Netherlands. The negotiation files for the three developing countries also show that more lenient requirements were set for the presence of a permanent establishment. Furthermore, all six files showed that the Netherlands did not always take the initiative to negotiate a treaty. No general conclusions can be drawn from this as every situation is different. The reasons to enter into negotiations range from a request from the international business community, the creation of economic niches and the establishment of a bilateral relationship to a country's desire for economic or democratic development, the wish for a more comprehensive treaty package and the relationship with one or more third countries, etc. In general, a treaty is negotiated only when a serious economic relationship has been established or is foreseen in the near future. Negotiations are started in accordance with the principles of tax treaty policy. In the six files we studied, the results of the negotiations were consistent with the principles of the NFV 2011.

The Netherlands enters into treaty negotiations in order to obtain as much advance certainty as possible. Accordingly, it is Dutch policy to include specific anti-misuse provisions in treaties or to reach agreement on an arbitration procedure. It does not declare national anti-misuse provisions applicable in a treaty as the treaty's provisions may then

become dependent on unforeseen changes in national laws or developments in a country's case law.

Under the Kingdom Act containing regulations on the approval and publication of treaties, the Minister of Foreign Affairs periodically provides the States General with a list of draft treaties that are still under negotiation. Pursuant to the same Act, the results of the negotiations are submitted to the States General for approval.

3.6 International developments

European Union

On 25 November 2013, the European Commission published a proposal for a Council Directive amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states (European Commission, 2013). It includes proposals to amend the Parent-Subsidiary Directive in order to combat tax avoidance.

The first proposal is a measure to combat misuse by means of artificial tax arrangements. These are arrangements that specifically exploit provisions in the Parent-Subsidiary Directive in order to obtain undue tax advantages, for example by interposing an intermediate subsidiary without substance in an arrangement to avoid withholding tax in a member state. Agreement has not yet been reached on this proposal.

The Commission's second proposed measure is to prevent improper use of participation exemption schemes so that hybrid loans do not result in double non-taxation. This proposal has been adopted (EU, 2014). In some cases, the source country may treat a distribution as deductible interest while the recipient country treats it as exempt dividend. To avoid this double non-taxation, the EU has proposed that a participation exemption scheme may be applied only if a source-country payment is not deductible. The member states must transpose it into their national legislation no later than 31 December 2015.

OECD/European Commission study of ruling practice

The OECD published a report entitled Harmful Tax Competition, an emerging global issue in 1998 (OECD, 1998) explaining how it intended to tackle harmful tax arrangements. A follow-up report in June 2000 contained a list of potentially harmful tax regimes in the OECD countries. The Netherlands did not satisfy three of the OECD's guidelines on the

taxation of international companies. In the second Progress Report, published in 2004 (OECD, 2004), the OECD reported that the Netherlands had replaced all, in its words, 'potentially harmful regimes' with an OECD-compliant APA/ATR practice.

On 11 June 2014, the European Commission decided to conduct a formal investigation of potential Dutch state aid in an APA. On the same date, the State Secretary for Finance informed the House of Representatives that when the Commission initiated the formal investigation it had confirmed on the basis of an in-depth study that the Netherlands had a robust and sound APA and ATR practice (Ministry of Finance, 2014a). The formal investigation related only to the case of Starbucks Manufacturing EMEA BV. The State Secretary for Finance noted in his letter that he was confident that the agreements with Starbucks would satisfy OECD transfer pricing guidelines. The findings of the investigation into Starbucks Manufacturing EMEA BV were not known when we concluded our audit for this present report.

OECD and G20
International agreements have been made and guidelines formulated on the principles of taxation. In particular, the OECD has introduced guidelines on, for instance, the exchange of information between countries and on intercompany pricing.

As part of the BEPS project (Action Plan on Base Erosion and Profit Shifting (OECD, 2013), the G20 and OECD have made proposals to address existing arrangements that are conducive to tax avoidance. The Netherlands supports the BEPS project. The United Nations Conference on Trade and Development (UNCTAD) has found a growing need for an international approach to tax issues. 'Unsustainable levels of public deficits and sovereign debt have made governments far more sensitive to tax avoidance, manipulative transfer pricing, tax havens and similar options available to multinational firms to unduly reduce their tax obligations in host and home countries' (UNCTAD, 2012). The OECD claims that international tax rules are no longer appropriate in today's world. The current system takes no account of the highly integrated global economy, the information society and other aspects of the modern world in which businesses operate. In action 8 of the BEPS, for example, the OECD calls for attention to be given to transfer pricing rules for intangible assets. The OECD also proposes that tax avoidance be eliminated by obliging multinationals to be open about the taxes they pay in a particular country so that other countries can see where profits and losses are recognised. They are not obliged to do so at present. In

Moscow, the G20 heads of state and government endorsed the principles of the BEPS project in points 6 and 50 of their Leaders' Declaration (G20, 2013).

As well as proposals to bring about the necessary automatic international exchange of information, the heads of government are formulating proposals to tackle tax planning by multinationals. The G20 and OECD are urging countries to examine how their tax systems contribute to the BEPS. The objectives are:

- to close the gaps between tax systems that multinationals exploit, while respecting the states' tax sovereignty;
- to revise existing international rules on tax treaties, permanent establishments and transfer pricing (as laid down in the model conventions and guidelines) where necessary in order to obtain assurance that taxes are levied where value is created. Treaty shopping must be curtailed by provisions in the treaties themselves;
- to enhance transparency, including a requirement that multinationals provide all relevant governments with needed information on their global allocation of the income and taxes paid among countries according to a common template (country by country reporting). Governments must be open about the tax arrangements (rulings, exemptions and tax benefits) they make with companies and about cases of aggressive tax planning. Enhanced transparency must be supported by better systems of information collection;
- these agreements must be implemented in 18 to 24 months' time (i.e. no later than the end of 2015). The OECD is developing instruments to help countries revise their existing treaty network.

In 2014 the OECD turned its attention to corporate transparency with a view to making beneficiaries known. The OECD BEPS report included 15 actions with intended outcomes and deadlines. The OECD's Secretary-General provided information on the plan's progress at a press conference on 16 September 2014 (OECD, 2014). Consensus had been reached on the first seven actions but they will not be formally finalised until the other eight points have been worked out in more detail in 2015, as they may have an impact on the first seven points. The countries that support this first part of the programme are the OECD countries, the other G20 countries and the candidate OECD countries. In total, 142 countries, including about 90 low and middle income countries, have been consulted about the programme. Businesses, trade unions, civil society organisations and academics have also contributed to the programme. The recommendations agreed upon in 2014 relate to hybrid entities, double deduction, the influence of taxation on the location of

service activities, treaty misuse, the greater role of transfer pricing guidelines and the artificial shifting of profits to low-tax jurisdictions.

Where necessary these points will be worked out in more detail in 2015 and the discussion of the remainder of the BEPS programme will concentrate on increasing the opportunities to tax profit that has been shifted, limiting the ability to lower profits on paper, strengthening the rules on permanent establishments, improving the collection and analysis of economic data, improving national rules that enable the generation of information on harmful tax avoidance and making international arbitration in taxation disputes more effective.

Implementation of the agreements will not be left entirely to individual countries. Preparations for an international conference to agree multilateral instruments to implement and streamline the BEPS action plan will begin in early 2015. In its press release on the outcomes achieved in 2014, the OECD observed that progress had been made in the field of transparency. Agreement had been reached on, for example, significant aspects of country-by-country reporting of profits, economic activity and the taxation of multinationals.

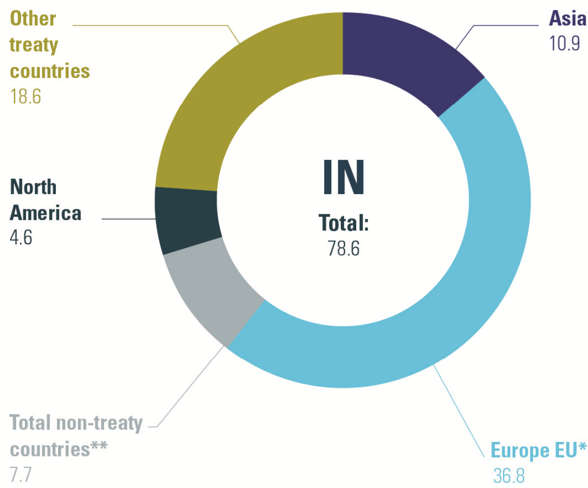
3.7 Development of dividend, interest and royalty flows

The House of Representatives asked us to describe the size of incoming and outgoing dividend, interest and royalty flows and the size of the participation exemption. SFIs must report this information to DNB for the purpose of compiling balance of payment statements. At our request, DNB provided figures only in so far as they could not be traced to individual companies. Some figures are therefore missing. For the royalties, DNB provided only aggregate incoming and outgoing flows until the end of 2011.

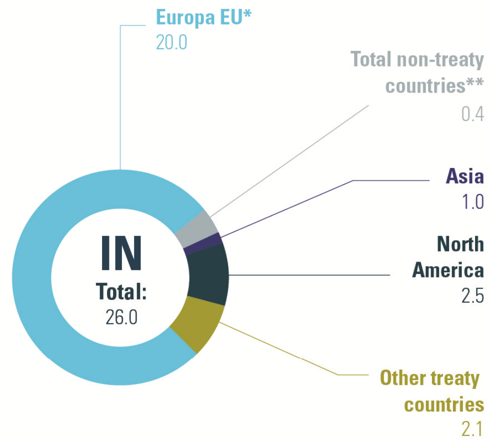
Figure 7 shows the average dividend and interest flows for the years 2008 to 2012. A more detailed breakdown is provided in annexe 4.

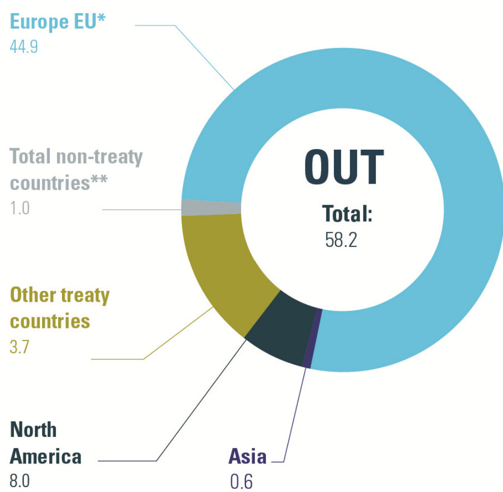
Figure 7 **Dividend and interest flows (in billions of euros)**

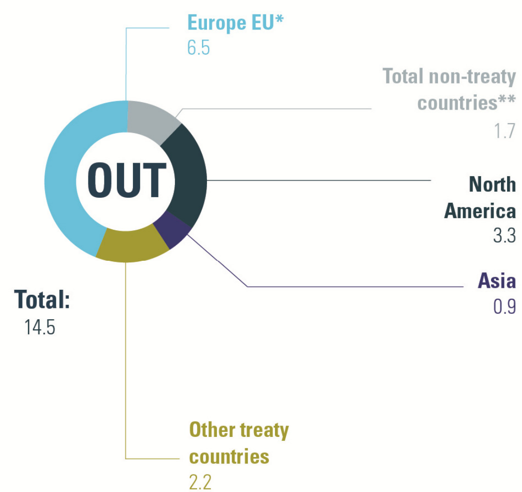
Average dividend flow, 2008-2012



Average interest flow, 2008-2012







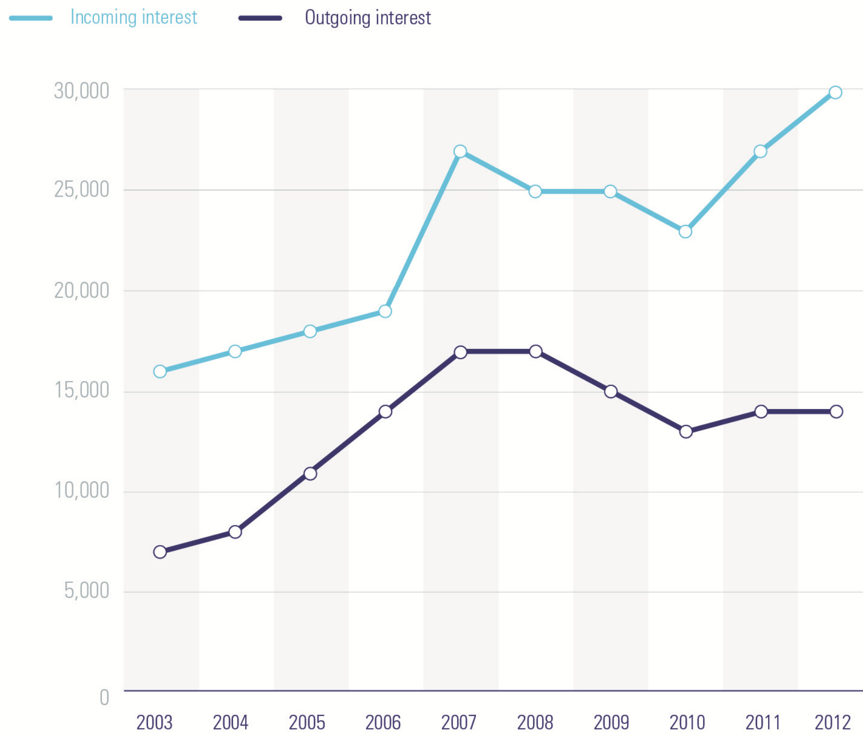
Source: DNB

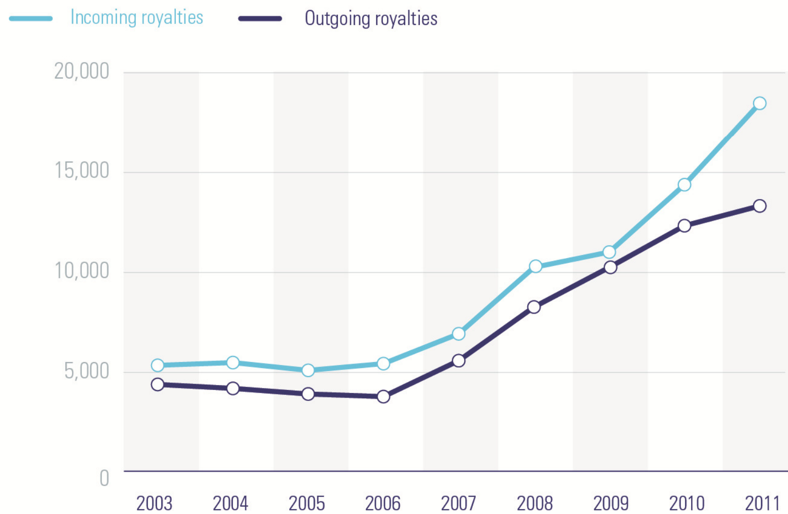
It can be seen from figure 7 that most of the dividend and interest flows are between the Netherlands and the rest of the European Union and flows between the Netherlands and non-treaty countries are relatively small. For a number of reasons, the incoming dividend and interest flows shown above are not necessarily directly related to the outgoing flows. The main reason is that SFIs also retain profits. Instead of distributing dividend receipts to the parent company, they can reinvest them in, for example, loans to foreign subsidiaries. Secondly, the Foreign Direct Investment (FDI) flows shown here are only part of the SFIs' income. A significant proportion of their financing consists of external funding in the form of securities and bank loans. This funding is not classified as FDI and the related interest payments are therefore not included in the figures shown here. The interest paid on group loans, by contrast, is included in the FDI figures and in the figures above. The third and final reason is the possible transformation of income flows; interest received on a group loan, for example can be passed on to the parent company in the form of a dividend.

We also had access to underlying figures that showed that both incoming and outgoing dividend, interest and royalty flows have steadily risen every year since 2003.

Figure 8 below shows the incoming and outgoing interest and royalty flows of SFIs. It does not show dividend flows because information on a significant proportion of the flows is missing from annexe 4 as the figures could be traced to individual companies.

Figure 8 **Incoming and outgoing interest and royalty flows, 2003-2012**





DNB cannot, provide a comparable overview of incoming and outgoing dividend flows as they could be traced to individual companies.

Figure 8 shows that both incoming and outgoing interest and royalty flows have increased. Interest flows almost doubled between 2003 and 2012 and royalty flows increased by a factor of more than three.

Dividend flows have increased even more sharply but the lack of figures prevents comparison with 2003. Annual totals for 2004 and 2012, however, indicate that incoming dividend flows increased by a factor of 5.6. Annual figures for 2006 and 2011 show that outgoing dividends increased by a factor of 2.1.

Table 2 **Dividend, interest and royalty flows (in millions of euros)**

	Base year *)	Comparative year	Factor increase
Dividend in	13,067	72,684	5.6
Dividend out	25,610	53,715	2.1
Interest in	14,402	29,583	1.8
Interest out	7,143	14,110	2.0
Royalties in	5,358	18,481	3.4
Royalties out	4,403	13,326	3.0

*) Base year and comparative year for incoming dividends: 2004 versus 2012; outgoing dividends: 2006 versus 2011; interest: 2003 versus 2011; and royalties: 2003 versus 2011.

These are substantial flows relative to the Netherlands' gross national income of €607 billion in 2012.

In 2013 the Tax and Customs Administration collected a total of €2.2 billion in dividend tax. It cannot be said what effect tax treaties or foreign groups had on this revenue.

In an annexe to the corporation tax return, the Administration asks questions about the income and expenses relating to international holding company activities, international licensing activities, international financing activities and other activities. We asked the Administration for a summary of this information. It was unable to provide one because it has not kept the information cumulatively since 2007. It could provide this information, though, for its APA/ATR team in Rotterdam. The Rotterdam Tax Office compared the net income and expenses stated in the annexes and the net income and expenses declared in the returns and concluded that the annexes were not sufficiently reliable. This was because taxpayers often did not answer the questions annexed to the return correctly if at all. The Administration noted that as this had no

direct consequences for the tax payable, it had not so far mobilised capacity for this part of the return.

When asked why taxpayers had to provide this information, the Administration said it provided an insight into a company's activities. Furthermore, the information helped it decide whether the return was filed correctly or not. The acceptability of the remuneration for licensing and financing activities could be seen at a glance from the allocation of income and expenses to the holding company, licensing, financing and other activities. Furthermore, the cost allocation is used to calculate how much foreign withholding tax can be credited against tax payable in the Netherlands (up to the maximum amount of corporation tax payable). A high cost allocation to the holding company activity can indicate the presence of non-deductible interest expense. If the 'other' category has been completed, it may indicate that there is no creditable loss on holding company activities. These are just some of the reasons that the questions in the return produce an indication. In summary, the annexe to the return provides the Tax and Customs Administration with a handy checklist to identify tax risks.

The APA/ATR team is the Advance Pricing Agreement (APA)/Advance Tax Ruling (ATR) team. Subject to the Organisation and Competence (APA/ATR Practice) Order (Ministry of Finance, 2014b), it deals with the corporation tax returns of financial service entities (DVLs) and companies engaged principally in holding company activities (together known as conduit companies) and with applications for APAs and ATRs. Financial service entities are entities that are engaged principally in providing interest and royalty services. A holding company holds shares in another company and performs management tasks.

We received a statement from the APA/ATR team of the profit distributions made by the taxpayers that fall under its competence and the associated dividend tax withholdings.

Table 3 **Profit distribution and dividend tax payments by companies falling under the competence of the Rotterdam/Rijnmond APA/ATR team (in millions of euros)**

Year	Profit distribution	Dividend tax
2010	45,999	103
2011	54,173	73
2012*	19,095	65

Source: APA/ATR team

*According to the Tax and Customs Administration, the figures for 2012 are relatively low because not all returns for the year had been processed.

It can be seen from the figures that, based on the standard 15% rate of outgoing dividend tax in the Netherlands, the application of treaties and European legislation meant little dividend tax (less than 1%) was withheld from the dividend payments made by companies falling under the APA/ATR team.

3.8 Conclusion

In comparison with other countries, the Netherlands was quick to conclude many treaties with trading partners that had lower withholding tax rates. As a result, like many of its neighbours, it has a favourable tax climate for international companies. Dutch tax treaty policy does not depart from the principles of the OECD model convention. As far as we could tell, the Netherlands also applies these principles in practice. Many neighbouring countries offer comparable tax advantages or are advantageous for other reasons. Like the Netherlands, Luxembourg, for example, does not withhold tax on interest and royalties. Unlike the Netherlands, the United Kingdom is the only large European country not to withhold tax on dividends. Multinationals use Dutch legislation and treaties to plan their international taxation. The most favourable arrangements have to be tailored to the circumstances of each multinational.

We learned from information submitted to the Dutch central bank (DNB) that substantial dividend, interest and royalty payments pass through the Netherlands, but we have no benchmark to draw further conclusions. We also found that incoming and outgoing dividend, interest and royalty flows had increased sharply in the past 10 years.

We also concluded that treaty negotiations were giving higher priority to the position of developing countries and the inclusion of anti-misuse provisions. The Netherlands does so in its treaty negotiations, as evidenced by the NFV 2011. Furthermore, the OECD member states have held talks on an amendment of the OECD model convention for the avoidance of double taxation, which the Netherlands also uses in treaty negotiations. The first results of the talks were announced in September 2014.

The Tax and Customs Administration does not keep cumulative information on the income and expenses of international holding company activities, international licensing activities, international

financing activities and other activities. It does ask questions about them, however, in the corporation tax return.

Recommendations
We found that the Netherlands was closely involved in initiatives taken by the OECD, G20, EU and United Nations to prevent tax avoidance. Initiatives by such international organisations that actively combat arrangements that are set up to minimise tax contrary to the spirit of the rules therefore deserve the sustained and active support of the Netherlands.

We recommend that the responsible members of the government:
1) when submitting new or revised treaties, inform parliament of the measures taken to prevent their misuse or unintended use;
2) step up cooperation with treaty partners, giving greater priority to the conclusion and application of tax treaties that:
   a) improve the exchange of information;
   b) prevent legal uncertainty for companies wishing to use a treaty (e.g. about how provisions to prevent misuse will be applied);
   c) actively assist the Tax and Customs Administration and the tax authority of the treaty partner where necessary.

If the House of Representatives wishes to receive reliable cumulative information on the size of dividend, interest and royalty flows, the State Secretary for Finance could be asked to collect this information and present it in a monitoring report.

4 Tax planning in practice

4.1 Examples of tax avoidance

The House of Representatives asked us to consider as many avoidance arrangements as possible in our audit. The Dutch legislation and tax treaties relating to taxation outside the Netherlands are described in chapters 2 and 3. They provide the starting point for finding possible forms of tax planning.

Tax planning is tailored so that a company benefits from differences in the taxation of its transactions and applicable tax rates. As there is no fixed pattern, we cannot say how often a particular arrangement is used. An arrangement's popularity is determined by a combination of many factors, such as national corporation tax rates and bases, withholding tax rates, the availability of tax credits for foreign withholding taxes, anti-misuse provisions in national laws or tax treaties and the presence of an investment protection agreement.

Section 4.2 looks at the following five arrangements found in practice.

A. Organisation of goods flows
Goods manufacturing, sourcing, distribution and sales can be located in different countries in order to create value where tax is the lowest. The logistics chain can be organised so that transactions are carried out where profit tax is low. Goods can be manufactured in China, exported via Hong Kong (low profit tax) and distributed in Europe through the Netherlands. More tax would be payable if the goods were exported directly from Shanghai. If distribution facilities are comparable, the choice of location will be influenced by the corporation tax rate in the Netherlands relative to that in, for instance, the UK (London) or Belgium (Antwerp).

B. Pooling
Group companies can pool their insurance or financing activities so that the group as a whole pays less tax. Pooling can also spread risks and lower financing costs if the pool is organised to generate profits in a low-tax country.

C. Organisation of dividend payments to exploit the Dutch participation exemption in combination with the tax treaties
Interposing a Dutch holding company can have advantages because the participation exemption exempts incoming dividends from tax in the Netherlands if they are taxed elsewhere.

D. Organisation of interest payments
Interest is paid in countries with a high tax rate and received in countries with a low tax rate. It can be tax advantageous to have a company that pays taxable interest first distribute a dividend to a foreign holding company and then lend money to a company in a country with a low tax rate on interest received.

E. Organisation of royalty payments
As withholding tax is not levied within the EU on royalties paid to other EU countries but is usually levied on payments made to copyright holders in non-EU countries, it can be advantageous to make payments to non-EU countries through the Netherlands as the Netherlands does not withhold tax on royalties.

In some cases, hybrid assets may not be taxed at all. An intercompany loan, for example, may be treated as a capital contribution in one country and as a loan in another. The treatment of such a hybrid loan can have significant tax consequences. A comparable problem arises with hybrid legal forms where the tax treatment differs from one country to another. In example E below, for instance, a hybrid legal form can be used to organise royalty payments.

Differences in corporation tax rates make it attractive to recognise profits where the corporation tax rate is the lowest (profit shifting). There are limits, however, on how much profit can be shifted. The national tax authorities must ensure that groups do not shift profits by using non-arm's length prices. Transfer prices should be equal to the price that would be charged between independent parties dealing at arm's length. We consider arm's length pricing in the Netherlands in chapter 5 and the conclusion of advance pricing agreements, advance tax rulings and compliance with substance requirements by conduit companies in the Netherlands in chapter 6.

4.2 Detailed examples of tax arrangements

This section considers several examples of how groups can be structured within the bounds of tax law and the tax treaties. As tax arrangements are tailored, we consider only the most frequent examples found in practice. The examples relate to the organisation of goods flows, pooling and the payment of dividends, interest and royalties. The use of special purpose vehicles (e.g. in business asset leasing arrangements), permanent establishments (branches of foreign companies) and cooperatives to reduce the tax burden is not considered.

Example A. Organisation of goods flows

Example of a group structure:

The taxation of the goods flow[4] in this group is shown in figure 9.

[4] The margins used in this example are indicative only. Their acceptability in practice depends on whether they are at arm's length and the supervision exercised by the tax authorities.

Figure 9 **Goods flows arrangement**

Tax
Costs
Net profit

Taxation of goods flow
(in thousands of euros)

China
Manufacturer
€ 125
€ 375 (25 %)
€ 1,000
Sale € **1,500**

Hong Kong
Exporter
€ 41.25
€ 208.75 (16,5 %)
€ 1,600
Sale € **1,850**

Netherlands
Distributor
€ 62.50
€ 187.50 (25 %)
€ 1,950
Sale € **2,200**

United Kingdom
Sale
€ 105
€ 395 (21 %)
€ 4,500
Sale € **5,000**

China
Manufacturer
and distributor
€ 187.50
(25 %)
€ 562.50
€ 1,200
Sale € **1,950**

If China performed all activities apart from sales in the UK and the sales price and costs remained the same, the profit after tax would be computed as follows.

United Kingdom
Sale
€ 157.50
(21 %) € 592.50
€ 4,250
Sale € **5,000**

Total taxation with Hong Kong and the Netherlands
€ **333.75**

€ **345**
Total taxation without Hong Kong and the Netherlands

A profit share is apportioned to each link in the chain depending on its function, risks and assets. The amount is based on the margins that independent parties with comparable activities would use. The Netherlands checks the arm's length nature with the aid of commercial databases that can be searched for comparable activities using the Statistical Classification of Economic Activities in the European Community (NACE). The first version dates from 1970; the first revision was published in 1990 (NACE Rev. 1) and the second (NACE Rev. 1.1) in 2002. The NACE is consistent with the UN's International Standard Industrial Classification of all Economic Activities. The OECD has also

issued guidelines on transfer pricing. It should be noted, though, that Hong Kong and China are not members of the OECD and may therefore use different standards to assess the prices charged.

Depending on the facts and circumstances in a particular case, the Tax and Customs Administration might not agree with the price charged by Hong Kong to the company registered in the Netherlands. The subsequent reduction in the purchasing price for the Dutch group company will produce a higher taxable profit in the Netherlands and a lower taxable profit in Hong Kong. The company in Hong Kong will then have to reach agreement with the local tax authority to adjust its profit for the lower selling price. The outcome will be uncertain and may lead to double taxation. To avoid this problem, companies try to reach advance pricing agreements with the Dutch tax authority. The agreement may be in the form of an APA between two countries.

B: Pooling arrangement

Group insurance pool

A multinational enterprise can set up an internal group insurance company in a low-tax country (e.g. on the Bahamas) or in a country that allows the formation of higher tax-free reserves (e.g. Luxembourg). A Dutch group company that takes out insurance from a group insurance company in a low-tax country can deduct the premiums from taxable profit in the Netherlands and the insurance company's profit is taxed at the low rate in its home country. In this example, too, the Tax and Customs Administration will assess whether the insurance services provided by the group company in the low-tax country and the transaction entered into by the Dutch group company are at arm's length. If both criteria are met, it will then assess whether the insurance conditions and premiums payable are at arm's length. If they are not, the Administration will challenge them.[5]

Group financing pool

As well as pooling their insurance activities, multinational enterprises often finance their group activities by means of a cash pool set up with the group's international house bank. The group companies pool their debit and credit bank balances and negotiate a lower interest rate on the pooled balance with the bank. An advantage can be gained if a large proportion of the benefits arising from the cash pool are allocated to a cash pool leader in a low-tax country. Here, too, the Tax and Customs

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[5] See, for example, The Hague district court, 11 July 2011, no. ECLI:NL:RBSGR:2011:BR4966, and Zeeland-West Brabant district court, 17 January 2014, no. ECLI:NL:RBZWB:2014:150.

Administration will assess the arm's length nature of the allocation of the cash pool.

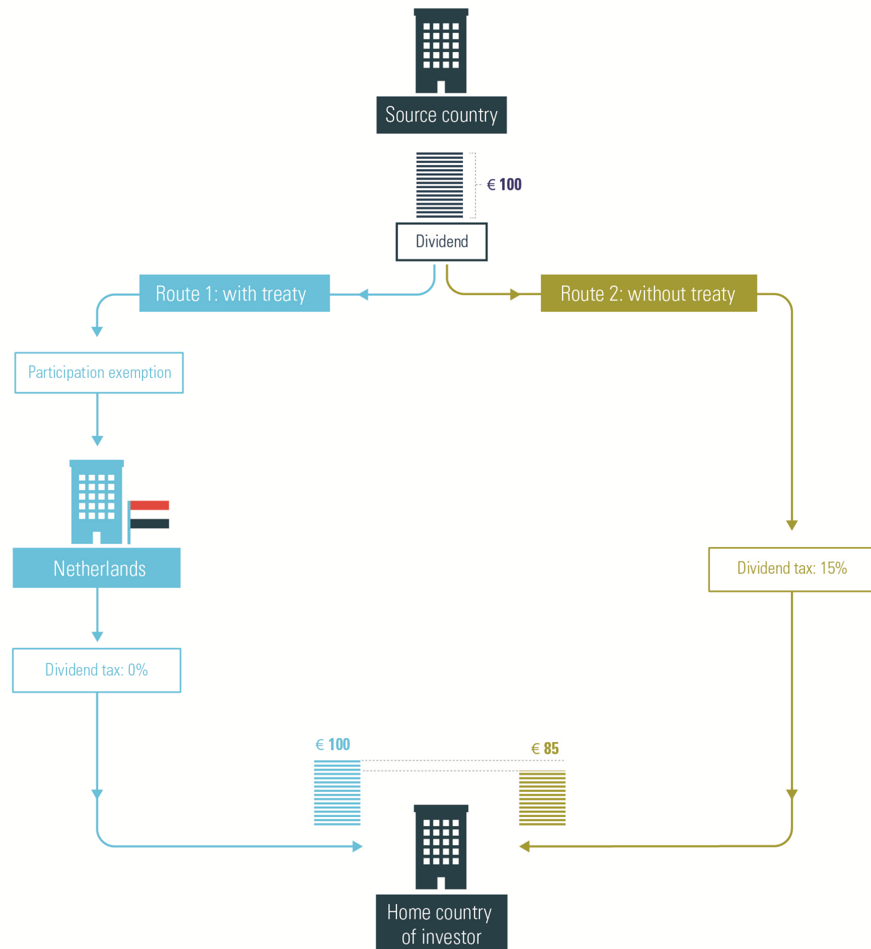
C: Dividend arrangement

An international group can have a Dutch company make foreign investments in order to benefit from a tax treaty with the Netherlands. An advantage can be gained if the source country has agreed a lower dividend tax rate in its treaty with the Netherlands than in the treaty with the country in which the investment is ultimately made. The participation exemption in the Netherlands prevents profits being taxed twice in the same group, first in the hands of a subsidiary company and then as dividend in the hands of the parent company. In such cases, it means a more favourable withholding tax rate is not nullified by additional taxation in the Netherlands.

Explanation of participation exemption and crediting of withholding tax
Country S (the source country) and country I (the investment country) do not have a tax treaty. A company in country S pays dividend to a company in country I. Under the laws of country S, dividend tax is withheld at 15%. The dividend tax cannot be credited against the profit tax payable in country I, possibly because country I does not give a tax credit for foreign withholding tax but more probably because country I does not tax dividend payments from the subsidiary and is thus neither able nor willing to credit the tax. The withheld source tax lowers the investor's effective return. If both countries S and I have tax treaties with the Netherlands less tax will be withheld. Where possible, the Netherlands agrees with source countries that taxes will not be withheld from dividend distributions because it exempts dividends and seeks to avoid withholding taxes that cannot be credited (otherwise Dutch companies with subsidiaries in country S would not compete with local companies on an equal footing). For the same reason, the Netherlands agrees not to withhold tax on dividends paid from the Netherlands to country I. Interposing a Dutch company between the companies in country S and I prevents the problem of uncreditable dividend tax and produces a higher return for an investor in country I.

This is shown in the next example.

Figure 10 **Use of the participation exemption scheme**



D: Interest arrangement

A company's net profit in a particular country depends in part on how it is financed. Its taxable profit will be higher if it is equity financed than if it is debt financed because the cost of equity is not deductible. In the years shortly before the credit crisis, many companies were acquired by private equity firms, with the transaction being financed after the acquired company had distributed a superdividend to the parent company. The resultant sharp fall in the acquired company's equity position meant it had to attract both external and internal (intragroup) capital. The interest payable on this debt reduced the taxable profit and could even produce a loss in the acquired company's home country. As a result, less tax was payable and losses even led to the refunding of taxes already paid. The effective tax burden within the group could be lowered if loans were provided by a group company in a low-tax country.

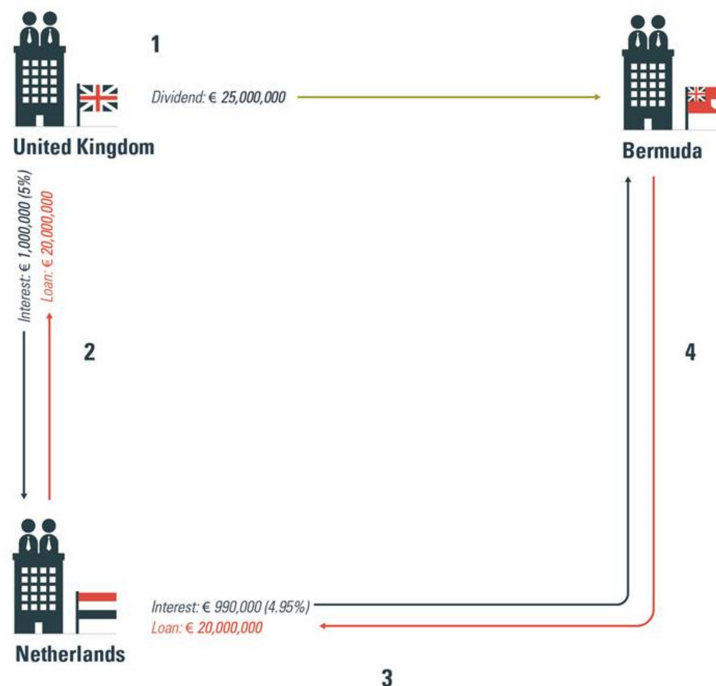
The interest rate and other conditions on intercompany loans must be at arm’s length. The interest margin is determined in part by the loan conditions and the lender’s risk profile. The banking and credit crisis has changed the arm’s length conditions that intercompany loans must satisfy. Financing conditions have become stricter.

The Comparable Uncontrolled Price (CUP) method is commonly used to assess the arm’s length nature of intercompany loans. This method compares a transaction between associated companies with a transaction that one of the parties enters into with a non-associated party (internal CUP) or with a free-market transaction between independent third parties (external CUP).

Figure 11 and table 4 shows how interest payments can be organised to reduce tax.[6]

Figure 11 **Example of how interest payments can be organised to reduce tax**

Explanation below figuur 11



[6] The example assumes that there are no restrictions on the deduction of interest in the United Kingdom and the anti-misuse provisions of Directive 2003/003/49/EC (EC, 2003) on the distribution of interest and royalties do not apply. The margins shown in this example are indicative only; their acceptability in practice will depend on whether they are at arm’s length and the supervision exercised by the tax authorities.

Explanation of figure 11
1) Action 1 A company in Bermuda acquires the shares of a profitable UK company (annual pre-tax profit of €2 million and substantial equity capital). The UK company pays 21% corporation tax on the profit: €420,000. The company in Bermuda has now become the parent company and has its UK subsidiary distribute a dividend to it of about €25 million. The dividend is paid tax free because the UK does not withhold tax on dividends. **2) Action 2** The UK company borrows €20 million from a group company in the Netherlands at an interest rate of 5% (€1 million per annum). Deduction of the interest in the UK reduces the taxable income. On account of the exemption from withholding tax on interest payments within the EU, the UK does not withhold tax from the interest payment to the group company in the Netherlands. **3) Action 3** The Dutch group company borrows €20 million from the company in Bermuda at 4.95% (€990,000 interest per annum) and onlends the same amount to the UK group company at 5% (see step 2 above). The Netherlands taxes the difference between the interest paid to Bermuda and the interest received from the UK. The interest received must be higher than the interest paid because the Dutch company has to receive an arm's length remuneration, a spread, for its activities, which is then taxed in the Netherlands after the deduction of costs. In this example the spread is €10,000 and the costs are €2,500, producing a taxable profit of €7,500, which, at a tax rate of 20%, represents €1,500 in corporation tax for the Dutch Tax and Customs Administration. The Netherlands does not withhold tax from the interest paid to Bermuda. The group company in Bermuda receives €990,000 (€1,000,000 - €10,000). **4) Action 4** The group company in Bermuda receives €990,000 in interest from the Netherlands, on which it pays no tax (if a loan had been contracted directly from the UK, the UK would have levied withholding tax). The group company in Bermuda incurs costs of €2,500 to collect and administer the interest from the Netherlands.

In this example, the profit in the UK and the tax remittance to the UK tax authority (€210,000) are halved by the withdrawal of capital from the UK company, the distribution of an untaxed dividend and the assumption of a loan.

Table 4 **Taxation of financing with and without a loan**

Country	Income	Paid – received interest (€)	Other costs	Taxable profit	Tax rate (%)	Tax (€)	Net profit
United Kingdom without arrangement	2,000,000			2,000,000	21	420,000	**1,580,000**
United Kingdom	2,000,000	-1,000,000		1,000,000	21	210,000	790,000
Netherlands		10,000	2,500	7,500	20	1,500	6,000
Bermuda		990,000	2,500	987,500	0	-	987,500
Total with arrangement	**2,000,000**	**0**	**5,000**	**1,995,000**		**211,500**	**1,783,500**
Benefit with arrangement							**203,500**

This example shows that the company can achieve a net benefit of €203,500 by paying a dividend in the UK and then borrowing a considerable amount from a Dutch group company.

E: Royalty arrangement

Some US multinationals exploit their intellectual property rights by making use of, for example, the Double Irish Dutch Sandwich and defer profit tax in the US by shifting their profits to a low-tax country. To do so, they must carry out the following actions.

Brief explanation of tax on worldwide income in the US
Companies in the US pay 35% corporate income tax on their worldwide income but receive a tax credit for taxes paid abroad. In the US regime, 35% corporate income tax is due on the profits they earn worldwide. A tax credit is available for taxes paid outside the US. A low rate in a source country therefore does not produce a tax advantage. The difference in taxation need not be paid in the US, however, if the foreign profits are not distributed directly to the US parent company and the US anti-misuse provisions do not apply.

To avoid or defer taxation in the US, the companies have to carry out four actions (see figure 12 and the explanation beneath it).

The margins shown in this example are indicative only; their acceptability in practice will depend on whether they are at arm’s length and the supervision exercised by the tax authorities. This example is merely an illustration of a possible arrangement, not an arrangement actually set up by a company.

Figure 12 **Royalty arrangement: Double Irish Dutch Sandwich**

Company with effective management elsewhere

Company with effective management

Only effective management

Royalty €

Licence

Sale of intangible assets

United States

A

Bermuda

Ireland (I)

Ireland (II)

D

United Kingdom

B

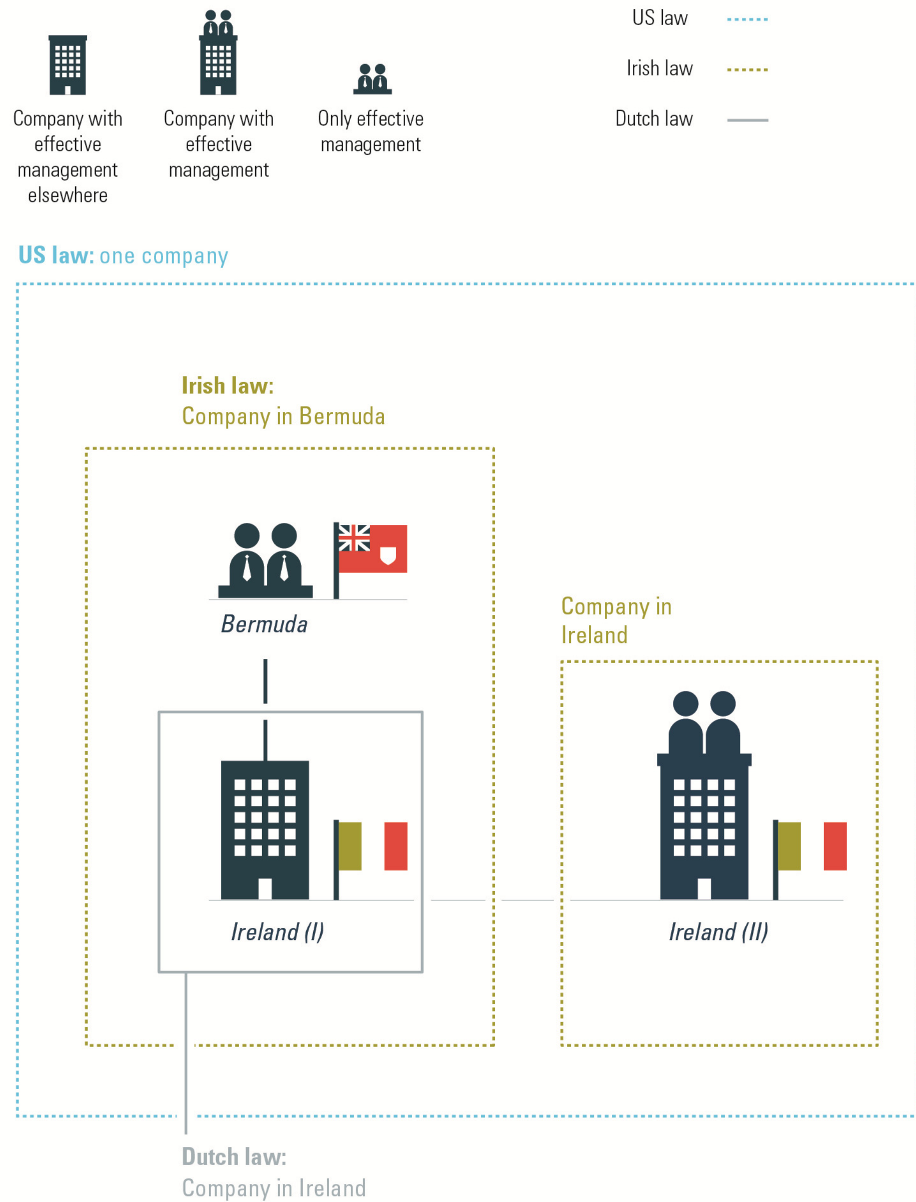
C

Netherlands

Explanation of figure 12
A) Action A A multinational established in the US sells non-US intangible assets to a subsidiary incorporated under Irish law but with effective management in Bermuda (Ireland I). Under Irish law, a company is established in the place of effective management and control, in this case Bermuda. The company in the US that sells the intangible assets pays 35% corporate income tax on its profits. Under US rules, the amount of the profit is limited if the assets are sold at an early stage. In addition, a second operating company is active with effective management in Ireland (Ireland II); see action C. **B) Action B** Ireland I issues a subsidiary licence to a Dutch group company. The Dutch company pays an arm's length royalty fee to Ireland I. The Netherlands does not levy withholding tax on royalty payments. Under Irish law, Ireland I is established in Bermuda and therefore pays no corporation tax in Ireland on the profit it earns. Since Bermuda does not levy profit tax, Ireland I does not pay profit tax in Bermuda either. **C) Action C** The Dutch group company in turn issues a sub-licence to Ireland II, for which it receives an arm's length royalty fee. Because the royalties are paid from Ireland to another EU country, i.e. the Netherlands, Ireland does not withhold tax on the payments that the Dutch company ultimately passes on to Bermuda. The Netherlands does levy corporation tax on the difference between the royalties received from Ireland II and the royalties paid to Ireland I less miscellaneous operating expenses. **D) Action D** Ireland II awards a sub-licence to branches in the EU, for example in the UK. The UK branch pays a royalty fee to Ireland II and under EU law does not withhold tax. In the UK, 21% corporation tax is payable on the net result, i.e. after the deduction of the royalty fee paid to Ireland II. Ireland II pays corporation tax on the difference between the royalties received from the UK and the royalties paid to the Dutch group company, less miscellaneous costs. The corporation tax rate in Ireland is 12.5% (versus 35% in the US and 25% in the Netherlands). The US treats the two Irish companies as one company; its anti-misuse provisions therefore do not apply and the profits earned in Ireland are not taxed in the US as long as Ireland I does not distribute its profit to the parent company in the US.

The arrangement uses a hybrid company in Ireland that is established in Bermuda under US law and in Ireland under Irish law, as shown in figure 13.

Figure 13 **Hybrid company**



This arrangement hinges on the hybrid nature of the company and thus its location. Annexe 5 contains a worked example of how the tax advantage is obtained.

The arrangement described above defers the US taxation of non-US intellectual property rights. The deferment can be so long that taxation is effectively permanently avoided, provided intercompany pricing rules for the various licences are observed. Such an arrangement has to be tailored.

Some listed parent companies in the US use this kind of arrangement to contract loans in the capital market in order to finance dividend distributions to their shareholders and thus reduce their taxable profit in the US by deducting the interest payments.

Some US parent companies move their head offices to Europe to avoid the 35% profit tax. This is known as inversion. The US has developed laws to prevent this practice. There must be a commercial reason for inversion, such as a merger between two listed companies. Depending on the facts and circumstances, this could lead to the levying of 30% withholding tax on payments from the US to a non-US head office.

Ireland announced on 14 October 2014 that it would end the Double Irish Dutch Sandwich, with a transitional period until 2020 for companies already using it.

4.3 Conclusion

Tax planning is tailored, with use being made of differences in the taxation of transactions and tax rates. The examples given in this section show that tax planning can considerably reduce the amount of tax payable (corporation tax and withholding taxes), subject to the applicable rules (anti-misuse provisions in national or international law, including the arm’s length principle). Owing to the absence of a fixed pattern, we cannot say how often a particular arrangement is used. The popularity of a particular arrangement depends on a combination of many factors, such as national corporation tax rates and bases, withholding tax rates, the availability of tax credits for taxes withheld in another country, anti-misuse provisions in national law or in tax treaties and the presence of an investment protection agreement.

A tax treaty is certainly one of the tools that can be used in tax planning but it is not a sine qua non.

5 Assessment of transfer prices

Both this chapter and chapter 6 consider transfer prices. This chapter looks at applicable legislation and how it is enforced by the Tax and Customs Administration in the Netherlands. Chapter 6 considers advance pricing agreements, advance tax rulings and the Administration's standards and compliance checks.

5.1 Transfer pricing and profit shifting

Because enterprises generally seek to organise their activities so as to lower their tax burden, while remaining within the bounds of the law, they allocate profits to low-tax countries and expenses to high-tax countries. This is known as profit shifting. One way to shift profit is transfer pricing. The tax authorities must ensure that profits are computed correctly, with income and expenses being recognised where they are actually earned or incurred. For this reason, transfer prices must be equal to the prices that independent parties would customarily pay. This is known as the arm's length principle.

The OECD member states have set out the arm's length principle for cross-border transactions in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010 accompanying the Model Tax Convention on Income and Capital 2010 (OECD, 2012). According to the OECD guidelines, the calculation of transfer prices is not an 'exact science'. Tax authorities are urged to be flexible and not to insist that taxpayers set transfer prices with a precision that is unrealistic in view of all the facts and circumstances. The OECD wants to amend and amplify the transfer pricing guidelines particularly with regard to intangible fixed assets, financial transactions and transparency. It aims to publish the new guidelines at the end of 2015.

The State Secretary for Finance published a new transfer pricing order on 13 November 2013 (Ministry of Finance, 2013a). It provides a further definition of aspects of the arm's length principle where the OECD guidelines leave room for interpretation or require clarification. The Corporation Tax Act 1969 requires documentation to be kept on transfer

pricing. The documentation can include the reasons for the chosen transfer pricing model and for the conditions, including the price, that apply to a transaction.

Furthermore, a taxpayer can request an advance pricing agreement from the Dutch tax inspector in order to gain certainty on the arm's length nature of the transfer price (Ministry of Finance, 2014b).

In some cases it is difficult to determine whether a transfer price is at arm's length. Companies are free to organise their activities as they wish. They are not yet obliged to disclose their profits by country. The tax authorities of some countries do not have the information necessary to compute an arm's length profit allocation. Furthermore, not all tax authorities have the capacity to check transfer prices or have given the matter sufficient attention.

5.2 Supervision by the Tax and Customs Administration

The Dutch Tax and Customs Administration supervises the use of arm's length transfer prices by multinational enterprises. Transfer pricing experts have been appointed at all tax offices. A national Transfer Pricing Coordination Group (CGVP) was set up within the Administration on 1 March 1998. It reports to the Tax Practices Directorate.

Under the updated order establishing the CGVP of 11 August 2004 (Ministry of Finance, 2004a), the CGVP is responsible for coordinating the implementation of transfer pricing policy and ensuring that the policy is implemented uniformly. The CGVP:

- coordinates the implementation of transfer pricing policy;
- acts as a transfer prices contact point for the Tax and Customs Administration, its offices and the Ministry;
- prepares policy for those cases in which incorrect use of the arm's length principle erodes the Dutch corporation tax base;
- advises the Directorate-General for the Tax and Customs Administration and the Directorate-General for Tax and Customs Policy and Legislation on the formulation and implementation of transfer pricing policy;
- advises the competent authority of the positions to be taken in consultation and arbitration cases involving transfer pricing;
- acts as a transfer pricing knowledge centre within the Tax and Customs Administration.

To ensure that transfer pricing policy is implemented uniformly, the CGVP requires the earliest possible insight into both the significance of transfer pricing cases and the Administration's response to them.

We found that the team discharged its tasks by:
- identifying tax risks;
- holding talks on possible APAs;
- holding talks further to adjustments made by foreign tax authorities that can trigger corresponding adjustments in the Netherlands;
- assisting and participating in in-depth examinations of transfer pricing systems.

The in-depth examinations usually involve collecting documentation, analysing the organisation and holding talks with the taxpayer's representatives in order to express an opinion on the transfer pricing system applied. If the transfer pricing system or its consequences are inconsistent with the arm's length principle, a solution will be selected that is retrospective (with appropriate adjustments) or forward-looking (often in the form of an APA), depending on the specific circumstances.

The preferred solution to a transfer pricing problem is a joint responsibility of the CGVP and the competent inspector. The CGVP reviews interim and final study reports on the transfer prices used by enterprises and issues binding advice on them. It also acts as a help desk and provides practical advice to the Administration's staff on request.

In its capacity as national coordinator, the CGVP worked in four regions in 2013, with an average of 8 staff per region working for it for a significant proportion of their time. The CGVP also has desks at the tax offices to ensure that transfer pricing experts can answer questions at every office. In 2013, 20 new people were recruited who will spend at least 75% of their time working on transfer pricing issues for the CGVP. The CGVP was involved in 250 transfer pricing cases in 2013.

The main transfer pricing problems in 2013

- Excessive debt financing of Dutch taxpayers (resulting in a very high interest expense).
- Reduction of the profits of Dutch taxpayers by means of business restructurings to shift profits to low-tax countries without significant functional changes.
- Location of tangible and intangible assets in low-tax countries so that little if any tax is paid on resultant profits. The study was part of the Location of Intangible Assets in Tax Havens project.
- Inadequate recharging of Dutch head office services to foreign group companies.
- Shifting group profits to low-tax countries by means of captive insurance companies that are paid excessively high non-arm's length insurance premiums.

- Shifting group profits to purchasing offices in low-tax countries by not crediting bulk purchasing discounts to the group companies responsible for bulk purchases.

Some of the issues listed in the box also arise in the tax planning examples. In other words, the Tax and Customs Administration considers transfer pricing in the Netherlands when accounting systems are set up to facilitate tax planning.

File investigation

We investigated 18 transfer pricing files to determine how the Tax and Customs Administration assessed the arm's length nature of the transfer prices used by multinational enterprises. Thirteen of the files related to APA applications and five to checks by the Administration on the arm's length nature of the transfer prices used by companies that did not apply for an APA. In so far as we could tell from the information we inspected, the Administration correctly applied the OECD guidelines and the transfer pricing order in the 18 files. It carried out comprehensive investigations and concluded well-reasoned APAs or carried out inspections that led to agreements for the future. The 13 files relating to applications for an APA are considered in chapter 6.

5.3 Conclusion

The Tax and Customs Administration carries out comprehensive investigations of the transfer prices used by multinational enterprises and considers current issues in this area. Through the national CGVP, it coordinates the implementation of a uniform transfer pricing policy. In so far as we can tell from the files we inspected, the Administration pays a great deal of attention to the correctness of transfer prices, collects detailed documentation and bases its assessments on the OECD model convention and the transfer pricing order.

6 Assessment of APAs, ATRs and substance requirements

The House of Representatives asked us to carry out an in-depth audit of the ruling practice in the Netherlands and to investigate SFIs' compliance with substance requirements, and their supervision and enforcement. We answer these questions in this chapter because the substance requirements are a condition for the conclusion of an APA or ATR. It should first be noted that unlike the Dutch central bank, the Tax and Customs Administration, which supervises compliance with the substance requirements, does not use the term SFI. The Administration refers to financial service entities and holding companies, collectively known as link companies. The term SFI covers all entities that submit reports for DNB to compile the Dutch balance of payments figures. Although DNB's definition of a conduit company and the Administration's definition of an SFI are comparable, there are differences in the number of entities and the monetary value of their activities. Since the two populations are not identical we cannot answer the question on the SFIs' compliance with substance requirements. We did consider how the Administration supervises and enforces the substance requirements.

6.1 Advance pricing agreements and advance tax rulings

The Dutch Tax and Customs Administration allows multinational enterprises to make agreements, within the bounds of the law, on the taxation of a proposed transaction. The agreements can be laid down in an Advance Pricing Agreement (APA) or an Advance Tax Ruling (ATR).

An APA approves the transfer prices that will be used in cross-border transactions between associated companies or members of the same group. At issue is whether the payment and other conditions would be customary between independent third parties (the arm's length principle). An APA also assesses whether the substance requirements have been satisfied.

An ATR provides advance certainty on, for example, the application of the participation exemption or the tax consequences of hybrid financing forms and/or hybrid legal forms in international groups.

The Administration’s tax rulings provide certainty for four or five years. If certainty is needed for a longer period, for example if substantial investments are being made, the Administration uses a term of 10 years, with the ruling being updated after five years.

The Administration is free not to conclude an APA or ATR. It does not provide advance certainty if, for example, it suspects criminal activity (such as money laundering, bribery, serious property offences and/or terrorist financing), the agreement would breach the good faith due to treaty partners and/or internationally or the applicant does not satisfy the substance requirements.

6.2 Substance requirements

Substance requirements restrict the benefits of Dutch tax treaties to multinational enterprises that have a recognisable presence in the Netherlands by owning and using tangible assets here and having natural persons carry on functions for its account and risk. It should be noted that the treaty partner decides whether or not the treaty benefits apply. The Administration informs the treaty partner only if there is no substance in the Netherlands.

The substance requirements relate to the place where decisions are made and accounts are kept and to whether there is exposure to real risks in the Netherlands. In practice, they can be satisfied simply by means of a trust office; there does not need to be a visible external presence with its own personnel in the Netherlands. All the required work can be carried out by an interposed trust office. If the substance requirements are not satisfied, the treaty partner can deny the treaty benefits and the Administration will not issue an APA/ATR. It is the ability to obtain certainty from the Administration on the Dutch tax consequences of a particular transaction that makes the Netherlands an attractive country for multinational enterprises. If a financial service entity does not satisfy the substance requirement of ‘running a real risk’, its income will not be included in the Dutch tax base and a tax credit will not be given for taxes withheld abroad. The remuneration paid for the services it performs will then be subject to corporation tax in the Netherlands.

Until 31 December 2013, the substance requirements applied to financial service entities only. Since 1 January 2014 they have also applied to holding companies that apply for an ATR. The table below lists the legislation governing the substance requirements and the changes made since 1 January 2014.

Table 5 **Application of substance requirements**

Financial service entities with APA	Until 31 December 2013: Yes: Order of 11 August 2004, no. IFZ2004/126M (Ministry of Finance, 2004b). As from 1 January 2014: Yes: article 3a of the International Assistance in the Levying of Taxes Implementation Decree and Order DGB2014/3101 (Ministry of Finance, 2014d).
Financial service entities without APA	Until 31 December 2013: Not included in legislation or formal order. Referred to in the Order of 11 August 2004, no. IFZ2004/126M. As from 1 January 2014: Yes, article 3a of the International Assistance in the Levying of Taxes Implementation Decree.
ATR applicants	Until 31 December 2013: No substance requirements. As from 1 January 2014: Yes, Order DGB 2014/3099 (Ministry of Finance, 2014e).
Comparable entities that do not apply for an ATR	No substance requirements.

Financial service entities have had to declare whether they satisfy the substance requirements in their tax returns since 1 January 2014. Before that date, the tax return had asked one question on the real risk and one on the substance requirements laid down in the then applicable order, no. IFZ2004/126M of 11 August 2004 (Ministry of Finance, 2004c). Those substance requirements were largely the same as the ones that apply at present.

Belgium and Luxembourg have similar arrangements, although the arrangement in Belgium is designed more to protect Belgium’s right to levy withholding tax on outgoing payments (House of Representatives, 2012).

The substance requirements are not the only anti-misuse provisions in national law and tax treaties. Others are considered in the following section.

6.3 Anti-misuse provisions

Both national law and tax treaties include provisions to prevent the unintended use of tax facilities.

6.3.1 National law

Under thin capitalisation rules, for example, a number of countries have limited the deductibility of interest payments, especially if a company is chiefly debt financed. The Netherlands has also introduced provisions[7] to prevent base erosion by limiting the deductibility of interest. Furthermore, the Dutch participation exemption is not applicable if a holding is classified as an investment. The Netherlands has also set substance requirements for financial service entities and companies that apply for an ATR.

6.3.2 Treaties

Tax treaties can include anti-misuse provisions to prevent companies enjoying undue treaty benefits. This can be achieved by laying down that national tax avoidance laws also apply in treaty situations or by including specific anti-misuse provisions in a treaty. The OECD model convention includes provisions on the exchange of information and on the conditions under which a treaty can be applied. Such requirements include:

- the tax treaty applies only to legal persons that are resident and subject to corporation tax in one of the treaty countries;
- dividend, interest or royalty recipients must be entitled to the proceeds, i.e. they must be the beneficial owners;
- transactions must be in keeping with the spirit of the treaty;
- the sole purpose of a transaction, incorporation of a company or use of a particular arrangement may not be to enjoy treaty benefits; this requirement is aimed principally at companies that are engaged primarily in receiving and paying interest, royalties and dividends within a group, with little actual presence in the treaty country.

Both specific tax information exchange agreements and regular tax treaties provide for the exchange of information, either spontaneously or on request. As well as bilateral treaties, the Netherlands has signed the multilateral Council of Europe-OECD Convention on Mutual Administrative Assistance in Tax Matters.[8] The State Secretary wishes to increase the exchange of information, tax transparency and administrative assistance

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[7] Sections 10a, 10b, 13l and 15ad of the Corporation Tax Act 1969.

[8] Kingdom Act of 28 January 2013, approving the Paris Protocol of 27 May 2010 amending the Convention on Mutual Administrative Assistance on Tax Matters (Dutch Treaty Series 2010, 221 and 314).

both multilaterally[9] and bilaterally.[10] Treaty countries, however, do not always provide feedback on what they do with the information. Furthermore, it often takes some time before the final consequence of sharing information become clear.

6.4 Supervision by the Tax and Customs Administration

The APA/ATR team

The APA/ATR team of the Tax and Customs Administration's Rotterdam Office deals with applications for rulings on the taxation of a proposed transaction by a multinational enterprise. The team's competence is defined in the Organisation and Competence (APA/ATR Practice) Order (Ministry of Finance, 2014b).

Until the beginning of 2014, the APA/ATR team had comprised 19.2 FTEs to supervise corporation tax and 5.7 FTEs to supervise value added tax. Eight people were added to the team in 2014. The team does not deal with all APA/ATR applications, only those made by taxpayers that fall under its competence and applications that the local inspector must put to it for binding advice. In general, low substance companies engaged in international activities are subject to the APA/ATR team. Financial service entities and entities engaged principally in holding and administering shareholdings, possibly in combination with financing and/or licensing activities, are 'low substance'.

In total, about 12,500 companies are subject to the APA/ATR team. The team receives about 10,000 tax returns every year. There are fewer tax returns because some taxpayers form a tax group and are included in a single tax return. An estimated 1,750 of these 10,000 taxpayers are financial service entities, which are engaged principally in passing on interest and royalties from one foreign group company to another. The other taxpayers are companies that hold shares in another company and perform management activities. Both types of taxpayer are known as link companies. Unlike the Tax and Customs Administration, the Dutch central bank (DNB) refers to them as SFIs. DNB recognised about 12,000 active SFIs in 2012. The differences are explained in the box below.

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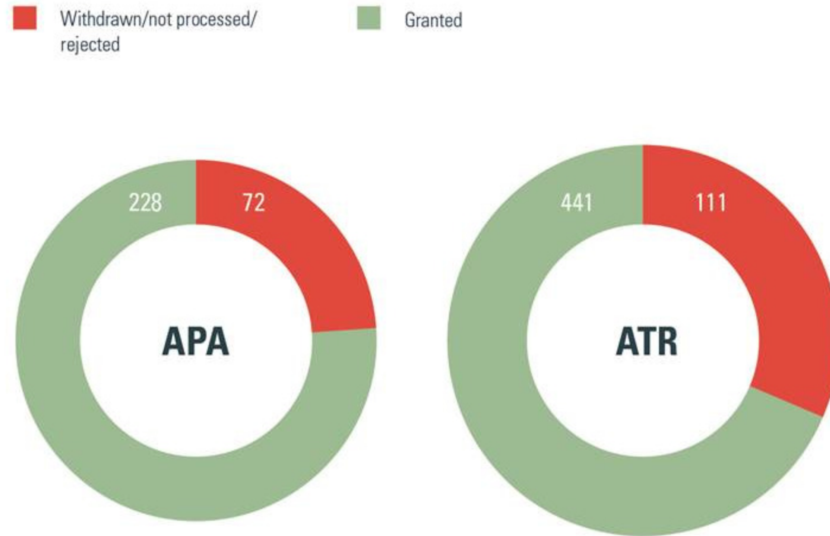
[9] Compare the Convention on Mutual Administrative Assistance in Tax Matters, as amended by Protocol of 27 May 2010, Dutch Treaty Series 2010, 221.

[10] By means of both specific bilateral tax information exchange agreements (TIEAs) and regular tax treaties (with an article that corresponds to article 26 of the OECD model convention, as it has read since 2005).

Explanation of the differences between SFIs (DNB) and conduit companies (Tax and Customs Administration)
In accordance with the Balance of Payment Reporting Requirements 2003, DNB requests information and data from SFIs in order to compile the balance of payments. SFIs are resident enterprises or institutions, regardless of legal form, in which non-residents directly or indirectly participate or on which they can exercise control on account of share ownership or otherwise and whose object and/or main activity, in combination with other resident group companies or otherwise, is: 1. principally to hold foreign assets and liabilities, and/or 2. to pass on revenue consisting of foreign royalty or licence payments to foreign group companies, and/or 3. to generate revenue and expenses chiefly by recharging foreign group companies. The Tax and Customs Administration does not use the term SFI. It refers to financial service entities and holding companies, collectively known as link companies. Some years ago DNB and the Ministry of Finance tried to link DNB's data on SFIs to the Administration's data on conduit companies as DNB's criteria to classify SFIs and the Administration's criteria to classify APA/ATR companies are similar. It was assumed beforehand that there were between 10,000 and 14,000 SFIs and about 12,500 link companies and that there would be a considerable overlap between the two populations. The classification data provided by DNB, however, showed that the number of SFIs and the amounts concerned were higher than that indicated by the comparable data on APA/ATR companies. This was probably because a number of SFIs were not subject to the APA/ATR team but to other operational teams of the Tax and Customs Administration. If this group was classified by certain material SFI 'characteristics', its size would probably increase by 3,000 to 5,000, depending on the criteria used. Owing to the mutual restrictions on the exchange of microdata, the differences could not be explained (Ministry of Finance, 2012).

About 15% of the eligible companies make APAs and ATRs with the Tax and Customs Administration. The APA/ATR team dealt with 852 applications in 2013, as shown in figure 14.

Figure 14 **Number of APA/ATR applications dealt with in 2013**



Source: 13th semi-annual report of the Tax and Customs Administration (Ministry of Finance, 2014h)

Some of these requests were for bilateral and multilateral APAs, in which two or more treaty countries agree the level of transfer prices. Eighteen bilateral and four multilateral APAs were issued in 2013. The applications were dealt with by the Ministry of Finance. Bilateral consultations were also held to clarify the application of the treaty in existing cases.

The APA/ATR team coordinates the policy-related aspects of APAs and ATRs with the relevant knowledge and coordination groups of the Administration and the Ministry of Finance. The relevant groups include the Transfer Pricing Coordination Group, the Anti-Tax Construction Coordination Group and the Tax Havens and Group Financing Coordination Group. As the APA/ATR team is represented in the relevant knowledge groups, coordination can take place when an APA/ATR application is being assessed or during an inspection.

The team often draws on the local inspector’s knowledge of the client before issuing an APA/ATR; the Administration does not systematically verify the information received in an application against the actual situation in detail. The APA/ATR team’s audit plan 2014-2016 pays more attention to verification and more detailed checks are made in a limited number of cases, including checks on compliance with substance

requirements. The Administration had not reviewed enough files for us to check the functioning of this specific part of the supervision.

Risk-based supervision
As well as dealing with applications for APAs and ATRs, the APA/ATR team also supervises taxpayers that have not applied for an APA/ATR. This supervision was stepped up in 2014, partly in response to concerns raised by the House of Representatives about substance requirements.

The Administration divides its supervisory and other capacity across the various taxes and benefits and in principle applies most of its capacity where the risks are highest. Influential factors include audit costs and benefits, preventive effect of an audit, political importance of a theme, and compliance with the supervision standards of the EU and other external parties. A central system has been developed specifically to select corporation tax for inspection (e.g. a request for documents or an audit of the enterprise's accounts). The selection is based on parameters set centrally, with supervision of transfer pricing being one of the parameters.

The APA/ATR team receives about 10,000 tax returns every year. Its supervision of the returns is risk-based. The team has a computerised system to select returns for inspection.[11] The system was specially developed for the companies falling under the APA/ATR team's competence. It currently has 40 parameters that determine whether a return can be settled administratively. The system is continuously improved in response to changes in the law and new insights. Selection factors include non-recurring income and expenses such as foreign exchange gains or losses and liquidation losses. Some of these selected returns are subject to an in-depth assessment. The APA/ATR team also audits accounts. The assessment of the returns can also consider the substance requirements and compliance with the APA or ATR conditions.

In accordance with the supervision plan, APAs and ATRs have been supervised since 2014 by means a questionnaire or a review of the facts underlying the APA/ATR. The plan is also used to check compliance with the APA/ATR conditions, including the substance requirements. Before 2014, supervision had been exercised in response to incidents.

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[11] The selection of tax returns for audit is not part of the national corporation tax system because nearly all conduit companies are classified as 'very large companies' and would be selected by the system.

The corporation tax return also includes a question on compliance with the substance requirements, where applicable. This approach was tightened up in 2014 and companies that no longer comply with the substance requirements must inform the Administration of which requirements they no longer satisfy before they file their tax returns. This reflects the Administration's ambition of horizontal supervision, with companies informing it of their own volition of any issues so that less supervision is necessary.

Some financial service entities fall under the competence of the APA/ATR team but do not apply for an advance ruling. More so than in the past, their compliance with the substance requirements has been checked by means of a questionnaire since 2014.[12] The number of entities concerned will be defined more precisely in the years ahead depending on the outcome of the supervision. We reviewed the questionnaire and found that it systematically checked compliance with the substance requirements. The checks are made at random, based on risk profile. We cannot express an opinion on its functioning as the questionnaire was only recently introduced.

File review

We reviewed how the APA/ATR team dealt with 24 APA/ATR applications. We reviewed 13 APA applications and 11 ATR applications. The applications related to, among other things, reviews of a hybrid entity's use of the participation exemption, the classification of a hybrid loan, the arm's length remuneration of a financial services entity with a sub-licence and the arm's length remuneration for a sales office's activities.

Our review considered the application, the considerations used to assess the application and the final APA or ATR. We reviewed the files in broad lines. The APA files were particularly large and contained a lot of technical information to support the transfer prices.

Handling of APA/ATR applications by the Tax and Customs Administration
The Tax and Customs Administration uses a set procedure to assess applications for an advance pricing agreement (Ministry of Finance, 2014c). Applications for an advance tax ruling are assessed in accordance with the Order on dealing with applications for advance certainty in the form of an ATR (Ministry of Finance, 2014e). Depending on the facts and circumstances, an APA application should include the following information: a) information on the transactions, products, business or agreements covered by the application; b) information on the companies and permanent establishments involved in the transactions or agreements; c) the other states to which the application relates;

[12] Source: APA/ATR team supervision plan 2014-2016.

d) information on the worldwide structure of the organisation, including information on the final beneficiaries of the applicant's assets, history, financial data, products, functions performed and the tangible and intangible assets used for these functions and the risks run for and by associated companies;
e) a description of the proposed transfer pricing method, including a comparability analysis, with comparable figures of independent market parties and any proposed changes;
f) the assumptions underpinning the application and an explanation of the effect of changes in the assumptions or other events, such as unforeseen results that can influence the validity of an APA;
g) the financial years covered by the application;
h) a general description of market conditions.

Depending on the circumstances, an ATR application should be accompanied by the following information:
a) detailed description of the facts and circumstances and the proposed transactions covered by the application;
b) the entities and the permanent establishments involved;
c) the other states to which the facts and the proposed transactions in the application relate;
d) information on the group's worldwide structure and history, including information on the final beneficiaries of the applicant's assets;
e) the financial years covered by the application.

A report is prepared for each APA or ATR issued. It includes:
a) the name of the responsible APA/ATR team member;
b) a reference to the file in which correspondence is kept;
c) a summary, including matters of special note;
d) the conclusion;
e) the relevant structure;
f) the certainty requested;
g) the facts;
h) an opinion;
i) a status review;
j) the APA or ATR.

An advance pricing agreement includes:
a) the facts and circumstances underlying the agreement, with information on the group, its activities in the Netherlands and a reference to underlying documents;
b) the transactions covered by the agreement;
c) the transfer pricing method and/or transfer prices;
d) the critical assumptions underlying the agreement, including the requirement that the Administration is given a true and full view of the activities and that foreign tax authorities have been and will be given a true and full view of the activities and their taxation in the Netherlands;
e) the treatment of the agreement in the corporation tax return with the condition that the return must state that the APA conditions have been satisfied; if this is no longer the case, the Administration must be informed;
f) a provision on the termination of the APA;
g) the scope of the APA;
h) the term of the APA.

Apart from the information on transfer prices, an advance tax ruling contains largely the same information. Unlike an APA, however, it states that the cost of the holdings to which the application relates is at least 15% equity financed. This applies to each holding. An ATR

also states that the applicant is established in the Netherlands for the purposes of Dutch tax law and the tax treaties concluded by the Netherlands and a certificate of residency can accordingly be issued. These requirements are slightly modified in the amended procedure published in 2014. In broad lines, however, they are unchanged.

An assessment of an APA consists chiefly of a price comparison with independent third parties, with the median return on sales being indicative for a sales company. For a financing company, comparisons are made of the interest payment, handling fee and risk fee. Royalties are usually compared with the payments made to a subsidiary licence holder, substantiated by a transfer pricing report. The requirement for financial service entities is that the applicant must run real risks. This requirement is satisfied if the equity necessary to bear the risk is equal to at least 1% of the principal of the loan or €2 million.

The adviser provides the relevant reports for the Administration to review. In many cases the assessment of an ATR application centres on the application of the participation exemption. The holding may not be held as an investment. Other ATR applications include:

- applications for advance certainty regarding international structures involving hybrid financing forms or hybrid legal forms;
- applications for advance certainty on whether an entity outside the Netherlands has a permanent establishment in the Netherlands.

We found from the 24 files we reviewed that the Tax and Customs Administration requested the necessary information and, after discussing it and requesting further information, usually took decisions that were well founded as far as we could ascertain, with several relevant experts being involved. If the set requirements were not satisfied in full, the application was withdrawn or formally rejected and an APA or ATR was not issued. The considerations briefly state the conclusions drawn from the information provided by the applicant. Rejected and withdrawn applications were documented in a similar manner.

6.5 Conclusion

About 15% of the eligible companies make use of the possibility to apply for advance pricing agreements or advance tax rulings with the Tax and Customs Administration. In 2013, the APA/ATR team dealt with 852 applications. In the files we reviewed, taxpayers' applications for an APA or ATR were dealt with and cleared carefully and as intended. The APA/ATR conditions are clearly laid down in tax laws and rules. To assess the applications, the Tax and Customs Administration requests and

reviews relevant information and has more than one expert check the APA/ATR before it is issued.

Until 1 January 2014 the Administration checked substance requirements chiefly before it assessed the applications. Supervision of the substance requirements was stepped up in 2014 and the Administration now pays more attention to companies that do not apply for an APA/ATR. Checks are made at random, based on risk profiles. In the period we investigated, the Administration had made preparations to step up its supervision and had carried out its first checks. We were therefore unable to review the functioning of the Administration's new working methods.

We cannot say to what extent SFIs comply with the substance requirements as the Administration does not use the term SFI and our audit found that the population of conduit companies known to the Administration did not match the population of SFIs known to DNB.

In practice is it relatively easy to satisfy the substance requirement of an actual presence in the Netherlands by using a trust office. In such cases, it is not necessary to have a visible presence with its own personnel in the Netherlands.

7 Provision of information to the House of Representatives

The Minister of Finance, the State Secretary for Finance and the Minister for Foreign Trade and Development Cooperation inform the House of Representatives in various ways of potential tax avoidance and its relationship with the tax treaty network.

Budget and annual report

The Minister of Finance and the Minister for Foreign Trade and Development Cooperation state in their budgets and annual reports what action they will take and have taken to combat tax avoidance.

The Minister of Finance wrote in his 2014 budget (Ministry of Finance, 2013b) that stability and certainty were important factors in the government's strategy to create an attractive tax climate for international companies in the Netherlands, but the government would not turn a blind eye to tax planning that exploited international mismatches and shifted profits to low-tax jurisdictions. In his annual report for 2013 (Ministry of Finance, 2014f) and his budget for 2014, the Minister refers to two letters that consider potential tax avoidance involving international arrangements in the Netherlands, and the measures the Netherlands intended to take to deter them.

The Minister for Foreign Trade and Development Cooperation explained in her 2014 annual report (House of Representatives, 2013c) how she wished to improve the investment climate in developing countries, both by strengthening the tax authorities in partner countries and by helping to combat tax avoidance. In her annual report, she, like the Minister of Finance, refers to the broad policy letter that considered potential tax avoidance using international arrangements in the Netherlands and the measures the government proposed to combat them.

International tax treaty policy

The State Secretary for Finance informs the House of potential tax avoidance in relation to the tax treaty network on an ad hoc basis and in response to questions from the House. As noted above the budgets and annual reports of the Minister of Finance and the Minister for Foreign

Trade and Development Cooperation also refer to the most important letters. The letters are included in the House's International Tax Treaty Policy file (Parliamentary Papers 25 087). The file is based on the House's debate on the Tax Treaty Policy Memorandum (NFV 2011). The most recent Parliamentary Paper is a letter from the State Secretary for Finance on the OECD's interim report on the BEPS programme (Ministry of Finance, 2014g).

Tax and Customs Administration

The Minister of Finance and the State Secretary for Finance account for their financial performance in their annual reports, and for, among other things, services provided, enforcement and output figures in the Tax and Customs Administration's semi-annual report. The report considers developments and outputs within the Administration as a whole and is therefore not an appropriate source of in-depth information on international taxation. In the Administration's 13th semi-annual report (Ministry of Finance, 2014h), the State Secretary presents two tables with information on the current ruling practice.

Table 6 **Ruling applications dealt with**

	2010	2011	2012	2013
Advance pricing agreements	272	319	321	300
Advance tax rulings	482	517	557	552

Table 7 **Ruling applications dealt with in 2013**

	APA	ATR	Total
Stock at 1 January 2013	240	254	494
Received	323	505	828
Withdrawn/Not processed	67	91	158
Rejected	5	20	25
Granted	**228**	**441**	**669**
Stock at 31 December 2013	263	207	470

The State Secretary for Finance's 14th semi-annual report, on the first half of 2014, was published on 2 October 2014 (Ministry of Finance, 2014i).

The House of Representatives regularly asks questions in response to suspected tax avoidance by multinational enterprises or reports in the media. The State Secretary's answers are consistent with our findings. The State Secretary is also bound by law not to provide information that can be traced to individual companies.

Treaty negotiations

Regarding the provision of information on the state of bilateral treaty negotiations, the State Secretary refers to the negotiation programme for tax treaties that he publishes every year at http://www.rijksoverheid.nl/nieuws/2014/07/11/onderhandelingen-belastingverdragen-in-2014.html (in Dutch only).

The Minister of Foreign Affairs periodically provides the House with a list of draft treaties under negotiation, including a list of bilateral tax treaties. The most recent report was published in October 2014 (Ministry of Foreign Affairs, 2014).

The Minister of Foreign Affairs and the State Secretary for Finance submit tax treaties to the House of Representatives for approval as a matter of course. When a new or amended tax treaty or amendment protocol is signed, a news item is published on the central government website.

As can be seen from the above, parliament is informed of the policy on many occasions, but the House does not have a complete picture of Dutch policy to improve the tax climate for multinational enterprises and its relationship with international tax planning. Very little unambiguous information is available on the policy results and the related payment flows; there are no systematic reports.

Conclusion

The Minister of Finance, the State Secretary for Finance, the Minister of Foreign Affairs and the Minister for Foreign Trade and Development Cooperation inform parliament on numerous occasions – in connection with tax treaty negotiations and in response to parliamentary questions arising from publications in the media and the publication of reports. Nevertheless, the House of Representatives does not have a complete picture of Dutch policy to improve the tax climate for multinational enterprises and its relationship with international tax planning. Very little unambiguous information is available on the policy results and the related payment flows; there are no systematic reports.[13] The information that is provided is consistent with that in our report. Government accountability is chiefly an internal matter for the State Secretary, policy departments and the Tax and Customs Administration.

[13] We previously highlighted the importance of collecting and analysing quantitative and qualitative information on the payments channelled through the Netherlands, sharing information with the parties combating money laundering and providing adequate information to the House of Representatives in our report Combating Money Laundering: State in 2013 (Court of Audit, 2014a).

Our audit found no reason to question the information provided to the State Secretary for Finance by the Tax and Customs Administration.

Recommendation

To strengthen the House of Representatives' information position, a periodic fiscal monitoring report should be issued on the tax climate for multinational enterprises and how it is exploited, the amount of money involved and the impact of measures taken to combat improper use of tax rules and tax treaties.

8 Response and afterword

The State Secretary for Finance responded to our audit on 28 October 2014. A summary of his response and our afterword are presented below. The full response can be read on our website at www.rekenkamer.nl (in Dutch).

8.1 Response of the State Secretary for Finance

The State Secretary was pleased with our conclusion that the Dutch tax climate was attractive to international businesses without being out of step with that in other European countries. He noted that retaining an attractive business climate, in which taxation was just one factor, had the government's constant attention. In pursuing this aim the government was focusing on rules that were consistent with international guidelines and on combating tax avoidance.

The State Secretary referred to the concerns we expressed in our report about the consequences of international tax avoidance for the sustainability of public finances and for a fair distribution of the tax burden, and the resultant recommendation to support international initiatives and measures to manage the situation. The State Secretary thought our conclusion significantly supported the government's policy.

Regarding our observation that the substance requirements could usually be satisfied in practice by means of a trust office, the State Secretary noted that Dutch substance requirements were not out of step with international practice. In his opinion, the comment that they could be satisfied simply by means of a trust office incorrectly created the impression that the requirements were unusually lenient.

In response to our conclusion that the House of Representatives did not have a complete picture of Dutch tax policy for international companies in relation to international tax planning and our associated recommendations, the State Secretary responded as follows.

He agreed with our recommendation that when submitting new or revised treaties he should inform parliament of the measures taken to prevent its misuse or unintended use. Proposals submitted to parliament to conclude or revise a tax treaty were already accompanied by an explanatory memorandum but it would be advisable to pay specific attention to anti-misuse measures in the future. The assessment framework agreed with the House of Representatives during the debate of the Tax Treaty Policy Memorandum 2011 also provided for this.

The State Secretary also agreed with our recommendation to step up cooperation with treaty partners and to pay additional attention when concluding and applying tax treaties to:
(a) improving the exchange of information;
(b) preventing legal uncertainty for businesses that wish to use the treaty (e.g. regarding the application of anti-misuse provisions);
(c) providing active assistance to the Tax and Customs Administration or the tax authority of the treaty partner where necessary.

The State Secretary wrote that significant progress had been made in these areas both internationally and unilaterally. The exchange of information had been improved by the FACTA agreement, the international Common Reporting Standards and the development of country by country reporting. With a view to the second point, the Netherlands systematically proposes that arbitration be included in treaty negotiations. To avoid arbitration procedures as much as possible, the Netherlands always actively participates in efforts to improve and speed up mutual consultation procedures. Regarding the third point, he referred to the Dutch participation in Tax and Development, the Tax Inspectors Without Borders project, other multilateral activities and the Dutch contribution to the IMF Trust Funds on Tax. He had informed the House of Representatives of the progress made in strengthening tax authorities in developing countries on 19 September 2014.

The State Secretary made several comments on our recommendation to improve the information provided to the House by issuing a periodic monitoring report on the tax climate for international companies and the use made of that climate, the amount of money involved, and the impact of measures to combat improper use of tax rules and tax treaties.

He wrote that wherever possible he already informed the House as fully as possible about the quantitative impact of proposed and existing measures and treaties. He could not deny, though, that it was often impossible to make reliable quantitative analyses. In his opinion, so

many factors influenced the tax climate for international businesses and the potential for misuse that it would rarely be possible to measure the impact of an individual measure. Certain aspects of our recommendation were therefore a matter of concern. Periodic reports giving an overview of the tax climate could be issued but the impact of anti-misuse measures was, he thought, difficult to measure. It could not be determined, for example, how taxpayers would have behaved if the measures had not been introduced. Another problem was that even if a measure's impact could be quantified it would take some time before it fed through into the tax figures.

The State Secretary observed that the size of dividend, interest and royalty payments to and from the Netherlands was already known from data published by De Nederlandsche Bank (the Dutch central bank) and Statistics Netherlands. The data could be stripped of the influence of special financial institutions to give an indication of the attractiveness of the Dutch investment climate. He suggested conducting a pilot project over the next five years to improve the provision of information to the House, involving a short annual review of developments in the tax climate.

8.2 Court of Audit's afterword

We note that the State Secretary's response indicated approval for our recommendations. He thought our concern about the consequences of international tax competition and the associated recommendation to support international initiatives and measures significantly supported the government's policy. We therefore assume that the State Secretary will address this concern in consultation with parliament, partly on the basis of our recommendations. Since one of the recommendations relates to the provision of comprehensive information on this complex matter to the House of Representatives and the State Secretary has proposed that an annual reporting system be established to do so, we suggest that the House consult the State Secretary to discuss how he can best meet its information requirement.

Annexe 1 Withholding tax rates in the EU

Country	Dividend (%)	Interest (%)	Royalties (%)	Number of withholding taxes
Austria	25	0	20	2
Belgium	10/15/25	15/25	15/25	3
Bulgaria	0/5	10	10	3
Croatia	12	15/20	15/20	3
Cyprus	0	0	5/10	1
Czech Republic	15	15	15	3
Denmark	0/15/27	0/25	25	3
Estonia	0	0	10	1
Finland	20	0	20	2
France	30	0	33.33	2
Germany	25	0	15	2
Greece	10	15	20	3
Hungary	0	0	0	0
Ireland	0/20	0/20	20	3
Italy	1.375/26	12.5/26	22,5	3
Latvia	0	0	0	0
Lithuania	0/15	0/10	10	3
Luxembourg	0/15	0	0	1
Malta	0	0	0	0
Netherlands	15	0	0	1
Poland	19	20	20	3
Portugal	25/35	25/35	25	3
Romania	16	16	16	3
Slovakia	0	19/35	19/35	2
Slovenia	15	15	15	3
Spain	21	21	24.75	3
Sweden	0/30	0	0	1
United Kingdom	0	20	20	2
Number of countries without withholding tax	7	12	6	3

Annexe 2 Dutch tax treaties and withholding tax rates

Treaties as at 1 January 2014 with withholding tax rate[14]

	Country[15]	Effective date	Ownership (minimum shareholding %)	Dividend investment (%)	Dividend shareholding (%)	Interest (%)	Royalties (%)
1	Albania	15-11-2005	50-25	15	0-5	5/10	10
2	Argentina	11-02-1998	25	15	10	12	3-5-10-15
3	Armenia	22-11-2002	10	15	5	0-5	5
4	Aruba, St Maarten, Curaçao	01-01-1965	0-25	15	7.5-5	0?	0
5	Australia	27-09-1976	-	15	15	10	10
6	Azerbaijan	18-12-2009	25	10	5	10-0	5-10
7	Bahrein	24-12-2009	10	10	0-10	0	0
8	Bangladesh	08-06-1994	10	15	10	10-0	10
9	Barbados	12-07-2007	10	15	0	5-0	5-0
10	Belarus	31-12-1997	25	15	5	5	3-5-10
11	Belgium	31-12-2010	10	15	5	10	0
12	Bermuda	08-06-2009	n/a	n/a	n/a	n/a	n/a
13	BES islands**	01-01-2011	0-25	15	7,5	10-0	0
14	Brazil	20-11-1991	-	15	15	10-15	15-25
15	Bulgaria	11-05-1994	25	15	5	0	5
16	Canada	21-08-1987	10-25	15	5	10	10
17	China* 01-01-2015	05-03-1988	-	10	10	10	10
18	Denmark	06-03-1998	10	15	0	0	0
19	Germany* 01-01-2015	18-09-1960	25	15	10	0	0
20	Egypt	20-05-2000	25	15	0	12	12
21	Ethiopia*		10	10	5	5	5
22	Estonia	08-11-1998	25	15	5	10	10-5
23	Philippines	20-09-1991	10	15	10	15-10	15-10
24	Finland	20-12-1997	5	15	5	0	0
25	France	29-03-1997	25	15	5	10-0	0
26	Georgia	21-02-2003	50-10	15	5-0	0	0
27	Ghana	12-11-2008	10	10	5	8	8
28	Greece	17-07-1984	25	15	5	10-8	7-5
29	Hungary	25-09-1987	25	15	5	0	0
30	Hong Kong	24-10-2011	50-10	10	0	0	3
31	Ireland	12-05-1970	25	15	0	0	0
32	Iceland	27-12-1998	10	15	0	0	0
33	India	22-01-1989	10	15	5	15-10	20
34	Indonesia	01-01-2004	-	10	10	10	10
35	Israel	09-09-1974	25	15	5-10	10-15	5-10

[14] The rates stated are the maximum withholding tax rates; under national law, a treaty country can levy a lower rate or may have to if there is an exemption for dividends on substantial holdings, intragroup interest or royalties under EU law.

[15] In the original report the countries are ordered alphabetically. In this annex we present the countries in the same order as in the original report.

	Country	Effective date	Ownership (minimum shareholding %)	Dividend investment (%)	Dividend shareholding (%)	Interest (%)	Royalties (%)
36	Italy	03-10-1993	50-10	15	5-10	10	5
37	Japan	29-12-2011	50-10	10	5-0	10-0	0
38	(Former) Yugoslavia	06-02-1983	25	15	5	0	0
39	Jordan	16-08-2007	10	15	5	5	10
40	Kazakhstan	02-05-1997	10	15	5	10	10
41	Kuwait	23-04-2002	10	10	0	0	5
42	Korea (ROK)	17-04-1981	25	15	10	10-0	15-10
43	Croatia	06-04-2001	10	15	0	0	0
44	Kyrgyzstan**	27-09-1987					
45	Latvia	29-01-1995	25	15	5	10	10-5
46	Lithuania	31-08-2000	25	15	5	10	10-5
47	Luxembourg	20-10-1969	25	15	2,5	0	0
48	Macedonia	21-04-1999	10	15	0	0	0
49	Malaysia	02-02-1989	25	15	0	10	8
50	Malta	09-11-1977	25	15	5	10	10
51	Morocco	10-06-1987	25	25	10	25	10
52	Mexico	13-10-1994	10	15	5	10-5	10
53	Moldova	01-06-2001	25	15	5	5	2
54	New Zealand	18-03-1981	-	15	15	10	10
55	Nigeria	09-12-1992	10	15	12.5	12.5	12.5
56	Norway	31-12-1990	10	15	0	0	0
57	Uganda	10-09-2006	50	15	5-0	10	10
58	Ukraine	02-11-1996	50-20	15	5-0	2-10	0-10
59	Uzbekistan	27-05-2002	25	15	5	10	10
60	Oman	28-12-2011	10	10	0	0	8
61	Austria	21-04-1971	25	15	5	0	10-0
62	Pakistan	04-10-1982	25	15	10	20-15-10	15-5
63	Panama	01-12-2011	15-50	15	0	5-0	5
64	Poland	18-03-2003	10	15	5	5-0	5
65	Portugal	11-08-2000	-	10	10	10	10
66	Qatar	25-12-2009	7.5	10	0	0	5
67	Romania	29-07-1999	25-10	15	5-0	3	3
68	Russian Federation	27-08-1998	25	15	5	0	0
69	Saudi Arabia	01-12-2010	10	10	5	5	7
70	Serbia****	06-02-1983	25	15	5	0	0
71	Singapore	31-08-1971	25	15	0	10	0
72	Slovenia	31-12-2005	10	15	5	5	5
73	Slovakia	19-12-1996	25	10	0	0	5
74	Spain	20-09-1972	25-50	15	5	10	6
75	Sri Lanka	24-01-1984	25	15	10	10	10
76	Suriname	13-04-1977	25	20	7.5	5-10	5-10
77	Tajikistan***	27-09-1987					
78	Taiwan	16-05-2001	-	10	10	10	10
79	Thailand	09-06-1976	25	25	5	10-25	5-15

	Country	Effective date	Ownership (minimum shareholding %)	Dividend investment (%)	Dividend shareholding (%)	Interest (%)	Royalties (%)
80	Czech Republic	11-04-1997	25	10	0	0	5
81	Tunisia	15-12-1995	10	15	0	10	11
82	Turkey	30-09-1988	25	20	15	10-15	10
83	Turkmenistan***	27-09-1987					
84	Venezuela	11-12-1997	25	10	0	5	5-7-10
85	United Kingdom	25-12-2010	10	10	0	0	0
86	United Arab Emirates	02-06-2010	10	10	5	0	0
87	United States of America	31-12-1993	80-10	15	0-5	0	0
88	Vietnam	25-10-1995	5-0-25	15	10-5	10	5-10-15
89	Zambia	09-11-1982	25	15	5	10	10
90	Zimbabwe	21-04-1991	25	20	10	10	10
91	South Africa	03-02-1972	10	15	0	0	0
92	South Korea	17-04-1981	25	15	10	10-0	15-10
93	Sweden	12-08-1992	25	15	0	0	0
94	Switzerland	09-11-2011	10	15	0	0	0

* New treaty signed, not yet effective.

** Negotiations being held or treaty must still be ratified.

*** Treaty with former Soviet Union.

**** Treaty with Former Yugoslavia.

Malawi and Mongolia terminated their treaties with the Netherlands on 1 January 2014; a new treaty is being negotiated with Malawi.

The actual withholding tax rate may differ from the rate stated here on account of, for example, different provisions in a treaty protocol, anti-misuse provisions in local legislation or if the national rate is lower than the treaty rate. There are also tax information exchange agreements, chiefly with countries that levy little if any profit tax.

Annexe 3 Treaties concluded by European countries and corporation tax rate

	Number of treaties	Corporation tax rate[16]
Austria	84	25%
Belgium	91	33.9%
Bulgaria	68	10%
Croatia	57	20%
Cyprus	48	12.5%
Czech Republic	82	19%
Denmark	76	24.5%
Estonia	55	0% on undistributed profits. 21% on distributed profits
Finland	75	20%
France	126	33.3%
Germany	96	30.175%-33.325%[17]
Greece	54	26%
Hungary	73	10/19%
Iceland	39	20%
Ireland	69	12.5%
Italy	93	31%
Latvia	57	15%
Lithuania	50	15%
Luxembourg	67	28.59%[18]
Malta	65	35%, effective 5%
Netherlands	94	20% up to €200,000, 25% on excess
Norway	85	27%
Poland	83	19%
Portugal	62	26%-30%[19]
Romania	86	16%
Russia	81	20%
Slovakia	64	22%
Slovenia	55	17%
Spain	85	30%
Sweden	84	22%
Switzerland	102	12%-24%[20]
Turkey	81	20%
Ukraine	69	18%
United Kingdom	122	21%

[16] The table presents the standard rates only.

[17] 15.825% federal plus 14.35% to 17.5% local. A further 18% for pensions and 15.5% for health care.

[18] Commercial activities, intellectual property 5.718%.

[19] Municipal surtax (maximum 1,5%) not included.

[20] Effective rate.

Annexe 4 Dividend, interest and royalty flows

Dividend flows

The Netherlands: **incoming** dividends received by the largest SFIs (in millions of euros)

Area	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average** 2008/2012
Africa	.	.	.	795	1,568	1,302	994	1,937	1,459	3,036	1,745
Australia	.	.	660	.	1,539	958	1,005	1,246	1,345	1,076	1,126
Asia	820	1,362	1,371	3,908	5,755	5,481	10,003	13,046	12,261	13,793	10,917
Europe, EU	5,725	5,913	13,531	14,918	38,272	35,261	33,219	44,923	39,395	31,147	36,789
Europe, non-EU	1,393	2,824	1,983	6,205	8,592	7,045	5,565	10,041	9,304	7,411	7,873
Central America	59	49	.	2,576	.	.	1,304	3,991	.	1,796	3,419
North America	.	706	.	7,764	.	2,061	2,945	7,609	5,936	4,505	4,611
South America	.	.	640	489	1,349	2,813	2,443	5,204	5,092	6,868	4,484
Africa (wt)	98	464	1,488	.	2,105	.	.	.	648	1,764	1,520
Australia (wt)	0	.	.	.	.	.	.	.	.	.	.
Asia (wt)	.	.	.	.	.	.	.	.	.	98	547
Europe, non-EU (wt)	.	.	.	.	.	.	.	354	941	1,190	1,009
Central America (wt)	27	.	.	.	.	180	.	489	210	.	505
North America (wt)	.	1,749	2,381	2,009	4,724	1,080	.	5,345	.	.	3,634
South America (wt)	.	.	.	171	234	266	441	.	622	.	.
Total*	Not known	13,067	Not known	Not known	Not known	Not known	Not known	Not known	Not known	72,684	78,647

Source: DNB

The data were compiled using a cut-off sample, as only the largest SFIs complete a monthly and annual detailed questionnaire. Other SFIs complete a less detailed questionnaire every other year. Size in this case is based on total assets: the largest SFIs are those that together account for about 90% of aggregate total assets.

'.' Amount traceable to individual companies and therefore not disclosed.

* To give a good indication of the increase in the flows, we have aggregated the flows for 2004 and 2012. We chose these years because, in our estimation, the cells not completed in those years represent a relatively small amount.

** The averages are calculated from the aggregate figures received from DNB for 2008 to 2012. As some areas are not included, the aggregate average does not total to exactly €78,647 million.

(wt) without treaty

Australia without treaty = American Samoa, Cook Islands, Fiji, Micronesia, Heard Island and McDonald Islands, Kiribati, Marshall Islands, New Caledonia, Norfolk, Nauru, Niue, French Polynesia, Papua New Guinea, Palau, Solomon Islands, Tokelau, East Timor, Tonga, Tuvalu, Vanuatu, Wallis and Futuna.

North America without treaty = Netherlands Antilles (DNB does not classify the Tax Regulations for the Kingdom as a tax treaty), Greenland, Guadeloupe, Martinique, St Pierre and Miquelon, Puerto Rico.

The Netherlands: **outgoing** dividends distributed by the largest SFIs (in millions of euros)

Area	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average 2008/2012
Africa	.	0	0	0	0	.	0	0	0	0	.
Australia	.	0	0	0	.	.	0	0	.	.	230
Asia	135	.	.	.	142	.	.	220	169	2,385	648
Europe, EU	12,840	18,860	14,887	24,202	31,960	38,885	39,159	57,981	45,109	43,306	44,888
Europe, non-EU	.	366	.	820	.	.	.	2,580	3,305	4,800	3,329
Central America	9	0	.	.	.	.	0	952	.	.	147
North America	.	.	.	588	.	.	5,853	4,155	3,571	,	7,976
South America	1	0	0	0	0	.	.	.	.	.	.
Africa (wt)	0	0	0	.	0	0	0	.	372	.	.
Australia (wt)	0	0	0	0	0	0	0	0	0	0	0
Asia (wt)	0	0	0	0	.	.	.	505	1,189	.	535
Europe, non-EU (wt)	0	.	0	.	0	0	.	.	.	.	.
Central America (wt)	.	0	0	0	.	4	.	.	.	.	109
North America (wt)	.	.	.	.	.	.	.	.	.	0	211
South America (wt)	2	0	0	0	0	0	0	0	0	0	0
Total*	Not known	Not known	Not known	25,610	Not known	Not known	Not known	Not known	53,715	Not known	58,163

Source: DNB

The figures relate to the largest SFIs, together representing about 90% of aggregate total assets.

'.' Amount traceable to individual companies and therefore not disclosed.

* To give a good indication of the increase in the flows, we have aggregated the flows for 2006 and 2011. We chose these years because, in our estimation, the cells not completed in those years represent a relatively small amount. As some areas are not included, the aggregate average does not total to exactly €58,163 million.

Interest flows

The Netherlands: **incoming** interest received by SFIs on group loans (in millions of euros)

Area	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average 2008/2012
Africa	4	5	6	31	72	86	98	107	368	693	270
Australia	126	228	146	66	26	125	56	111	172	167	126
Asia	67	64	63	313	530	443	972	1,476	1,101	890	977
Europe, EU	13,31	14,135	14,544	15,325	21,626	20,227	19,695	17,380	20,857	22,016	20,035
Europe, non-EU	1,023	697	743	742	1,404	1,276	914	854	1,086	1,724	1,171
Central America	44	28	98	101	176	123	126	124	238	260	174
North America	1,367	1,387	1,856	2,465	3,207	2,753	2,556	2,085	2,161	2,792	2,469
South America	114	179	96	40	201	226	383	525	424	325	377
Africa (wt)	18	11	7	37	39	91	114	184	273	294	192
Australia (wt)	.	1	.	.	.	.	.	.	.	.	.
Asia (wt)	1	2	8	3	3	3	33	74	101	298	102
Europe, non-EU (wt)	204	11	28	37	30	24	14	54	49	37	36
Central America (wt)	29	98	51	59	109	70	104	97	63	48	76
North America (wt)	13	7	5	31	7	9	10	10	12	.	8
South Ame4rica (wt)	21	21	24	18	17	18	21	11	24	39	22
Total*	16,402	16,874	17,675	19,268	27,447	25,474	25,096	23,092	26,929	29,583	26,035

Source: DNB

The figures include dividend paid by smaller SFIs, which report interest and dividends together as a single flow.

‘.’ Amount traceable to individual companies and therefore not disclosed.

* To give a good indication of the increase in flows we have aggregated the figures even though some annual figures are missing. The missing years represent a relatively small amount relative to the annual totals.

The Netherlands: **outgoing** interest paid by SFIs on group loans (in millions of euros)

Area	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average 2008/2012
Africa	1	2	9	18	56	15	5	25	1	1	9
Australia	14	19	43	27	45	49	50	37	82	52	54
Asia	72	171	222	249	481	273	432	880	1,214	1,481	856
Europe, EU	4,323	3,547	5,271	7,249	8,208	9,085	6,861	5,205	5,679	5,585	6,483
Europe, non-EU	516	284	439	654	1,005	1,037	795	419	1,169	1,239	932
Central America	519	577	735	563	1,150	833	1,131	936	1,119	1,215	1,047
North America	724	1,430	2,283	2,076	2,386	2,576	3,268	3,739	3,803	3,335	3,344
South America	165	15	31	74	35	158	55	4	6	21	49
Africa (wt)	9	8	13	10	36	22	30	410	16	28	101
Australia (wt)	.	0	.	.	.	.	.	.	.	.	,
Asia (wt)	.	0	0	1	3	3	29	3	17	88	28
Europe, non-EU (wt)	200	395	443	499	432	390	146	122	320	201	236
Central America (wt)	429	317	467	649	1,029	704	652	640	512	729	647
North America (wt)	170	941	1,337	1,949	2,117	1,993	1,176	209	34	126	707
South America (wt)	1	1	1	4	37	57	50	10	7	9	27
Total*	7,143	7,707	11,294	14,022	17,020	17,195	14,680	12,639	13,979	14,110	14,520

Source: DNB

The figures include dividend from smaller SFIs, which report interest and dividends together as a single flow.

‘.’ Amount traceable to individual companies and therefore not disclosed.

* To give a good indication of the increase in flows we have aggregated the figures even though some annual figures are missing. The missing years represent a relatively small amount relative to the annual totals.

Royalties paid/received by SFIs (in millions of euros)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average 2007/2011
Incoming royalties	5,358	5,496	5,107	5,443	6,935	10,255	11,020	14,387	18,481	.	12,216
Outgoing royalties	4,403	4,205	3,926	3,795	5,591	8,273	10,254	12,337	13,326	.	9,956

Source: DNB

The data on royalty flows provided by DNB represent about 99% of all SFIs.

‘.’ Amount traceable to individual companies and therefore not disclosed.

Annexe 5 Example of the Double Irish Dutch Sandwich

ROYALTY WITH ARRANGEMENT			
UK company			
Expenses (€)		Income (€)	
Royalty paid to IRL II company*	5,000,000*	Sales revenue	100,000,000
Other expenses**	70,000,000**		
Profit before tax	25,000,000		
	100,000,000		**100,000,000**
Profit tax, 21%	5,250,000		
Profit after tax	19,750,000		
Company in Ireland (Ireland II)			
Expenses (€)		Income (€)	
Royalty paid to NL company	4,800,000	Royalty from UK company	5,000,000
Other expenses***	50,000		
Profit before tax***	150,000		
	5,000,000		**5,000,000**
Profit tax, 12.5%	18,750		
Profit after tax****	131,250		
NL company			
Expenses (€)		Income (€)	
Royalty paid to Ireland I company	4,608,000	Royalty from Ireland II company	4,800,000
Other expenses***	50,000		
Profit before tax***	142,000		
	4,800,000		**4,800,000**
Profit tax, 25%	35,500		
Profit after tax	106,500		
Company in Bermuda (Ireland I)			
Expenses (€)		Income (€)	
Other expenses	50,000	Royalty from NL company	4,608,000
Profit before tax	4,558,000		
	4,608,000		**4,608,000**
Corporation tax, 0%	-		
Profit after tax	4,558,000		
TOTALS			
Sales revenue	100,000,000		
Other expenses	70,150,000		
Profit before tax	29,850,000		
Tax	5,304,250		
Profit after tax	24,545,750		
Average tax rate	17.77%		

ROYALTY WITHOUT ARRANGEMENT			
UK company			
Expenses (€)		Income (€)	
Royalty paid to US company*	5,000,000*	Sales revenue	100,000,000
Other expenses	70,000,000		
Profit before tax	25,000,000		
	100,000,000		**100,000,000**
Tax, 21%	5,250,000		
Profit after tax	**19,750,000**		
US company			
Expenses (€)		Income (€)	
Other expenses	50,000	Royalty from UK company	5,000,000
Profit before tax	4,950,000		
	5,000,000		**5,000,000**
Tax, 35%	1,732,500		
Profit after tax	3,217,500		
TOTALS			
Sales revenue	100,000,000		
Other expenses	70,050,000		
Profit before tax	29,950,000		
Tax	6,982,500		
Profit after tax	22,967,500		
Average tax rate	23.31%		

* Sale of a product to a consumer. A 5% royalty is paid on the product sold.

** Cost of goods purchased (excl. royalty), operating costs and interest expense.

*** Arm's length margin is 4% of revenue (other expenses plus pre-tax profit is 4%).

**** Ireland II often also has operating activities that are remunerated separately. They are not included in this example.

Annexe 6 Audit methodology

Methods used

Desk research
For the purpose of our audit, we analysed the laws and rules of greatest relevance to tax planning and tax treaties. We considered the corporation tax base (innovation box) and corporation tax rate, methods to avoid double taxation (participation exemption and tax credit systems) and anti-misuse provisions in the Corporation Tax Act 1969. We also studied the legislation on the exchange of information with foreign countries. We studied the Tax Treaty Policy Memorandum 2011 and reviewed the decisions on the conclusion of advance pricing agreements and advance tax rulings with the Tax and Customs Administration. We also determined with which countries the Netherlands had concluded a treaty and the reduced rate of withholding tax agreed with other states. In broad lines we made comparisons chiefly with neighbouring countries. We studied OECD proposals to combat avoidance. We also analysed the OECD and UN model conventions for the avoidance of double taxation.

We went through the main Parliamentary Papers on debates of tax planning in the Netherlands and we visited websites of tax advisers and trust offices and followed reports on tax evasion in the international press.

We also studied reports issued by SEO, Oxfam-Novib and others.

For the examples of arrangements used in practice, we studied professional literature and reports in the international press. We submitted the examples to the Tax and Customs Administration for it to check in broad lines.

Oral information
We held talks with experts in academia, at civil society organisations, the Tax Division of the Supreme Court of the Netherlands, and staff at the Dutch central bank, the Ministry of Finance, the Tax and Customs Administration, the Dutch Association of Tax Advisers and research consultancies.

File review
We reviewed six recent files at the Ministry of Finance on the conclusion of tax treaties.

At the Rotterdam Tax Office we studied a total of 49 files:
- 24 files on APA/ATR applications (13 APA and 11 ATR) by multinational enterprises and their assessment;
- five files on transfer pricing where a tax audit had been initiated retrospectively and the internal 2012 annual report of the Transfer Pricing Coordination Group;
- 10 corporation tax returns assessed traditionally falling under the competence of the Rotterdam APA/ATR team and a summary of the outcomes of these assessments in 2013;
- 10 files where the Tax and Customs Administration exchanged information with a treaty partner;
- the internal audit plan of the APA/ATR team;
- a newly drafted questionnaire to check compliance with substance requirements;
- the design of corporation tax returns.

Scope of the audit and audit report
We confined our audit to profit taxes and taxes withheld from dividend, interest and royalty payments. We did not audit tax planning in relation to value added tax. The report refers to national anti-misuse provisions in general terms. Provisions to prevent the unintended use of the participation exemption or the deduction of certain interest payments are detailed and highly technical in nature. The examples given in the report pay little if any attention to the various legal forms that can be used, such as cooperatives, permanent establishments, limited partnerships and foreign legal forms, hybrid or otherwise. We confine ourselves to the principle that a transfer price in the Netherlands must be at arm’s length and give examples of arrangements to reduce taxable profit and withholding tax on dividend, interest and royalty payments.

Annexe 7 Glossary

Advance Pricing Agreement	Agreement with a tax authority on the calculation of transfer prices.
Advance Tax Ruling	Agreement with a tax authority on the treatment of a taxable transaction.
Arm's length principle	The principle that transactions between associated parties a are made as though they were between unrelated parties.
Associated company	A company in which another company has a capital or other interest of at least 1/3 or two companies that are at least 1/3 owned by the same shareholder. Associated companies can also be identified by checking the distribution of control among them.
Base erosion	Reduction of the tax base.
Beneficial owner	The actual beneficiary of a payment (especially dividends, interest or royalties from abroad).
Beneficiary	In tax treaties, usually the beneficial owner (q.v.). For supervisory purposes, usually a private individual with an interest in the company.
Capital interest	An interest in a company's share capital.
Comparable Uncontrolled Price	A method to set prices where a transaction between associated parties is compared with a transaction that one of the parties has concluded with a non-associated party (internal CUP) or with a free market transaction between third parties (external CUP).
Conduit company	Collective term for holding companies and financial service entities.
Credit method or system	Method or system in which a tax credit is given to offset profit tax payable in the country in which a company that receives the dividend, interest or royalties is established.

Developing country	A country with a significantly lower standard of living than a 'rich' country.
Financial service entity	A legal person whose activities in a particular year consist chiefly of receiving interest, royalty, rent and lease payments and making interest, royalty, rent and lease payments from and to entitles not resident in the Netherlands that are members of the same group as the taxpayer.
G20	A group consisting of 19 countries and the European Union that acts as a forum for cooperation and consultation in the international financial system.
Group	A group of associated companies. (See also multinational enterprise).
Holding company	A company that holds shares in another company and carries out management tasks. (See also parent company.)
Hybrid legal form	A legal form that is treated differently for tax purposes in different countries.
Hybrid loan	A loan that is classified differently for tax purposes in different countries.
Innovation box	A tax facility for research and development work.
Investment protection agreement	An agreement between countries to protect each other's investments (and to promote investments).
Multinational enterprise	A group that carries on its business in more than one country. (See also group.)
Operating company	A company that is owned by a holding company.
Parent company	A company that owns shares in group companies and carries out management tasks. (See also holding company.)
Parent-Subsidiary Directive	The common tax regime for parent companies and subsidiaries in different EU member states.

Participation exemption	A tax exemption for income from substantial holdings to avoid double taxation.
Permanent establishment	A fixed place of business from which a foreign legal entity performs an activity.
Pooling	The combination of, for example, a group's financing and insurance activities in a group company incorporated specifically for that purpose.
Profit shifting	The allocation of income and expenses to associated companies in order to minimise the group's overall tax burden.
Royalty	Payments for the use of intellectual property licences, copyrights in books and music carriers (legal royalties), management fees, many forms of consultancy fees, technical service fees, payments for the transfer of know-how and rental payments for movable assets.
Ruling	An agreement with a tax authority, for example in the form of an APA or ATR.
Special Financial Institution	A resident enterprise or institution, regardless of legal form, in which non-residents directly or indirectly participate or on which they can exercise control on account of share ownership or otherwise and whose object and/or main activity, in combination with other resident group companies or otherwise, is: 1. principally to hold foreign assets and liabilities, and/or 2. to pass on revenue consisting of foreign royalty or licence payments to foreign group companies, and/or 3. to generate turnover and expenses chiefly by recharging foreign group companies.
Spontaneous information exchange	The exchange of information between tax authorities without a formal request being received.
Spread	Payment for activities performed or services provided based on the difference between the payments received and paid.
State of residence principle	Principle whereby income is taxed in the country in which the taxpayer is established, not the country in which the benefits arise.

Subsidiary	Company whose shares are owned by a parent or holding company.
Substance requirements	Requirements an entity must satisfy to conclude an APA or ATR with the tax authority or to enjoy benefits under a tax treaty.
Tax avoidance	An arrangement, within the law, to minimise tax payable.
Tax base	The base on which tax, e.g. corporation tax, is levied.
Tax information exchange agreement	Agreement intended solely to facilitate the exchange of tax information between treaty partners.
Tax planning	The organisation of a company's activities to optimise its tax position. (See also tax avoidance.)
Tax treaty	An agreement between states laying down which state may tax which income.
Thin capitalisation rules	Rules to prevent debt financing eroding the tax base.
Transfer prices	Prices that associated companies charge each other for goods and services provided.
Treaty shopping	The allocation of the income of an entity in a treaty state to a beneficiary in a third state to gain an undue benefit from the treaty.
Trust office	An office engaged in the management of companies.
Withholding tax	A tax in the source country on outgoing dividend, interest and royalty payments.
Worldwide income	Income earned anywhere in the world.

Annexe 8 Abbreviations

APA	Advance pricing agreement
ATR	Advance tax ruling
BEPS	Action Plan on Base Erosion and Profit Shifting
CGVP	Transfer Pricing Coordination Group
CUP	Comparable Uncontrolled Price
DNB	Dutch central bank (De Nederlandsche Bank N.V.)
EU	European Union
FDI	Foreign Direct Investment
IPA	Investment Protection Agreement
NACE	Nomenclature statistique des activités économiques dans la Communauté Européenne (Statistical Classification of Economic Activities in the European Union)
NFV 2011	Tax Treaty Policy Memorandum 2011
SFI	Special Financial Institution
OECD	Organisation for Economic Co-operation and Development
TIEA	Tax information exchange agreement
UN	United Nations
US	United States of America

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Translation

Translation Department
Ministry of Foreign Affairs

Infrographics

Schwandt Infographics

Cover

Design: Corps Ontwerpers, The Hague
Photo: iStock

The Hague, February 2015