

## 2022 Transfer Pricing Decree

On July 1, 2022 the new Transfer Pricing Decree of June 14, 2022 was published (hereinafter: the Decree). The Decree replaces the transfer pricing decree of April 22, 2018 and section V of the Questions and Answers (Financial Service Entities) Decree from 2014.

The most important changes compared to the previous decree from 2018 are the following:

- Several completely new sections on financial transactions have been added. The reason for their addition is the publication of the new Chapter X of the OECD guidelines, which places more focus on substance and the application of the Comparable Uncontrolled Price (CUP) method. A completely new section on intra-group financial services has also been added.
- A change has been made to the policy on intra-group services.
- The section on government policy has been expanded with a section on governmental aid measures, in particular in response to the COVID-19 pandemic.
- Textual changes have been made in order to ensure the terminology used is more consistent with the terminology used in the OECD guidelines and in Dutch legislation and regulations.

The OECD Transfer Pricing Guidelines have been amended over the last few years (most recently on January 20, 2022), partly as a result of the OECD's BEPS project. These OECD guidelines will also be regularly updated in the future and if necessary will result in a new transfer pricing decree. The most important changes to the Decree are summarized below.

### 1. Subsidies, tax incentives and limited deductible expenses

The central question with regard to aid measures is whether and how these affect transfer prices, which mainly occurs if the transfer price is based on incurred costs. According to the Decree, subsidies are deducted from the cost base if there is a direct link between the subsidy and the supply of the product or service. The Decree also states that additional taxes can lead to an increase in the cost base used. According to the Decree, if tax concessions are granted in the form of a deduction from the taxable profit, such as the investment deduction, then these cannot be deducted from the cost base used. With regard to the Temporary emergency bridging measure for sustained employment (*Tijdelijke noodmaatregel overbrugging voor behoud van werkgelegenheid*; NOW), the question is how this will affect the transfer prices, in particular with regard to cost-related remuneration. According to the Decree, parties should take account of the NOW that was granted to one or more parties if third parties would also do that. The Decree states that an adjustment must be made at arm's length and not be aimed at realizing a decrease in turnover that may provide a right to the NOW. According to the Decree, the taxpayer must make a plausible case that comparable unrelated entities would, in similar circumstances, have agreed a transfer pricing adjustment in a similar manner.

It should be noted that this clarification of policy is very late, given that the financial years in which the aid measures apply have already closed. Furthermore, meeting the requirement for making a plausible case about how unrelated parties have acted in similar circumstances appears to be difficult in practice.

## **2. Intra-group services**

Like the 2018 decree, the Decree makes it possible to opt for applying the simplified method for low-value added services (the OECD guidelines refer to 'low value-adding intra-group service'). If opting for this, a profit margin of 5% can be used without having to be substantiated. The 2018 decree included approved policy for low-value added services so that only the relevant actual costs are charged (including financing costs). It is striking that this approved policy now no longer appears in the text of the new Decree, having been replaced by a brief reference to the OECD guidelines, in which the option to recharge on a cost basis still exists. The footnote explicitly states that the Dutch tax authorities have discretionary power in deciding whether or not to apply this option. It is unclear what this change to the Decree is intended to achieve, but omitting the term 'approved policy' and adding 'discretionary power' seems to indicate a less flexible stance by the Dutch tax authorities on this point.

## **3. Characterization of the intercompany loan transaction**

The new version of the OECD guidelines published in 2022 contains a new Chapter X on financial transactions, which is also found in the Decree. According to the Decree, with regard to intra-group loans, the lack of control and/or financial capacity a party has in relation to certain risks may mean that the relevant risks and the associated fee should be allocated to the party that exercises control over those risks and has sufficient financial capacity to bear those risks. If the transaction cannot be made at arm's length with an adjustment of the price and/or changes to the other conditions, then according to the Decree this can in extreme cases lead to ignoring or reclassifying (part of) the loan.

## **4. Arm's length interest**

The OECD Guidelines describe several methods for determining the arm's length interest rate. The OECD's preference is for the CUP method. In addition to the CUP method, the OECD guidelines and the new Decree also describe the 'cost of funds approach'. This is a method in which the costs incurred by the lender to borrow the lent money itself are increased by coverage for costs, a risk premium and a fee for the required equity. The Decree states that if a taxpayer only performs an agent or intermediary function, they are only entitled to remuneration consisting of a surcharge on the costs of their own function.

It also states that the party that is not in control of the risks associated with the investment in a financial asset, is only entitled to a risk-free rate of return. The risk-free rate of return is generally determined by using the interest rate on eligible government

bonds. The Decree subsequently notes that the borrower is however entitled to deduct the arm's length interest. The difference between the arm's length interest rate and the risk-free rate of return (the risk premium) accrues to the party that is in control of the risks associated with the investment. The basic assumption here is that the total interest income is subject to a profit tax. In this respect it is striking that the Decree offers the Dutch tax authorities the option to deviate from the explanation given in the Decree if part of a group's profit is not subject to a profit tax, provided that this leads to an outcome based on the arm's length principle. We believe that this statement does not help clarify what can be expected from the Dutch tax authorities in this respect.

## 5. Financial service entities

The Decree includes a completely new section on financial service entities (*dienstverleningslichamen*; DVLs). These are taxpayers that enter into transactions with related entities which primarily, in law or in fact, consist of the direct or indirect receipt and payment of interest, royalties, rental or lease payments, in whatever name or in whatever form. Under the arm's length principle, the remuneration of the DVL must be assessed on the basis of the functions, activities and risks of the DVL. The OECD guidelines are used to determine the arm's length fee for a DVL. The Decree distinguishes between the following three situations for assessing the transfer pricing system of a DVL: The DVL has:

1. Full control over credit risks and has the necessary financial capacity to do so. In this situation, an appropriate interest rate should be determined on the basis of a comparability study carried out per individual inbound and outbound related transaction on the basis of the CUP method.
2. No control over credit risks and/or insufficient financial capacity: a cost-plus fee is the only appropriate remuneration here.
3. Shared control (both in a quantitative and qualitative sense) over credit risk and has the necessary financial capacity to do so. The financial consequences should be shared on a pro rata basis, depending on the relative degree of control the participants have in relation to the relevant transactions and associated risks.

In the first and third situation, it should also be established whether, and to what extent, the DVL would independently (without guarantees from related entities) be able to raise borrowed capital from an unrelated party. If it cannot, the loan is regarded as a loan to the guarantor, which then contributes the funds as equity (either through or not through the parent company) in the DVL. This then raises the question whether the interest income is fully subject to tax at the DVL.

The Decree quite explicitly notes with regard to the third situation that *"it is unlikely to be common that in similar unrelated transactions under similar circumstances for the risk borne by the DVL to be contractually limited without regard to the relative degree to which the parties exercise control over the relevant risks."* Our experience is that, in practice, the risk is contractually limited at most DVLs. The view set out in the Decree therefore seems to be a significant change in policy of the Dutch tax authorities and

seems to suggest that remuneration should henceforth be based on a cost-plus instead of on a typical spread.

The Decree recognizes that case law of the Supreme Court uses other specific criteria for qualifying a loan as equity and that this may create tension between the OECD guidelines and Dutch case law. The Decree notes here that if a taxpayer asks for advance certainty on the application of the arm's length principle, the OECD guidelines will be taken as the starting point. It is especially striking that the Dutch tax authorities thus explicitly state here that they will deviate from settled case law and will take their interpretation of the OECD guidelines as the starting point for their policy!

## **6. Cash pooling**

The section on cash pooling is also new. The Decree states that if one or more cash pool participants hold debit or credit positions in the pool for an extended period of time, it is necessary to check whether this is a different type of transaction, such as a deposit with a longer term or a loan. This could result in a different (and higher) remuneration based on the arm's length principle being appropriate compared to the remuneration for a short-term position of the participant in the cash pool.

In allocating the synergy benefits, the Decree states that the options realistically available to cash pool participants must be taken into account. According to the Decree, the synergy benefits will usually have to be distributed among the participants in the cash pool via the determination of the arm's length interest rate on the debit and credit positions of the participants in the cash pool.

With regard to 'cross-guarantees', the Decree notes that the support of a participant in the event one or more participants are in default should be regarded as an act in the capital domain.

## **7. Guarantees**

The section on guarantees in the Decree is not new, but has been rewritten in more practical terms.

The fee for a guarantee may be determined on the basis of the CUP method, but if that is not possible, it can also be determined on the basis of the yield approach. Under the yield approach, the guarantee fee cannot exceed the difference between the interest rate that the borrower would have to pay with an explicit guarantee from the group (whereby the credit rating is the same as the group rating) and the interest rate the borrower would have to pay without a guarantee. In determining the credit rating in the latter case, the fact that the borrower is a member of the group must however be taken into account (in the Decree this is referred to as the derivative rating, with the implicit support of the group also been taken into account). The derivative rating lies somewhere between the borrower's standalone rating and the group rating. The Decree contains an approval for determining the guarantee fee at half of the benefit

derived by the guarantor if in an individual case it is not possible to determine a specific arm's length guarantee fee.

## **8. Captives**

This is another section that is not new, but which has been expanded compared to the previous decree.

To characterize captives, the Decree has formulated five specific questions. These must all be answered affirmatively in order to arrive at the conclusion that there are in fact actual insurance transactions. In such a situation the related insurance company should receive a fee that is the same as that for similar unrelated insurance companies.

## **9. International consultation possible**

The Decree again refers to early consultation on potential double taxation resulting from transfer pricing adjustments. Taxpayers may submit a request for a mutual agreement procedure. The Decree refers to tax treaties, the EU Arbitration Convention, the EU Arbitration Directive – as implemented in the Netherlands in the Fiscal Arbitration Act – and to the latest MAP Decree of November 15, 2021.

### **KPMG Meijburg & Co comments**

The changes to the Decree are mainly a reaction to international developments, in particular the changes made to the OECD guidelines in respect of financial transactions, intra-group services and recent OECD publications on the treatment of government subsidies. On the one hand, the changes explain how the Netherlands interprets the OECD guidelines and clarifies for the practice the position taken by the Dutch tax authorities. On the other, a tightening of policy seems noticeable, which we see, for example, in the position taken on DVLs, where the policy creates tension with existing Dutch case law. The cancellation of the approved policy on remunerating low-value added services on a cost basis is an example of a change where the flexibility in policy seems to have been somewhat diminished.

Should you have any questions about the above, Meijburg's advisors would be pleased to use their expertise to help you.

KPMG Meijburg & Co  
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