Public consultation on Bill implementing ATAD2

On May 29, 2017, an amendment to the EU Anti-Tax Avoidance Directive was adopted, so that this directive also focuses on combating hybrid mismatches between EU Member States and third countries (ATAD2). We had already paid attention to this in our previous memorandum. On October 29, 2018, the government launched an internet consultation to give interested parties the opportunity to respond to the draft bill to implement ATAD2. This bill and the changes it will entail for corporate income tax are discussed below.

1 Implementation of ATAD2 in short

1.1 Hybrid mismatches

ATAD2 tackles tax avoidance via hybrid mismatches in affiliated relationships. Hybrid mismatches concern situations in which differences between tax systems are used with regard to the qualification of entities, instruments or permanent establishments. Hybrid mismatches may result in a tax deduction whereby the corresponding income is not taxed anywhere, or where the same payment is deducted several times.

The consultation document distinguishes between hybrid mismatches with:

- Hybrid entities;
- Hybrid financial instruments;
- Hybrid permanent establishments;
- Hybrid transfers;
- Imported hybrid mismatches; and
- Situations involving dual domicile.

In line with ATAD2, the consequences of these hybrid mismatches will be neutralized. Depending on the mismatch and the treatment outside the Netherlands, this will be effected by refusing the deduction or taxing the income. The neutralization will only take place to the extent necessary to neutralize the mismatch (proportionally).

In the case of mismatches that result in a deduction without the corresponding payment being subject to tax (deduction no inclusion), the payment will not, primarily, be allowed to be deducted (primary rule). If the primary rule is not applied, the payment must be taxed at the recipient (secondary rule).
In the case of mismatches that trigger a double deduction, neutralization will take place by refusing the deduction in one of the countries. The deduction must primarily take place in the payor’s country. It will be refused in the other country. If the primary rule does not offer a solution, then the payor’s country must refuse the deduction.

ATAD2 links Dutch corporate income tax to the tax systems of other countries. As a result, international arrangements will become even more sensitive to regulatory changes in the various countries. The hybrid mismatch rules, which will apply to financial years commencing on or after January 1, 2020, are addressed in more detail below.

As of January 1, 2020, the policy statement on hybrid entities under the tax treaty with the US will be withdrawn (Policy Statement of July 6, 2005, IFZ2005/546M). In short, this policy statement provides for the reduced rate on dividends in the tax treaty with the US to be applied to BV/CV (private limited liability company/limited partnership) structures.

1.2 Reversed hybrids (BV/CV structures)

The consultation document also contains a subject-to-tax measure for 'reversed hybrid entities' such as the BV/CV. This concerns entities that are not regarded as being subject to tax in the country of incorporation, establishment or registration (also referred to as 'tax transparent'), while being regarded as non-transparent in the country of the participants in the entity. If (a part of) the entity's profit is not subject to tax, then this will occur in the Netherlands if the entity is incorporated, established or registered in the Netherlands. The measure not only tackles the effect (neutralization), but also the cause (the elimination of the qualification difference). The reversed hybrid rules will apply to financial years commencing on or after January 1, 2022.

For the sake of clarity we would like to point out that, as of 2018, BV/CV structures had already become less attractive as a result of CFC measures in the US and that as of January 1, 2020, payments to BV/CV structures could be affected by the abovementioned hybrid mismatch rules. As of January 1, 2020, the payments can be excluded from deduction. The subject-to-tax measure, which will apply as of January 1, 2022 and as a result of which income will be taxed in the Netherlands at the BV/CV, is additional to this. From that moment on there will of course no longer be a hybrid mismatch; after all the income is taxed at the recipient. A deduction limitation by virtue of the hybrid mismatch rules will then no longer take place at the paying company.

2 A closer look at the hybrid mismatch rules

2.1 Mismatch with hybrid entities

There is a hybrid entity if an entity is regarded as tax transparent in one State, but as non-transparent in the other State. This may result in neither of the states involved taxing the hybrid entity's profit, or in a double deduction being allowed.
The mismatches with hybrid entities can be divided into three main types:

a. Payments to hybrid entities;
b. Payments by hybrid entities;
c. Situations involving double deductions.

The primary rule of the Dutch implementation of ATAD2 with regard to a. and b. will be that the payments are not allowed to be deducted. The secondary rule will be that the payment must be taxed at the recipient. With regard to c., in line with the primary and the secondary rule for double deduction, the Netherlands will not allow the deduction at the payor if it is permitted in the investor's State.

2.2 Mismatch with hybrid financial instruments

A financial instrument is any instrument that yields a return on equity or debt. There is a hybrid financial instrument if a State permits payments based on that financial instrument to be deducted from the profit, while the corresponding income is not taxed or not taxed within a reasonable period at the recipient as a result of a difference in the qualification of the fiscal instrument or the payment based on it. Hybrid financial instruments also include the hybrid transfer. The hybrid transfer will however be dealt with separately later on.

In order to determine whether the corresponding income is taxed within a reasonable period, the tax period at the recipient that begins within 12 months of the end of the tax period within which the payor has taken the deduction into account will be examined. If this is not the case, there can still be a reasonable period if the payments are expected to be taken into account at the recipient and the payment conditions for the hybrid instrument would also have been agreed by independent parties.

The Dutch implementation will have as primary rule that the payments are not allowed to be deducted. This is not expected to occur frequently in EU situations, given that the EU Parent-Subsidiary Directive also provides for an anti-abuse rule for hybrid financial instruments. The secondary rule will be that the payment must be taxed at the recipient.

2.3 Mismatch with hybrid permanent establishments

There is a hybrid permanent establishment if there is a difference of opinion between States about the presence and/or attribution of profit to business activities in a State. The mismatches with hybrid permanent establishments can be divided into four main types:

a. Disregarded permanent establishments;
b. Payments to an entity with a permanent establishment;
c. Situations involving presumed payments (‘dealings’);
d. Situations involving double deductions.

With regard to a., in the case of disregarded permanent establishments, the Netherlands will, as the country of the head office, effectively tax the income in the Netherlands. The Netherlands will also implement the rule that the deduction of the payments will be refused in the case of payments to a disregarded permanent establishment.

If a Dutch company makes payments to an entity with a permanent establishment and the entity’s State and the State of the permanent establishment attribute the payments to one another, then the Netherlands will have as primary rule that the deduction of the payments to the entity will be refused. In addition to this, the Netherlands will implement as secondary rule that the income will be taxed in the head office’s State.

In cases of a presumed payment between head office and permanent establishment that leads to a deduction without the presumed payment being taxed (situation c.), the Netherlands will have as primary rule that the deduction at the permanent establishment will be refused. As secondary rule, the Netherlands will tax the presumed payment at the level of the head office.

In double deduction situations (situation d.), where the Netherlands is the State of the investor, it will effectively refuse the deduction insofar as there is a double deduction. If the Netherlands is the payor's State and the investor's State does not refuse the deduction, then the Netherlands will refuse the deduction insofar as there is a double deduction.

2.4 Mismatch with hybrid transfers

A hybrid transfer is a form of hybrid mismatch with a financial instrument. It is often a combination of transactions. For example, lending shares around the dividend date. Such a hybrid transfer between parties in various countries and the associated different treatment may result in a deductible item being taken into account at the one contracting party, while no corresponding income is taxed at the other contracting party. The primary rule in that case is that the deduction is refused. As secondary rule, the income will be taxed. Thus if Party A is established outside the Netherlands and takes an expense into account and Party B is established in the Netherlands and receives income that is not taxed, then the deduction must primarily be refused outside the Netherlands. If this does not happen, then the Netherlands will tax the income.

2.5 Imported hybrid mismatches

Hybrid mismatches can also occur between two or more States that are not members of the EU. These states may not have any anti-hybrid mismatch rules. By using taxpayers that are not established in the EU as intermediaries, mismatches could be imported; mismatches that without these intermediaries would be neutralized. For example, where a company in country A (non-EU) provides a hybrid loan to a company in country B (non-EU). The payments on this hybrid loan are deductible in country B and not taxed in country A. The company in country B provides a normal loan to a Dutch company. The payments on this loan are, in principle, deductible in the Netherlands. Without additional rules, this arrangement would result in deductible interest in the Netherlands, in country B only the balance of the interest income and the deductible payments is taxed, and in country A the payment is received exempt from tax. The Netherlands will refuse the interest deduction in this situation. This would also be the case if funds were lent directly from country A.

2.6 Situations involving dual domicile

If a company has a double domicile and is taxed in more than one country, either because there are no tax treaties or because these do not offer any solution, it is possible that the income and expenses are taken into account in more than one country. For such situations, it is stipulated that the deduction will be refused in both countries to the extent that net costs (after the deduction of double-taxed income) are deducted twice. The Netherlands will allow the deduction if the other country is an EU Member State and the treaty between both countries designates the Netherlands as the country of residence.

3 Final remarks

The consultation closes on December 10, 2018. If approval is granted, the responses will subsequently be published. After the consultation has closed, the response will be included in a final bill. After the implementation of ATAD2, Dutch corporate income tax will become even more complex. International arrangements will have to be re-assessed and possibly modified.

Meijburg & Co
October 2018