



Implementation of ATAD1 in Dutch tax law

On Budget Day, the Dutch government submitted a legislative proposal regarding the implementation of the Anti-Tax Avoidance Directive as agreed mid 2016 by the EU member states (“ATAD1”). The most important measures are the earnings stripping rules that limit the deductibility of interest and measures for controlled foreign companies (“CFC”).

Introduction earnings stripping rule

As from 1 January 2019, a new general interest deduction limitation will be introduced. The earnings stripping rule is a measure that limits the deductibility of *excess* net interest expenses. The deduction of the net interest expenses is limited to the higher of:

- 30% of the tax EBITDA (earnings before interest, tax, depreciation and amortization);
- The threshold of EUR 1,000,000.

The *net* interest is the difference between interest expenses and interest income, on both third party and intercompany loans. For this provision ‘interest’ also includes related costs and foreign exchange results. The EBITDA is

calculated on basis of the tax accounts and excludes tax exempt income, such as qualifying dividends and capital gains.

The non-deductible interest can be carried forward without limitation in time and can be deducted from the taxable profits in future years (to the extent the interest does not exceed the threshold in those years). The carry forward possibilities are restricted in case of a change in control of at least 30%.

The earnings stripping rules will apply per taxpayer, irrespective whether the taxpayer is part of a group. A fiscal unity is regarded as one taxpayer. Furthermore, detailed rules for (de)consolidation and for (de)mergers have been included.

The earnings stripping rules in the Netherlands do not include a group escape, nor will there be any grandfathering for existing loans.

Abolishment of specific interest deduction limitations

The counterpart of the introduction of the general interest limitation by way of the

earnings stripping rule is that some specific interest deduction limitations in the Dutch

Corporate Income Tax Act (CITA) will be abolished as of 1 January 2019. This is the case for the limitation of interest expenses for acquisition vehicles (article 15ad CITA) and the excessive participation financing rule (article 13l CITA). The interest deduction limitation targeting base erosion (article 10a CITA) remains applicable.

CFC rules

As part of ATAD1, the Netherlands is also required to introduce controlled foreign company (CFC) rules as from 1 January 2019. These rules should prevent companies from shifting profits to subsidiaries or permanent establishments in low-tax jurisdictions.

An (in)direct subsidiary of a Dutch taxpayer is considered a CFC if it holds – alone or together with related entities/persons – a direct or indirect interest of more than 50% of the nominal capital, voting rights or entitlement to profits in a foreign entity or if the Dutch taxpayer has a permanent establishment.

ATAD1 allows EU member states two options on how to determine the CFC's income: Model A and Model B.

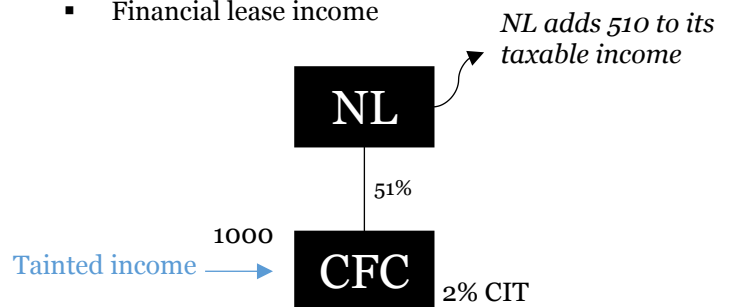
- Model A: a number of categories of passive non-distributed income of the CFC is included in the Dutch tax base.
- Model B: profit reported by the CFC is attributed to the significant people functions performed in the Netherlands based on the arm's length principle.

The Dutch government is of the opinion that the Model B is already embedded in the Dutch Corporate Income Tax Act through the arm's length principle. In addition, and more than strictly necessary, the Netherlands now proposes to introduce Model A for CFCs in certain jurisdictions.

The proposal entails that Model A applies if a CFC is located in a jurisdiction with a statutory profit tax rate of less than 7% or in a jurisdiction that is blacklisted by the EU for being a non-cooperative jurisdiction. The Dutch Ministry of Finance will annually publish an exhaustive list of jurisdictions to which Model A applies.

If an entity is considered a CFC, the net passive investment income ("tainted income") of the CFC that is not distributed before year-end is added to the Dutch tax base of the Dutch (controlling) entity on a pro rata basis. This tainted income includes among others:

- Dividend income
- Interest income
- Royalty income
- Financial lease income



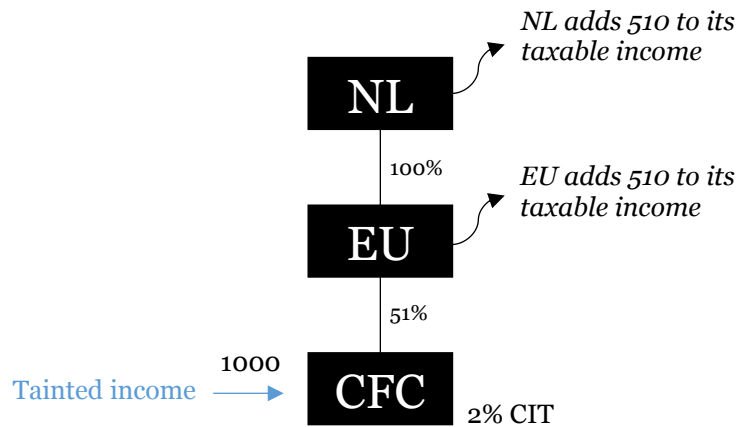
The CFC income is (re)calculated according to Dutch standards, including transfer pricing rules. The corporate income tax paid by the CFC in its country of residence can, under circumstances, be credited.

Two exceptions are proposed, under which the income of a CFC is not added to the tax base of a Dutch (controlling) entity:

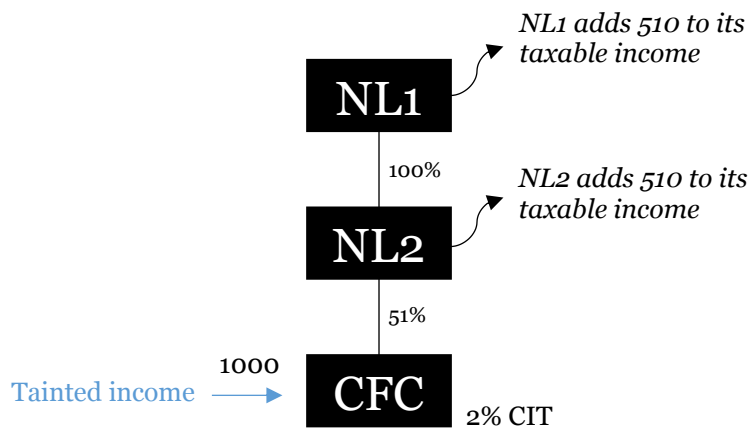
- If the income of the CFC consists mainly (i.e. at least 70%) of other 'not tainted' income; or
- If the CFC performs a genuine economic activity.

Whether a CFC performs a genuine economic activity is determined based on the 'relevant substance' requirements that are effective as from 1 January 2018 for the dividend withholding tax. These include the minimum substance requirements, a EUR 100,000 annual salary requirement and having an own office space.

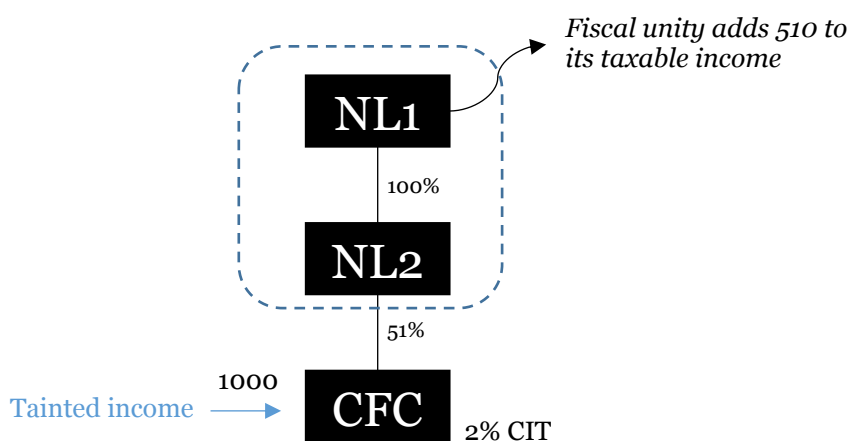
The proposal does not contain measures preventing double taxation due to the application of CFC rules by other jurisdictions. Such a situation whereby the income of a CFC is attributed to multiple countries, according to their respective CFC legislation, can be pictured as follows.



If multiple Dutch entities are considered controlling entity of a CFC, income of the CFC is attributed to all these entities.



If these entities are part of a CIT fiscal unity, the CFC income is attributed to the fiscal unity as a whole.



Final remark

The implementation of ATAD1 in Dutch tax law may have an impact on the tax position of Dutch corporate taxpayers and we recommend to review the corporate income tax position carefully. It should be noted that the legislative proposals may change in the coming months during the parliamentary proceedings. We will carefully follow the developments.