Atlas
Tax lawyers / Fiscalisten

LEGISLATIVE PROPOSAL ON THE DUTCH IMPLEMENTATION OF ANTI-HYBRID RULES PURSUANT TO THE ANTI-TAX AVOIDANCE DIRECTIVE

On 2 July 2019, the legislative proposal to implement the provisions of the EU Anti-Tax Avoidance Directive 2 (ATAD2) was submitted to the Dutch parliament. ATAD 2 combats both hybrid mismatches among EU Member States and between EU Member States and third countries. The content of the legislative proposal is in line with the draft bill that was opened for public consultation in October 2018. However, the legislative proposal contains some welcome clarifications in the explanatory statements following the questions raised as part of the internet consultation.

Hybrid mismatches

ATAD 2 aims to prevent situations of a double deduction (DD) and a deduction without inclusion (D/NI) resulting from a hybrid mismatch. The Dutch anti-hybrid rules only apply to the extent that a hybrid mismatch, as described below, results in a DD or D/NI situation. This means that, for example, transfer pricing differences are not covered by this proposal. The proposal covers the following types of hybrid mismatches:

- Hybrid financial instruments: A hybrid financial instrument is an instrument (e.g. a loan) giving rise to a D/NI outcome as a result of a mismatch in qualification of the

instrument/payment by the payor and recipient jurisdictions. Under circumstances, also the transfer of financial instruments resulting in a mismatch of ownership can qualify as a hybrid mismatch.

- (Reversed) hybrid entities: A D/NI or DD outcome involving a hybrid entity could arise as a result of a payment made by or to a (reverse) hybrid entity. The D/NI or DD outcome should be a result of a difference in attribution of the payment between the hybrid entity and investor(s) jurisdictions.
- Hybrid and disregarded permanent establishments: This type of hybrid mismatch exists in case a D/NI or DD outcome arises due to a difference in allocation of payments to a permanent establishment (PE) or due to payments to a disregarded PE. In addition, a difference in the recognition of deemed payments between a head office and PE (dealings) are also covered.
- Dual resident entities: Situations involving a payment made by an entity that is considered a resident of (at least) two jurisdictions that result in a DD outcome.
- Imported mismatches: These would arise if payments are made to a non-hybrid entity which are related to and used to finance a deduction of payments by the non-hybrid entity in a hybrid mismatch situation.

Neutralizing the effect of D/NI and DD outcomes

The Netherlands implements primary rules and secondary rules to neutralize the different types of hybrid mismatches described above. This is in line with ATAD 2. The rules do not solve the hybrid mismatch as such, but eliminate the effect resulting from the hybrid mismatch.

When a hybrid mismatch results in a D/NI outcome, under the primary rule, the deduction of the payment will be disallowed if the Netherlands is the jurisdiction of the payor. The secondary rule only applies if the deduction is not disallowed by the payor jurisdiction because the payor jurisdiction does not apply anti-hybrid rules. Under this secondary rule, the corresponding income will then be included for tax purposes if the Netherlands is the recipient jurisdiction.

In case of mismatches that result in double deduction, one of the jurisdictions should refuse the deduction. The deduction must primary take place in the payor's country and hence be refused in the other country. If the primary rule does not offer a solution, then the payor's country must refuse the deduction.

If the double deduction results from a payment made by a dual resident entity, as a general rule the Netherlands will disallow the deduction. The deduction will however be granted if the entity is a resident of the Netherlands based on a tax treaty with an EU Member State.

Specific elements of the Dutch implementation

Covered transactions

In general, the anti-hybrid rules only apply to hybrid mismatches between related parties. A related party is defined as a 25% interest (in line with ATAD 1 rules).

Further, structured arrangements with third parties in which the hybrid mismatch advantage is priced or the hybridity is part of the set-up of the arrangements are also covered in the ATAD 2 proposal.

Definition of payments

Under the legislative proposal, not only actual payments are covered but also deemed payments in a hybrid mismatch situation (e.g. as a result of a transfer pricing correction). Other types of deductions such as depreciation/amortization expenses are not regarded as payments. Only in case of a double deduction of these expenses, the anti-hybrid rules will deny the deduction.

Documentation obligation

A new documentation obligation related to the hybrid mismatch rules is introduced. A taxpayer who takes the position in the tax return that the hybrid mismatch rules do not apply, must include information in its administration substantiating this position. If a taxpayer does apply the hybrid mismatch rules in its tax return, it must include information in its accounts and records showing how the hybrid mismatches rules are applied, e.g. a structure chart and a tax and legal assessment of the relevant hybrid financial instruments, entities and/or PEs.

If a taxpayer fails to comply with the documentation obligation or only partly complies with it, it will be presumed that the hybrid mismatch rules apply. This means that a heavier burden of proof will come to rest on the taxpayer because it must then be shown that the hybrid mismatch rules do not apply.

Reversed hybrids (CV/BV structures)

The legislative proposal also contains a subject-to-tax rule for 'reversed hybrid entities' such as in the CV/BV structure. This concerns entities that are not regarded as being subject to tax in the country of incorporation, establishment or registration ('tax transparent'), while being regarded as 'non-transparent' in the country of the participants in that entity. If (part of) the entity's profit is not subject to tax, then taxation will occur in the Netherlands if the entity is incorporated, established or registered in the Netherlands. This is typically the case for a CV. The measure not only neutralizes the effect but also eliminates the difference in qualification of the entity. The subject to tax rule for reversed hybrid entities will apply to financial years starting on or after 1 January 2022.

For completeness we note that as of 1 January 2020, payments to CV/BV structures would be affected by the abovementioned 'regular' hybrid mismatch rules. As of 1 January 2020, the

payments can be disallowed from deduction. The subject-to-tax measure, applicable as from 1 January 2022 and based on which the income will be taxed in the Netherlands at the CV level, is additional to this. From that moment on there will no longer be a hybrid mismatch; the income is included at the recipient. A deduction limitation by virtue of the hybrid mismatch rules will then no longer take place at the paying company.

In conjunction with the legislative proposal, the Decree dated 6 July 2005 published by the Dutch State secretary of Finance on the application of the Netherlands – United States tax treaty with respect to reverse hybrid entities will be abolished effective 1 January 2020. As a result, in case a US shareholder holds an interest in a Dutch tax resident entity via a reverse hybrid entity (e.g. a Dutch CV), in principle Dutch dividend withholding tax will apply to distributions as from 1 January 2020.

Final remarks

The provisions of ATAD 2 have to be applied as from 1 January 2020 and/or 1 January 2022 (for the subject-tax-rule). The legislative proposal generally follows ATAD 2. Further to the internet consultation, the proposal provides useful guidance and welcomes clarifications on several aspects of the proposed rules. Parliamentary process may lead to further clarifications, but no significant structural amendments are expected.

It is also indicated that the Dutch rules on the qualification of foreign partnerships may be revised which may likely lead to a reduction of hybrid entity qualifications. The documentation obligation is expected to be very relevant in practice. It remains important to assess international arrangements and structures and make changes where necessary prior to 1 January 2020.