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The ATAD general anti-avoidance rule in the Netherlands

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The Dutch legislator decided not to implement the General Anti-Avoidance Rule ("GAAR") of the EU Anti-Tax Avoidance Directive ("ATAD") and to rely on the court developed fraus legis doctrine. As there are several discrepancies between the GAAR of ATAD and the concept of *fraus legis*, question arises whether this is actually sufficient for a proper implementation.

Introduction

1. The Anti-Tax Avoidance Directive ("ATAD") as adopted by the European Council contains anti-abuse measures which Member States of the European Union had to implement in their domestic laws. The ATAD set minimum standards and Member States were free to impose more strict rules. Article 6 of ATAD contains a general anti-avoidance rule ("GAAR"), with the aim to tackle abusive tax practices that have not been dealt with through specifically targeted provisions. Like most of the ATAD measures, the GAAR should have been implemented by the Member States before 1 January 2019.

After the release of BEPS Action 6, it has been considered important by the European Commission to ensure that the GAAR applies in a uniform manner, so that the scope and results of the application in domestic and cross-border situations do not differ[1].

The following table reflects how the ATAD has been transposed into Dutch law:

1 Paragraph 11 of the Preamble to Council Directive (EU) 2016/1164a.

Articles Directive	Implementation Dutch tax code	
	Articles of Corporate Income Tax Act 1969 («CIT»)	In summary
Art. 4 Earnings stripping rule	Article 15b CIT	* 30% of EBITDA * Threshold: Eur 1,000,000 * No grandfathering * Application at level fiscal unity * No equity ratio nor group ratio * Exemption for certain existing public infrastructure projects
	Article 15ba - 15bc CIT	* Unlimited carry forward of interest (change of control provisions)
Art . 5 Exit taxation	Article 15c and Article 15d CIT *(already existing)*	* No more (unlimited) deferral of payment
	Article 25b Collection of Taxes Act 1990	* Only payment in installments for a period of max. 5 years * Interest is calculated on instalments * Guarantee only required under circumstances
Art. 6 General anti-abuse rule	Not enacted	* Court developed fraus legis doctrine

Articles Directive	Implementation Dutch tax code	
	Articles of Corporate Income Tax Act 1969 («CIT»)	In summary
Art. 7 and Art. 8 CFC-rules	Article 13ab CITA	* Model A and Model B * Control: if taxpayer owns, alone or together with related entities (in)directly > 50% voting rights, capital interest or profit rights * Low taxation: less than 9% statutory tax rate or resident in blacklisted country * Minimus exemption (Model A): yes, if 30% or less of the total income of the CFC is considered tainted * Loss carry forward (Model A): six years
	Juncto Article 2e Implementing Decree 1971	* Substance escape (Model A): Yes, if the Dutch controlling company performs a substantive economic activity
Art. 9 Hybrid mismatches	Article 12aa CITA: Primary rule	* Netherlands implemented Primary rule and Secondary rule
Art. 9 bis Reverse hybrid rule	Article 12ab CITA: Secondary rule	* Effective as of 1 January 2020
Art. 9 ter Dual resident mismatch	Article 12ac CITA: definitions	* No temporary exception for financial institutions
	Article 12ad CITA: imported hybrid mismatches	* Documentation requirements
	Article 12ae CITA: dual resident mismaach	* Reverse hybrid mismatches: as of 1 January 2022
	Article 12af CITA: credit disallowed deduction	* Proposal: reverse hybrid entities subject to Dutch dividend withholding tax on profit distributions
	Article 12ag: documentation requirements	* Announced to investigate classification of foreign entities and partnerships
	Article 15e, clause 9 CITA: no foreign PE exemption in case of branch PE	

GAAR of ATAD

2. The Preamble of ATAD further acknowledges the basic concept that taxpayers are in principle allowed to choose the most tax efficient way to structure their business. With this statement the Preamble aligns the purpose of the GAAR to considerations previously through the discussion of BEPS Action 6, as well as existing case law [2].

Paragraph 2 of article 6 of the ATAD specially states that all valid economic reasons should be considered by Member States when assessing a potential case of abuse under its GAAR.

Although leaving room for the Member States, such as the possibility of Specific Anti-Avoidance Rules ("SAARs") and the option to apply penalties where the GAAR is applicable, the Preamble is clear in its intention to ensure a uniform application of the GAAR in both domestic and cross-border situations. Such uniform application should not only be considered between Member States but also towards third countries.

According to the Directive, the GAAR should apply if:

- the main purpose or one of the main purposes of the arrangement (or series of arrangements) is obtaining a tax advantage *(subjective test)*;
- that defeats the object or purpose of the applicable tax law *(objective test)*; and
- is not genuine having regard to all relevant facts and circumstances (*artificiality test*).

The arrangement is deemed to be non-genuine when it is not put into place for valid commercial reasons reflecting an economic reality. The provisions of ATAD thus combine a subjective test that is objectified by the objective test with the artificiality requirement that is to be tested in the light of the economic reality, required by the CJEU.

If the GAAR is considered applicable, Member States should ignore the particular arrangement (or series of arrangements) for the purpose of calculating the corporate income tax liability – to be calculated in accordance with the national law of the Member State.

Implementation in the Netherlands

3. Many Member States already knew the concept of a GAAR, either as a statutory rule in their domestic law or as a doctrinal approach. Some Member States have therefore indicated that the anti-abuse rules currently implemented in their domestic laws were already in line with the GAAR.

Also in the Netherlands, the legislator was of opinion that the GAAR of ATAD was already implemented into domestic legislation, although not statutory, but through the doctrine

2 Refer, among others, CJEU, C-255/02, Halifax and C-419/14, WebMindLicenses.

of *fraus legis*[3]. The State Secretary of Finance indicated this *fraus legis* doctrine, as a general legal framework that achieves the objective of the GAAR, is considered sufficient for the implementation.

Fraus legis *in the Netherlands*

4. The *fraus legis* doctrine in the Netherlands is a court developed GAAR and is, in its current form, effectively used as of 1984[4]. This doctrine is basically a substance-over-form rule aimed at tax-avoidance situations that contravene the object and purpose of the law. It also applies in the presence of specific anti-abuse provisions.

When *fraus legis* is applied by the courts, it is important to keep in mind that the application of *fraus legis* is considered to be an "*ultimum remedium*"; only after all normal interpretation methods have been exhausted, *fraus legis* can be applied. The courts cannot apply *fraus legis ex officio*. It is up to the tax inspector to state and, where necessary, prove the facts which lead to the conclusion that the taxpayer has acted in *fraudem legis*.

Concept of fraus legis

5. Under the *fraus legis* doctrine, the actual facts of an arrangement are reclassified or substituted to reflect its true substance. There are two requirements for applying *fraus legis*:

- Subjective requirement: the decisive purpose for entering into an arrangement is to avoid Dutch taxation; and
- Objective requirement: the arrangement is contrary to the object and purpose of the legislation.

6. Subjective requirement - When assessing the subjective requirement– also referred to as the motive requirement – it should be determined whether the envisaged tax benefit is the predominant motive to enter into the arrangement.

Some examples of commercial (non-tax) motives accepted by the Supreme Court are foreign tax motives, the creation of a holding company structure; and business succession or acquisition[5].

When taxpayers have more options, they have the freedom to choose the most favorable approach. This so-called "*more ways doctrine*" (which is actually part of *fraus legis*) is relevant when taxpayers have the choice between arrangements, but decide upon a certain option for the avoidance of Dutch taxation. Taxpayers are allowed to choose the most beneficial way forward. However, if one of the different options includes wholly artificial intermediate steps, the motive test may still be met[6].

An example is a business reorganization in which companies are transferred intragroup against a loan with a low-taxed group company instead of being contributed as equity[7]. In the wording of the Supreme Court: "*The circumstance that the set of transactions, in total, has a business motive does not exclude that therein transactions are included that are not necessary to obtain that [business] objective and which – if accepted – would result in an arbitrary and continuing avoidance of taxation.*"[8].

7. Objective requirement - When assessing whether the objective requirement - also referred to as normative requirement - is met, one should determine whether the arrangement chosen by the taxpayer is contrary to the object and purpose of the legislation. In essence taxpayers have the freedom to choose the most favorable structure as long as it does not contravene the object and purpose of the law. This is also the case if taxpayers take advantage of a mismatch between two or more jurisdictions[9].

According to the Supreme Court, foreign taxation can be relevant to determine whether the objective requirement is met. For example, if a Dutch domestic taxpayer is eroding its taxable basis by artificially creating intercompany interest expenses, the objective requirement would not be met in case the corresponding interest income is subject to tax at a reasonable rate[10].

The consequences of fraus legis

8. The application of *fraus legis* makes it possible not only to ignore (parts of) the arrangement but also to recharacterize the legal acts leading to the arrangement in such a way that taxation is in compliance with the object and purpose of the relevant tax legislation. In general, for the application of *fraus legis*, the tax administration has the **burden of proof**.

In respect of the application of SAARs, the burden of proof is divided between the taxpayer and the tax authorities depending on the wording of the SAAR.

That fact a court rules that *fraus legis* applies does not automatically mean that a penalty will be imposed. In the Netherlands, a penalty will not be imposed if the taxpayer took a so-called "defensible position" in its tax return meaning that the taxpayer was under the presumption of being in a correct position. The fact that *fraus legis* is an *ultimum remedium* can in general be seen as a strong argument that the taxpayer has a defensible position[11].

3 Kamerstukken II, 2018–2019, 35 030, no. 3, p. 14-15.

4 Supreme Court, 21 November 1984, BNB 1985/32. Note that the Supreme Court first applied the *fraus legis* doctrine in a tax case, as early as in 1926 (Supreme Court, 26 May 1926, NJ 1926/723).

5 See R.L.H. IJzerman, Form and substance in tax law : IFA Cahier Volume 87a, 2002, p. 460.

6 See S.J.C. Hemels *in* A Key Element of Tax Systems in the Post-BEPS Tax World, Chapter 21 - Netherlands in GAARs, 2016, p. 440.

7 See R. Kok and I. Mosquera Valderrama, Anti-avoidance measures of general nature and scope - GAAR and other rules : IFA Cahier Volume 103A, 2018, p. 13.

8 Supreme Court, 6 September 1995, BNB 1996/4.

9 Supreme Court, 7 February 2014, BNB 2014/79. See also M. Lukkien and A. Roelofsen, Assessing BEPS: origins, standards, and responses : IFA Cahier 102A, 2017. p. 558-560.

10 For example Supreme Court, 10 March 1993, BNB 1993/194.

11 Compare Supreme Court, 21 April 2017, BNB 2017/162.

Combat tax avoidance and international mismatches

9. Question is whether *fraus legis* can be invoked successfully by the Dutch tax authorities to combat undesirable tax avoidance. The Dutch tax authorities have tried a number of cases, but have not been very successful in their attempts. This is mainly due to the objective requirement; the application of *fraus legis* is limited to arrangements that are contrary to the object and purpose of Dutch legislation. Even if the only objective of an arrangement is a clear tax avoidance, *fraus legis* will only apply if the arrangement is contrary to the object and purpose of the Dutch legislation. For example, the fact that an international mismatch occurs does not necessarily mean that the arrangement contravenes the object and purpose of the law. It is, generally speaking, for the legislature to resolve non-taxation or double dips resulting from international mismatches, not for the Supreme Court. The same is true for non-taxation due to hybrid entity mismatches, hybrid income mismatches and TP mismatches.

Fraus tractatus

10. The Dutch tax authorities have tried several times to apply *fraus legis* in cases where a double tax treaty (DDT) was applicable.

The Supreme Court is, however, reluctant to apply the consequences of *fraus legis* also in a DTT context[12]. It can be said that the consequences of *fraus legis* can only be applied to the provisions of a DTT if both contracting States have explicitly agreed upon such a provision. There are some DTTs in which it is specifically mentioned that it allows the applicability of *fraus legis*, such as the tax treaties with Germany, Hong Kong and Panama. Since no such reference is made in the DTT with France, the Dutch tax authorities cannot successfully invoke *fraus tractatus* in a supposedly abusive structure involving France.

11. It is another matter whether a doctrine of *fraus tractatus* - abuse of the DTT itself - exists in Dutch law. In a decision regarding a cash box structure, the Supreme Court held that neither the DTT, nor the explanatory notes of the Contracting States involved, supported the opinion of the tax authorities that the purpose and object of the treaty would be infringed if the income was not taxed in the Netherlands[13]. Indeed, the Supreme Court has been extremely reluctant to allow DTT provisions to be set aside on the basis of an inwritten doctrine of *fraus tractatus*[14].

12. As the qualification of domestic provisions on the basis of *fraus legis* generally does not have an effect on DTTs, the State Secretary of Finance indicated that treaty abuse can only be targeted on the basis of explicit anti-abuse provisions in the double tax treaties, such as a principal purpose test or a limitation on benefits clause[15].

12 Supreme Court, 6 December 2002, BNB 2003/285.

13 Supreme Court, 15 December 1993, BNB 1994/259.

14 Compare Supreme Court, 12 May 2006, BNB 2007/36.

15 Letter State Secretary of Finance, 5 October 2015.

EU Parent Subsidiary Directive

13. As indicated above, the Dutch legislature was of the opinion that the *fraus legis* doctrine is sufficient - and does not require any amendments - to fulfil the compulsory implementation of the EU GAAR. Notwithstanding this opinion, the Netherlands has implemented the GAAR in the amended EU Parent Subsidiary Directive ("PSD") through specific provisions. This GAAR has been implemented in existing SAARs; via the corporate income tax regime for non-resident corporate shareholders and the dividend withholding tax regime - both focusing on artificiality and tax avoidance motives. Since the provisions of the PSD and ATAD are more or less equal, this may look peculiar. The explanation of the State Secretary of Finance is that anti-abuse provisions of the PSD are in the form of a Targeted Anti-Avoidance Rule ("TAAR") rather than a GAAR[16] does not seem to be very convincing.

In practice

14. The role of a GAAR is to specify and determine in what circumstances tax benefits are not intended to be granted. It empowers the tax administration to combat tax avoidance where the interpretation of the statutory law is not enough, even if courts are supposed to control the application of the GAAR by the tax authorities.

Fraus legis is being called upon rather rarely in the Netherlands. Tax inspectors typically prefer the application of the specific anti-avoidance rules (SAARs).

This is the natural consequence of *fraus legis* being the *ultimum remedium*. Also the legislature clearly does not want to rely only on the applicability of *fraus legis* to protect the Dutch tax base. As a result, many specific anti-avoidance rules are being introduced to prevent the erosion of the Dutch tax base.

Fraus legis cannot be used if the legislative body could foresee the potential tax avoidance and did not amend the law accordingly or if a legal action is provided to address a particular evasion.

Differences between fraus legis *and EU GAAR*

15. The question arises whether the *fraus legis* doctrine as developed by the courts in the Netherlands is actually sufficient for a proper implementation of the GAAR of ATAD.

As indicated above, the State Secretary of Finance has stated that the Netherlands already has *fraus legis*, and that the GAAR from ATAD does not have to be implemented because, in essence, it is the same as *fraus legis*.

The similarities between the ATAD and *fraus legis* are that they both have a subjective and objective test. There are, however, a few differences.

According to the State Secretary of Finance, the only difference between the Directive and the doctrine is that *fraus legis* as developed by the Dutch courts lacks an artificiality test. Where the European Commission puts the emphasis on the artificial character of the arrangement, the State Secretary

16 Kamerstukken II, 2018-2019, 35 030, nr. 3, p. 14-15.

indicated that this can also be derived from the subjective test. The business reasons that are included in the ATAD that are relevant to the determination of artificiality are also relevant in the assessment of the subjective requirement in applying *fraus legis*. But if we take a closer look at the wording, one could say that the subjective test of ATAD is defined broader; "*the main purpose or one of the main purposes*" versus "*the decisive motive*" of *fraus legis*. Unfortunately the Parliamentary history does not elaborate on this.

What has also not been discussed in the Parliamentary history is that where *fraus legis* (or better: *fraus tractatus*) has never been successfully applied in situations where DTTs apply, the ATAD focuses on abuse of national systems in international cross-border situations.

Further, the fact that *fraus legis* applies its substitution doctrine for recharacterizing an arrangement can be different from disregarding an arrangement in the GAAR. The wording of the ATAD GAAR implies that the arrangements shall be ignored when an arrangement is artificial. The question is whether leaving out the arrangement is similar to substitution.

Lastly, as mentioned above (V. § 7), because the objective requirement is not met, *fraus legis* cannot successfully be invoked if the corresponding income is sufficiently taxed at a reasonable rate. In the EU GAAR, the taxation in the other jurisdiction seems not relevant.

As the interpretation of the GAAR will be determined by the CJEU as a Community doctrine, it will be interesting to see how the development of the doctrine of *fraus legis* is going to take place. Not only in the area of corporate income tax – the scope of the ATAD – but also in other areas of tax law.

Final remarks

16. Although one might have hoped that the ATAD would lead to a uniform implementation by the Member States, there are significant differences in implementation by the various Member States. As for the other measures, also the GAAR is open to multiple interpretations and hence the application by the various Member States may lead to even more differences. Only after the verdict of the CJEU on the correct application of the measures, a uniform application by all Member States can be expected. Until such uniform interpretation is reached at the EU level, national courts of the EU Member States will interpret the EU GAAR. in different ways, possibly influenced by their national GAARs. Such an outcome undeniably leads to legal uncertainty for business carrying out activities in more than one Member State.

17. Last remark regards the interesting question on possible effects of the rulings of the CJEU in the Danish beneficial ownership cases[17], in which the Danish tax authorities denied the benefits of the PSD under the EU abuse of law concept (prior to the GAAR of ATAD). More specifically whether the Danish cases could force the Netherlands to disallow application of the participation exemption based on EU anti-abuse concept in case of supposedly abusive structures. For the application of the participation exemption in the Netherlands, there are no real anti-abuse rules, such as economic nexus or substance requirements. Likely not, if it can be uphold that the participation exemption is not the main purposes of the structure (refer objective test). But what if two minority shareholders who individually do not meet the minimum threshold of 5% combine their stakes in a joint holding company that does meet the threshold? Could this be seen as contrary to the object and purpose of the PSD under the anti-abuse concept of the CJEU? If the CJEU ruled this in case of Danish dividend withholding tax, why not in case of Dutch corporate income tax? Perhaps a bridge too far, we should not exclude this.

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17 CJUE, gde ch., 26 févr. 2019, C-116/16, C-117/16, T Danmark e.a. : FI 2-2019, n° 5.2.