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DUTCH TAX TREATY POLICY 2020

On 29 May 2020 the State Secretary of Finance published an updated note on the Dutch treaty policy. This document is the successor of the 2011 version which was outdated due to national and international developments on tax-avoidance. With the drafting of the note the internet consultation of the Dutch treaty policy in 2018 is also taken into consideration. In respect of the international developments the OECD Base Erosion and Profit Shifting project (hereafter 'BEPS project') and multiple changes of the OECD- and UN model treaty are mainly relevant. In this alert we highlight the most important (new) parts of the Tax Treaty Policy 2020.

1. Negotiations of tax treaties

In principle, the Netherlands is open to a tax treaty with every other state. However, due to limitations of capacity there is some sort of prioritization. Moreover, in the note it is mentioned the Netherlands will not enter into new treaties with states that are included on the EU list of non-cooperative states. Also, existing treaties with these states will possibly be revisited.

Based on the note a different policy is in place for low taxed countries as the Netherlands do not have a principle reason not to enter into a new treaty with countries that have a statutory rate of 9% or lower for corporates.

2. Treaty abuse and tax-avoidance

2.1. BEPS action point 6 and the MLI

An important part of the note deals with the use of tax treaties for tax avoidance purposes. According to the new treaty policy, the avoidance of tax treaty abuse is a priority for the Dutch government. The BEPS project provided various solutions to prevent treaty abuse including the minimum standards of action point 6.

A part of the Dutch tax treaties already includes anti-abuse measures. According to the new tax policy it is important that all Dutch tax treaties (eventually) include the minimum standard to prevent treaty abuse. The Multilateral Instrument (hereafter: 'MLI') is of crucial importance in this respect because the MLI enables the participating countries to update their tax treaties without negotiating each tax treaty separately.

However, the MLI has not been signed by all treaty countries and it is also possible that some countries do not appoint the treaty with the Netherlands under the MLI so that the MLI does not have any effect. Based on the Tax Treaty Policy 2020, the Netherlands will engage with those countries to agree on minimum standards.

The new treaty policy also provides that the Netherlands will not enter into a new a treaty without including minimum standards. This also applies to protocols to tax treaties that the Netherlands agree on with their treaty partner.

The minimum standards consist of the following parts:

1. A preamble stating the relevant treaty is not meant to facilitate double non-taxation or provide with a lower taxation due to tax evasion or tax-avoidance;
2. Anti-abuse rules in tax treaties. In this case the preference of the Netherlands is to include a Principle Purpose Test (hereafter 'PPT'). Via the PPT the intention of the structure is tested by an objective analysis. If one of the main purposes of the structure or transaction is to obtain treaty benefits, the treaty benefits could be denied. The PPT contains open standards whereby also the intention of the structure or transaction is taken into consideration. Consequently, structures with sufficient economic nexus should generally not be targeted by the PPT.
3. Effective litigation via Mutual Agreement Procedure.

2.2 Other anti-abuse provisions BEPS

Besides the minimum standards, the Netherlands also indicated to be in favor of implementing several additional measures of the BEPS-project. These additional measures consist of:

- A measure that contains the application of the treaty in case income or an advantage is received by or via a hybrid entity;
- A general saving clause;
- A measure that contains the treaty position of dual resident entities;
- Measures to avoid artificial evasion of the qualification of a permanent establishment;
- Minimum holding period to avoid dividend transfer transactions;
- Claw back period for immovable-property-entities;
- Using the credit method instead of exemption method for specific cases;
- A measure to prevent restriction of entitlement of the source country for income that is attributed to third jurisdictions where this income is taxed at a low tariff;
- Aligning corrections in transfer price;
- an obligated and binding arbitration.

Hereafter follows a further explanation on some of the other specific anti-abuse measures.

2.2.1. Hybrid entities

A hybrid entity is an entity whereby a mismatch between states regarding the qualification of that entity exists. As part of the BEPS project a treaty provision is formulated which provides with a set of rules to allocate/deny treaty benefits for income/benefits attributed to or by hybrid entities. This provision tests if the income, for which a treaty benefit is requested, is factually taxed in the other state. The goal is to

prevent tax benefits to be unintentional attributed or not be attributed to (underlying) participants. In the Dutch Tax Treaty Policy 2020 is stated that the Netherlands already has tax treaties with these kinds of provisions. This is, for example, the case for tax treaty with the United States.

2.2.2. Permanent establishment

In BEPS action point 7 several important changes to the concept of a permanent establishment are proposed. For example, a stricter application of the exemption for preparatory work, an anti-abuse provision against (artificially) splitting up projects or contracts, and an extension of the permanent establishment concept regarding (the role of) dependent agents.

Currently these changes via the MLI do not affect the tax treaties due to an amendment on the Dutch tax treaties, but, according to the new treaty policy this might change via bilateral negotiations if an effective form of dispute resolution would be implemented.

2.2.3. Obligated binding arbitration

Because of the desired legal certainty for tax payers the Netherlands is willing to, in addition to the minimum standards, include obligated and binding arbitration in its tax treaties.

2.2.4. ATAD 1 and ATAD 2

Bilateral tax treaties could restrict application of the regulations implementing ATAD 1 and ATAD 2, since tax treaties are above national law in legal order.

Based on the Dutch Tax Treaty Policy 2020 the aim is to include provisions in tax treaties to make sure that the Dutch legislation for the implementation of ATAD 1 and ATAD 2 can be effectuated.

2.2.5. International discussion about profit allocation and minimum level of taxation

Based on the Dutch Tax Treaty Policy 2020, the Netherlands values the Pillar 1 and Pillar 2 initiatives from BEPS 2.0. The Netherlands has the view that concluding new agreements about profit allocation (Pillar 1) and introduction of a minimum level of taxation (Pillar 2) will be most efficient based on a multilateral approach.

Conclusions in respect of the international discussion about profit allocation and a minimum level of taxation are not yet known. However, once available, these results could have an impact on the treaty policy.

3. Withholding tax on interest and royalties

Per 1 January 2021, a conditional withholding tax on interest and royalties will be introduced. The main goal of this new legislation is to restrict the flow of funds through the Netherlands to low taxed countries or countries that appear on the EU list of non-cooperative jurisdictions. Besides that, the new withholding tax prevents that the Dutch tax base shifts to low taxed countries. The Netherlands has as new principle in relation to these countries that this conditional withholding tax on interest and royalties should be effectuated.

If the Netherlands has an existing tax treaty with a low taxed state or with a state that is mentioned on the EU list, the Netherlands will take the initiative to renegotiate the tax treaty. The aim is to adjust the treaty in a way that the Dutch withholding tax on interest and royalty payments to low taxed states could be effectuated.

4. Developing countries

4.1. General

There is extensive focus in the Dutch Tax Treaty Policy 2020 on treaties between the Netherlands and developing countries. In summary the Netherlands is willing to accept some less favorable treaty provisions from the UN model treaty to support developing countries. This policy deviates from the policy toward non-developing countries because these treaties are in principle based on the OECD model treaty. Hereafter we outline a few important concessions.

4.2. Withholding tax on dividends, interests and royalties

In the new note, the policy of the Netherlands regarding withholding tax on payments of dividend, interests and royalties from developing countries is outlined. The Netherlands is willing to accept a higher withholding tax for these countries. However, the economical position of the Netherlands compared to other (West-European) countries is taken into account in this regard. Moreover, it is also of importance that excessive withholding taxes also discourages investments in developing countries.

However, based on the new policy, the Netherlands is willing not to aim for a lowest possible withholding tax, even if comparable countries with the Netherlands agree to lower withholding taxes with developing countries. In such case, the Netherlands requests the developing country to prove there is new policy on withholding taxes.

4.3. Source state tax on provided services (on basis of net income)

In the UN model treaty a more extensive permanent establishment concept is included, in comparison to the OECD model treaty. On the basis of the UN model treaty, a permanent establishment also applies if a resident of a state provides services in another state for more than 183 days within a period of 12 months. The Netherlands is

willing to include the more extensive concept in treaties with developing countries so these countries will be entitled to tax certain activities sooner.

4.4. Source state taxation for payments of technical services (on basis of gross income)

As of 2017 in the UN model convention a provision has been included that creates source state taxation on payment for technical services. The Netherlands has multiple objections against such provisions as there is generally only a limited possibility to credit the taxes withheld since normally these are provided on a net basis, whereas locally is taxed on a gross basis. Another objection from the Netherlands is that there is no requirement on where the service is provided.

According to the Dutch Tax Treaty Policy 2020, the Netherlands is willing to accept the consequences of those objections and given the exceptional position of the treaty countries is willing to accept the new provisions in the UN model convention, if the service is provided in the developing country.

5. Conclusion

The Dutch Tax Treaty Policy 2020 contains several important new developments. One of the main developments in this respect is the policy of the Netherlands with respect to the developments on preventing tax-avoidance. Besides that, the Netherlands will, according to the Dutch Tax Treaty Policy 2020, take into account the special position of treaty countries. Both aspects could have an impact on Dutch companies.

More information?

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