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Your letter (reference)

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Subject Government's response to the report from SEO Economics Amsterdam on Other Financial Institutions and the IBFD report on developing countries

Madam President, Mr President,

On 23 January 2013 the Lower House Standing Committee on Finance held consultations on, among other things, taxation of international businesses[1]. This topic was discussed further in the Continued General Consultations on 14 February 2013. The State Secretary for Finance promised[2] the Lower House that at the end of the summer we would send a letter containing the government's response to the report conducted by SEO Economics Amsterdam (hereinafter: "the SEO report") and to a government-commissioned study by the International Bureau of Fiscal Documentation (IBFD) of the tax treaties the Netherlands has with a number of developing countries (hereinafter: "the IBFD report"). This letter and the appended memorandum are in fulfilment of this promise; we will also announce a few initiatives.

International taxation, a global issue
In previous letters to the Upper and Lower Houses[3] on international taxation, the State Secretary for Finance described how, in part by making use of the absence of integration between the various national legal systems, internationally operating businesses are able to influence their total tax burden. This is an international, even global issue. Global issues demand global solutions. Work is being done on this, specifically within the Organisation for Economic Cooperation and Development (OECD), the G8 and the G20. The OECD Action Plan which was presented on 19 July 2013 comprises fifteen action points for this purpose. The Netherlands will take active part in elaborating the various action points by sending delegates of the Dutch Ministry of Finance and the Dutch Tax Authorities to participate in the work groups.

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[1] Parliamentary Papers II 2012/13, 25 087, no. 34.
[2] Parliamentary Papers II 2012/13, 25 087, no. 59.
[3] The letters to the Lower House dated 26 October 2009 (Parliamentary Papers II 2009/10, 31 369, no. 8), 25 June 2012 (Parliamentary Papers II 2011/12, 25 087, no. 32) and dated 17 January 2013 (Parliamentary Papers II 2012/13, 25 087, no. 34) and the letter dated 29 May 2013 to the Upper House (included in the report of written consultations with the Upper House; Parliamentary Papers I, 2012–13, 25 087, D).

Within the European Union (EU) initiatives are also being developed to counter tax fraud and tax avoidance by international businesses. They primarily focus on increased transparency, for example by means of automatic exchange of information and by expanding reporting obligations for companies. The Netherlands actively supports these measures and finds it important to act jointly with other EU and OECD member countries.

In the search for a global solution, the Netherlands always stresses that the solutions must be binding for all states, so that a level playing field between states and between companies is ensured. The disadvantage of applying unilateral measures in the Netherlands is that they do not prevent opportunities for tax avoidance via organisational structures involving other countries, whereas they can be detrimental to the competitive position of Dutch companies. The same can be said of measures that bind only the member states of the European Union: they do not solve the global issue of tax avoidance either, and they too can be detrimental to the competitive position of European companies. The OECD Action Plan and the collaboration with the G20 offer a promising framework for tightening the rules worldwide. The Netherlands has pointed out to the OECD that developing countries also need to be involved in this.

However, the previous letters also tell you that the Netherlands needs to take a critical look at itself. In a number of cases the question may arise of whether the fact that certain link companies[4] established in the Netherlands make use of the Dutch treaty network is in keeping with the spirit of Dutch legislation and with the intentions of the contracting states. The government therefore does not close its eyes to criticism of the role played by Dutch link companies in international group structures or to the conspicuous volume of the monetary flows that pass through Dutch special financial institutions.

To fully appreciate the implications of this criticism, the government attaches great importance to the outcomes of the aforementioned reports from the IBFD and SEO. The IBFD report is appended to this letter.

Developing countries
The IBFD study shows that the five Dutch treaties with the poorest developing countries differ very little from the treaties these developing countries have with other countries. The IBFD's analysis of flows of funds involving Dutch special financial institutions makes it clear that the Dutch treaties in themselves do not offer sufficient explanation of the volume of investments by Dutch special financial institutions in those countries.

The IBFD report does show that the treaties contain next to nothing in the way of anti-abuse provisions. Even though this can be explained by the fact that when the treaties were concluded, there was less focus on this aspect than there is today, the government is of the opinion that action should be taken to bring about changes in this respect. The Netherlands will therefore suggest to the 23

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[4] These are companies in international groups which, after corporation tax has been paid in the country where the business is active, facilitate the reimbursement to investors of the capital they have contributed without the burden of additional tax.

developing countries with which it has a tax treaty, or with which negotiations are taking place, the inclusion of anti-abuse measures in the treaty.

Lastly, the IBFD report confirms that formulating and enforcing good national legislation and effectively combating abuse of treaties is equally important. Developing countries need a well-equipped public administration for this purpose.

The economic importance of special financial institutions and the unintended use of tax rules

The State Secretary for Finance has always said that, to reach a well-considered decision, it is necessary to have greater insight into the importance of these link companies to the Dutch economy. The SEO report which was published on 11 June 2013 expands this insight. It analyses the volume, composition and economic importance of the non-banking financial sector. It also discusses the tax motives that play a role in establishing such companies in the Netherlands and outlines the risks associated with this sector.

According to SEO, this sector contributes an estimated € 3 to € 3.4 billion per year to the Dutch economy, involving between 8,800 and 13,000 FTEs. If only because of the economic importance of this sector, the government is greatly concerned about harming its competitive position by introducing far-reaching measures at a national level. This is also one reason why the government primarily focuses on a global approach.

The SEO report gives better insight into the nature and scope of the various flows of funds involving Dutch special financial institutions. In the appended memorandum we will discuss the SEO report in greater detail. In its consideration of what measures may be necessary, the government concludes from the SEO report that the application of tax treaties becomes contrary to the spirit of the rules in cases in which Dutch companies receive interest or royalties from a country with which the Netherlands has a tax treaty and then pay out interest or royalties to a company established in a low-tax jurisdiction. The interest or royalties are deductible in the source country, and they are taxed at a low rate in the destination country. Any measures to be taken by the Netherlands would primarily have to be aimed at this flow. The situation is different for Dutch companies that receive and pay out dividends. Then profit is taxed in the source country and dividends are not deductible.

When it had nearly completed this letter, the government learned of a report by the CPB Netherlands Bureau for Economic Policy Analysis on the significance of Dutch tax treaties. According to the CPB, tax treaties lead to higher investments and thus strengthen the economy. But the risk is inherent in tax treaties that the taxes at source are avoided in the country from which the profits have come. Unilateral measures cannot fully remove this risk because this often merely leads to shifting the monetary flows. The CPB is therefore also of the opinion that international measures are needed, amongst which the exchange of information will presumably have the greatest effect. Nevertheless, the Dutch government acknowledges that it has a responsibility of its own, which is expressed in the measures proposed in this letter.

National solutions
Despite its clear preference for a coordinated international approach, the government is of the opinion that the Netherlands has its own responsibility in preventing unintended use of treaties in combination with Dutch legislation. We may not rule out the use of unilateral measures. For this reason the government proposes a number of measures that are outlined below. These measures will not alter the basic structure of the Dutch tax system.

The government is convinced that measures must be specifically aimed at cases in which the risk of unintended use exists, and they must lie in the direction in which it is expected that solutions will be sought in an international context. There is a growing conviction in the international community that states are jointly responsible for sharing relevant information. This responsibility for transparency and for sharing relevant facts also rest on the Netherlands.

Measures
At present – in contrast to many other countries – the Netherlands makes certain requirements of link companies that receive interest or royalty payments from other countries and pay out interest or royalties to other countries[5] when they wish to obtain advance certainty from the Dutch Tax Administration's APA/ATR team. These requirements, which state that the management and the accounting must be conducted with capital that is consistent with the functions and risks of the company, will be included amongst the rules that apply to all such companies, even those that do not request advance certainty.

This will be linked to the requirement that, when they rely on the application of a tax treaty with the Netherlands in their dealings in another country, their tax return must state whether they comply with these requirements. The Netherlands will spontaneously provide information about companies that do not meet the requirements to the relevant treaty partner. That state will then have all the relevant information it needs to assess whether the treaty benefits have been relied on with good reason.

Additionally, the Dutch Tax Administration will spontaneously share with foreign tax administrations the contents of APAs[6] agreed with tax-paying entities in cases in which the group has no activities in the Netherlands other than receiving and paying out interest or royalties through the link company.

The government wants to take a third measure in the area of APAs and ATRs. Requests from companies that wish to have advance certainty about their "holding company activities" – receiving and paying out dividends – will only be considered when the group in which they operate has sufficient nexus with the Netherlands. Nexus can consist of actual presence or a serious plan to create that nexus. We may speak of actual presence if companies meet the requirements applicable to financial service entities. We think it is undesirable for the Dutch Tax Administration to deploy its capacity in cases in which there are no such ties.

In relation to developing countries, the Netherlands will suggest to Zambia that the bilateral treaty be updated and will approach the other developing countries about whether they wish to add anti-abuse provisions to the existing tax treaties. In

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[5] These are known as financial service entities (*dienstverleningslichamen*).
[6] Advance Pricing Agreements, advance certainty about transfer prices to be used in a group context.

concluding new treaties, what anti-abuse provisions they should include will be considered in close cooperation with the developing countries. Wherever possible, the Netherlands will further expand its support to capacity building in tax administrations in the partner countries and will release extra funds for this if necessary. In the end, capacity building is one of the most important ways in which developing countries can combat losses due to tax avoidance and tax evasion.

Finally, in the context of restricting integrity risks, the government proposes tightening the Regulations Governing Sound Operational Practices under the Trust Offices (Supervision) Act in consultation with De Nederlandsche Bank.

The memorandum
The appended memorandum will explain in greater detail how the government views the problem of international tax avoidance in general. We will give our vision of the role played in this regard by Dutch special financial institutions and of the position and interests of developing countries. In that context we will devote attention to the motions adopted in the House and to undertakings we have made in this context. We will give a more comprehensive response to the SEO and IBFD reports and will describe the present state of affairs in relation to a number of international initiatives developed within the framework of the G8, the G20, the OECD and the EU. This will include a more detailed discussion of developments in relation to information exchange and country by country reporting. The memorandum will discuss the Dutch contributions in this regard to the international initiatives and will make clear what steps the Netherlands will take on its own.

This primarily relates to the role of the Netherlands in combating possible tax avoidance in other countries via the Netherlands. Evasion of Dutch taxation via tax havens in other countries and organisational structures that are used in this context, which was brought up for discussion by the Lower House on 10 April 2013[7], is already actively combated by the Dutch Tax Administration. If new phenomena should give cause, the government will make proposals for new legislation.

In the debate on a point of order in the Lower House on 22 May 2013[8] questions were asked about the role of the Confederation of Netherlands Industry and Employers VNO-NCW. As it does with other professional lobby organisations, the Ministry of Finance holds regular consultations with representatives of VNO-NCW about the feasibility of measures and about their consequences for the business climate. The government is of the opinion that such open consultations improve the quality of the legislation as well as compliance with it.

We trust that this letter and the appended memorandum have informed the two Houses to their satisfaction.

[7] Proceedings II, 2012/13, no. 73
[8] Proceedings II, 2012/13, no. 85

Yours sincerely,

The State Secretary for Finance
Frans Weekers

The Minister for Foreign Trade and Development Cooperation
Lilianne Ploumen

Memorandum to the letter from the State Secretary for Finance and the Minister for Foreign Trade and Development Cooperation dated 30 August 2013

1. International taxation

The letters from the State Secretary for Finance to the Lower House dated 26 October 2009[9], 25 June 2012[10] and 17 January 2013[11] and the letter to the Upper House dated 29 May 2013[12] gave extensive coverage to international taxation.

These letters make it clear that internationally operating businesses have more means available to them to influence their tax burden than do nationally operating businesses. Several causes can be cited. To start with, internationally operating companies can carry out their activities where taxes are lowest. This cause is not criticised, but some other causes are. In the first place there is the absence of interrelationship between the different national legal systems. Another cause is that a number of principles used in concluding tax treaties and in their application have not been sufficiently adapted to changes in the operations of international companies. For example, in several places the question has arisen as to whether the definition of the term 'permanent establishment' is still satisfactory. This term acts as a threshold to prevent countries from making foreign companies tax-liable even if their activities in that country are negligible. It is very much the question whether the present definition is still appropriate in view of today's possibilities to generate large sales with a very small physical presence in a country. It also seems necessary to rethink the international principles for intercompany transfer prices in allocating and valuing intellectual property, risks and equity capital and the benefits arising therefrom.

Internationally, broad support has emerged to repair these weaknesses in the international system and to tighten the rules. However, many countries also use tax measures to make their business climate attractive to international companies. This leads to a fairly universal dilemma in how they deal with tax avoidance. On the one hand, countries are aware of the need for measures against tax avoidance; on the other hand, they realise that measures taken by one state do not solve the problem and that such measures may even unnecessarily harm the competitive position of their own country and their own business community. Because many companies have a highly flexible organisational structure, activities, assets and funding flows can be moved quite simply to other countries. The action plan of the Organisation for Economic Cooperation and Development (OECD), which will be discussed more extensively below, names another disadvantage of measures taken by individual states: it entails the risk that these measures are inadequately coordinated, thus unnecessarily creating uncertainty amongst internationally operating businesses.

The government also faces this dilemma. For this reason we have a strong preference for measures in an international context, measures that are also binding for all states.

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[9] Parliamentary Papers II 2009-10, 31 369, no. 8.
[10] Parliamentary Papers II 2011-12, 25 087, no. 32
[11] Parliamentary Papers II 2012-13, 25 087, no. 34
[12] Included in the report of written consultations with the Upper House: Parliamentary Papers I, 2012–13, 25 087, D.

The aforementioned letters also acknowledge that the Netherlands plays a role of its own in this complex international issue, primarily on account of the presence in the Netherlands of large numbers of link companies. These are companies with a specific role in international groups: after profit tax has been paid in the country where the company operates, they reimburse the investors for the capital they contributed without further taxation. In a number of cases the question can arise whether the fact that these companies make use of the Dutch treaties is in keeping with the spirit of Dutch legislation and the intention of the contracting states.

In answering the question whether measures are needed to combat these causes, not only must competitive position be weighed, but consideration must also be given to the interests of the specific sectors. For this reason the government has always said in this debate that for a well-considered decision, it is important to have more insight into the importance of these link companies to the Dutch economy.

The SEO report[13], published on 11 June 2013, has increased this insight. It analyses the volume and composition of the non-banking financial sector and its economic importance. It also investigates the tax motives that play a role in establishing such companies in the Netherlands and the risks attached to this sector. The government response to the outcomes of this investigation is limited to the part pertaining to the special financial institutions.

2. The SEO report

Three relevant parts of the SEO report will be reviewed: characteristics and volume of the sector, fiscal reasons to establish a company in the Netherlands with the corresponding risks, and the economic importance of the sector. Each of these aspects will be discussed separately.

2.1. Characteristics of the special financial institutions and volume of the non-banking sector

A description of the sector is useful to put an end to a number of misunderstandings that regularly crop up in the debate. There are 23,500 object companies and there are 12,000 special financial institutions, 9,000 of which are both object company and special financial institution. When we speak of 'letter box companies', it is the latter group of 9,000 that we are referring to. They are (by definition) companies whose interests are directly or indirectly held by non-residents, companies that attract financial resources from other countries and invest them in other countries as well, companies of which a trust office is the director or for which it makes its address available.

Measurements have shown that each year the 12,000 special financial institutions receive payments in the neighbourhood of € 4,000 billion and disburse an amount roughly equal to that. Because this amount is the sum total of equity transactions (loans, redemption payments, capital deposits and capital repayments) and income flows (dividends, interest and royalties paid and received), no conclusions can be linked to this figure. What is more significant is the volume of the income flows received and paid. For 2010 the flows of dividends, interest and royalties totalled some € 153 billion (inbound) and € 125 billion (outbound). Breaking this figure down yields the following amounts (in millions of euros):

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[13] *"Uit de schaduw van het bankwezen"* [In the shadows of the banking sector]

	Received	Paid
Dividend	106,735	76,433
Intragroup interest	24,090	13,304
External interest	6,789	21,256
Royalties	15,742	13,256

To get an impression of the volume of the sector, the total assets also form an indication. In 2010, the 12,000 special financial institutions held assets amounting to € 2,890 billion. Total assets of the traditional financial institutions (banks, insurance companies and pension funds) came to € 3,749 billion, with the banks responsible for € 2,251 billion.

2.2. Tax reasons to establish special financial institutions in the Netherlands and the associated risks

The description of the Dutch business climate in the report has confirmed the government in its view that the tax climate in the Netherlands makes this country attractive for foreign investments. This promotes activities and employment opportunity in the Netherlands.

However, the report also states that the combination of various regulations, each of which was introduced on the basis of sound economic considerations, offers attractive opportunities in relation to international tax planning. As was apparent from earlier letters, the government is aware of this. It is why the Netherlands takes an active and constructive position on initiatives of the OECD and the EU to find an answer to this international problem. Later in this memorandum we will discuss progress in these international initiatives and the objective of the Netherlands in this respect.

As did the letter from the State Secretary for Finance dated 17 January 2013, the report describes the tax consequences groups want to achieve by including a Dutch special financial institution as a link company in their international structure. Firstly, their reliance on a Dutch tax treaty limits the source tax charged on payments of dividends, interest or royalties to the Dutch special financial institution. In the Netherlands, dividends received are generally subject to the participation exemption. Interest and royalties received are subject to the normal rate, but because the interest and royalties paid on profits are deducted, the tax owed in the Netherlands is small in comparison with the volume of the flows of funds. And finally, payments made by the Dutch special financial institution are generally not subject to tax at source.

The government feels it is important to repeat here that the right of the source state to levy tax on the profit obtained by the group in that country is not limited by the bilateral treaties with the Netherlands or by Dutch national legislation.

Based on this analysis of tax motives, the SEO report adopts an approach in which it assesses whether these motives are in the spirit of the legislation. For this purpose the report makes a distinction between the prevention of double taxation and the prevention of single taxation. On the basis of this distinction, the various flows of funds through the Netherlands are broken down and the risk of the unintended use of tax treaties is quantified.

From this point of view, SEO sees a risk in situations in which interest and royalties are paid to companies in low-tax jurisdictions (a tax rate of less than 15%). These payments are deducted from the profits in the source country, and in the Netherlands tax is only owed on a commercial margin between amounts received and paid. If the interest or royalties are ultimately taxed only at a very low rate or are received tax-free, this does not seem to be in the spirit of the legislation and treaties.

SEO regards as double taxation the levy of corporation tax on a company's profits and then the levy of dividend tax on the profit distributions to the shareholder in that company. In that case, prevention of this additional dividend tax is not contrary to the spirit of the legislation. But if the profit of the company is not initially taxed, or is taxed at a very low rate and the dividends are subsequently not taxed in the country itself or in the Netherlands (participation exemption), SEO regards this as avoidance of single taxation, which is contrary to the spirit of the law.

The government is of the opinion that this position, that if tax is not paid once somewhere in the entire business chain, this is always inconsistent with the spirit of the rules, cannot always be upheld. Under certain circumstances it may be at odds with the principle of national sovereignty and the right of a country to make arrangements autonomously for purposes of taxation. If the source country, the country where the business activities take place, decides to tax profits at a low rate, or not at all, this does not necessarily form a reason for other countries to choose to tax dividend payments. There are two internationally recognised reasons for this. Firstly, the destination state in fact infringes on the tax policy of the source state. Where the source state apparently finds an exemption expedient, the destination state undoes this by levying tax on the dividends. Secondly, as a result of the additional tax levied by the destination state, its residents cannot compete on equal terms with other companies in the source state. Whereas the latter are exempt, the former would be taxed additionally at the rate of the destination state. It is to prevent precisely this that the participation exemption applies in the Netherlands. To prevent abuse in cases involving a low-taxed investment participation, offsetting is applied rather than an exemption.

This may be different in cases in which the low-tax country levies dividend tax instead of profit tax and because the company relies unduly on the tax treaty with the Netherlands, the dividend payment is not taxed. This could be cause for concern, particularly in relation to developing countries. Among the low-tax developing countries, the Netherlands has tax treaties only with Uzbekistan, Moldavia and Georgia. We will come back to the special relationship with developing countries later.

In quantifying flows of funds that may be contrary to the spirit of the law, SEO excludes all flows between EU countries. The idea behind this is that tax has already been paid on these flows of direct payments on the grounds of the European Directive on Taxation of Parent Companies and their Subsidiaries and the Interest and Royalties Directive, so that source tax could not be levied, and so placement of a Dutch special financial institution in the chain was thus not done on the basis of a tax motive.

On the grounds of the foregoing the government concludes from the SEO report that only flows of interest and royalty payments received by Dutch special financial institutions and paid out to companies in low-tax jurisdictions entail a fundamental risk that the group as a whole pays too little tax and that it is thus acting contrary to the spirit of the rules.

SEO estimates the volume of the interest flows in this context at € 1.3 to € 3.8 billion euro per year. The volume depends on the definition of low-tax jurisdictions. For royalties, SEO cannot make an exact calculation, but the report refers to an amount of a maximum of the same order of magnitude.

The government shares SEO's view that the substantial flows of funds processed by Dutch special financial institutions entail risks for the Netherlands. Firstly, SEO mentions the integrity risk. This is the risk that flows of funds related to or arising from illegal activities are channelled to their destination via Dutch special financial institutions. The government is aware of this risk and intends, among other things, to tighten in consultation with De Nederlandsche Bank the Regulations Governing Sound Operational Practices under the Trust Offices (Supervision) Act[14].

We work to limit this risk to the extent possible by means of measures in the area of supervision and transparency. This is why Dutch legislation sets increasingly high standards for trust offices that provide services to special financial institutions and it is why the Dutch Tax Administration always lends maximum cooperation to requests from other countries to exchange relevant information. As is apparent from the peer review of the Netherlands by the Global Forum on Transparency for Tax Purposes, the Netherlands complies with the international requirements in this area[15].

In addition SEO points out the risk that the volume of the special financial institution sector will damage the reputation of the Netherlands. It is widely known that, in recent years, the accusations in national political discussions and in the national media as to the status of the Netherlands as a tax haven[16] have been more and more frequent. The government regrets this because discussions about our tax legislation and the inherent uncertainty in these discussions in relation to the possibility of tightening legislation cause unnecessary unrest. This makes the country less attractive for investments.

Lastly, SEO points out the risk of tax base erosion in developing countries. When a developing country agrees in its bilateral tax treaty with the Netherlands to lower its source taxes on dividends, interest and royalties, this leads to a decline in its tax revenues from existing flows. In relation to this effect, SEO could only include

[14] This tightening also arises from the IMF evaluation of the implementation of the international standards against money laundering and terrorist financing (FATF) from 2011.
[15] On this point, see the letter from the State Secretary for Finance dated 26 October 2011 (Parliamentary Papers II, 2011-12, 25 087, no. 28).
[16] In this section we will not consider what must be deemed to be a tax haven and whether the term is used here in the proper context.

in its report information on dividend flows from developing countries[17]. In 2011, Dutch special financial institutions received € 3.3 billion from developing countries (around 2.5% of their total dividend receipts in that year), € 2.85 billion of which came from countries with which the Netherlands has a tax treaty. In combination with an average difference between the national rate and the treaty rate, this leads to lower revenues from source tax in the amount of € 145 million[18].

Naturally, the idea is that, by concluding the treaty, the developing country will become more attractive for investments from the Netherlands. An increase in investments will lead to more jobs and to more and different tax revenues in that country. In the government's view, in a discussion of the possible erosion of tax base in developing countries, it is therefore not correct only to cite the lower taxes at source.

Later in this memorandum the investigation conducted by the IBFD will be discussed of bilateral tax treaties between the Netherlands and a number of developing countries. The systemic risk named in the SEO report is too far removed from a discussion on international taxation and so we will not discuss it here.

2.3. Economic importance of special financial institutions to the Netherlands
SEO made an estimate of the importance of special financial institutions to the Dutch economy. The report looked at tax paid, at the volume of business of sectors that provide services to special financial institutions and at employment opportunity, both in the special financial institutions and in the providers of business services.

A number of reactions after publication of the SEO report criticised these outcomes. SEO responded to this criticism. There is no reason for the government to doubt the order of magnitude of the volume of business of third parties and employment opportunity estimated by SEO. These figures at any rate convince the government that in taking any measures, it must be borne in mind that, particularly if they are not specific enough, such measures can have serious consequences for employment opportunity in special financial institutions and in companies that provide services to special financial institutions. The government will take this into account.

Questions were also asked about the tax revenues estimated by SEO. The corporation tax paid (€ 1,208 million in 2011) by special financial institutions was measured using micro-level data and is thus not questioned.

According to estimates of the Ministry of Finance, the revenues from dividend tax for the coming years will be just under € 2.5 billion. Dividend tax acts as an advance levy of income tax and corporation tax. After refunds are made of the advance levies, a net amount remains of approximately half of the gross proceeds from dividend tax. On account of the economic crisis the net yield from dividend tax now and in the near future will be at a relatively low level, approximately € 1.2

[17] The definition of the term 'developing countries' is taken from the first three columns of the list of the OECD's Development Assistance Committee (DAC) and includes LDCs (least developed countries), OLICs (other low-income countries), per capita Gross National Income (GNI) <$1,005 in 2010 and LMICs (low middle-income countries), per capita BNI between $1,005 and $3,975 in 2010.
[18] The difference between this figure for 2011 and the loss calculated for 2010, € 70 million, is striking.

billion. The net yield from dividend tax is estimated at € 1.6 billion on a structural basis. These estimates are based on data from the Tax Administration.

SEO estimates the dividend tax paid by special financial institutions to be € 1,064 million in 2011. For 2008 and 2009 the Ministry of Finance earlier estimated amounts of € 133 million and € 86 million respectively for APA/ATR-related entries[19]. The criteria to be considered an APA or ATR company and a special financial institution are not entirely the same. This means that for final conclusions a further comparison must be made. The big difference does make us assume that the average effective rate on the relevant dividend flows which SEO took as its starting point was too high. The portion of the dividend flows subject to a rate of 0% is probably larger than the figure assumed by SEO in its estimates.

2.4. Response of Tax Justice NL

During consultations with the Standing Committee for Finance, the State Secretary for Finance said that he would include the response from non-governmental organisations (NGOs) to the SEO rapport. The NGOs working in the Netherlands in the field of taxation are linked in Tax Justice NL (TJN). They issued a joint response.

In a general sense, TJN is of the opinion that the study conducted by SEO is not independent and unilateral, that existing policy is mistakenly defended and that the economic added value of the sector is overestimated. TJN thinks that the risks of money laundering, corruption, bribery, liability and violation of human rights deserve more attention. It also thinks that the disadvantages to Dutch citizens and the Dutch state are not taken into account, mistakenly so, and it questions the revenues from dividend tax estimated by SEO. TJN finds that erosion of the tax base in developing countries is underestimated. According to TJN, interest and royalty payments are mistakenly not taken into consideration, there should be attention to transfer prices and a broader definition should have been used for developing countries.

We do not share the categorical rejection of the SEO conclusions by TJN. We feel that the SEO report gives an objective view of the various issues and problems. TJN names a number of topics that should have received more attention, but in our opinion they were not covered by the instructions given to SEO by Holland Financial Centre. The same is true of aspects of transfer prices. It should be noted that it is apparent from this memorandum that the government and a number of international organisations do recognise this problem.

TJN quite rightly feels that an estimation of the disadvantages for developing countries should also give consideration to flows of interest and royalties. SEO does not disagree, but was unable to furnish those details because of the data confidentiality requirements set by De Nederlandsche Bank. Many of the choices made in selecting the category of countries to involve in such an estimate are defensible. In the end it is a political decision; we will come back to this in our conclusions. We cannot agree with the criticism that SEO did not consider the disadvantages to Dutch citizens and the Dutch state. SEO actually made an attempt to formulate criteria by which this damage could be measured, and devotes explicit attention to the risks inherent in the large number of special

[19] Letter dated 25 June 2012, Parliamentary Papers II 2011-2012, 25 087, no. 32

financial institutions in the Netherlands. We will come back elsewhere to TJN's critical remarks in relation to SEO's estimated revenues from dividend tax.

Although we do not share all the criticism of TJN, this does not alter the fact that the government recognises that there are problem areas in the complete fabric of rules for international taxation and that the government can understand the criticism of organisations such as TJN of the role played by Dutch companies in this regard. Indeed, this is the very reason why the government announces in this memorandum that action will be taken.

3. International state of affairs

The government sees the problems of tax planning by internationally operating companies as an issue that can only be meaningfully dealt with in an international context and for which effective solutions can be found almost nowhere but in the form of international arrangements. It is therefore important to consider the international developments in this area.

3.1. G20/OECD project: Base Erosion and Profit Shifting (BEPS)

The heads of government and finance ministers of the G20 have underscored the importance of adequate taxation of international companies. This is important in preventing budget deficits and with a view to the tax ethics of other taxpayers. Based on this idea, the G20 asked the OECD to identify the weaknesses and to develop solutions.

In February 2013 the OECD issued its report titled 'Addressing Base Erosion and Profit Shifting´ [20], listing weaknesses in the taxation of internationally operating companies. Following this report, at the meeting of the G20 finance ministers on 19 July 2013, an action plan was presented[21] (hereinafter: the OECD Action Plan).

In the OECD Action Plan the OECD, in collaboration with a number of G20 countries that are not OECD members, proposes completing the following actions within the coming two years.

- Produce a report on the difficulties that arise in applying the present rules for international taxation in the digital economy and possible means of resolving them.
- Make changes to the OECD Model Tax Convention and make recommendations to member states for the design of national provisions to neutralise the effects of hybrid mismatches. This is to avoid costs being deducted twice or that the income corresponding to deductible costs is not taxed as a result of the fact that two states handle a financing instrument or an entity in different ways.
- Draw up a description of national preferential regimes. Take measures to improve transparency and to facilitate the exchange of rulings on the application of these regimes and set substantial activity requirements for the use of preferential regimes. Investigate how this can be expanded to include non-OECD member states.
- Make changes to the OECD Model Tax Convention and issue recommendations to member states for the design of national provisions to combat treaty abuse.
- Issue recommendations to member states for the design of national provisions for controlled foreign companies (CFC). This will give them a means of

[20] http://www.oecd.org/tax/beps.htm
[21] http://www.oecd.org/ctp/BEPSActionPlan.pdf

countering the artificial shift of capital and profits of parent companies to subsidiaries in low-tax jurisdictions.
- Issue recommendations to member states for the design of national provisions and make changes to the Transfer Pricing Guidelines (hereinafter: TPG) in order to put an stop to base erosion by means of excessive interest deductions.
- Make changes to the definition of permanent establishment in the OECD Model Tax Convention to put an end to structures which artificially prevent exceptions to permanent establishment status.
- Alter the TPG to ensure that the outcomes are better aligned with the creation of value in the business chain. Three attention areas are distinguished in this respect:
  - allocation and transfer of intangible sources of income in a group context;
  - allocation and transfer of risks and capital in a group context;
  - transactions that are not likely to take place between independent third parties.
- Develop a methodology with which to better estimate the economic consequences of tax avoidance.
- Make recommendations for mandatory disclosure rules about aggressive or abusive transactions or structures.
- Revise the existing requirements for documentation of transfer pricing.
- Adjust the OECD Model Tax Convention to make consultation procedures between states more efficient.
- Develop a multilateral instrument to make it easier to incorporate the proposed measures quickly in bilateral treaties.

To achieve these objectives within the proposed period, the OECD will make some adjustments to its working structure. Several working parties (WP) report to the Committee on Fiscal Affairs, which is responsible for coordinating the entire BEPS project. WP1 deals with matters related to the OECD Model Tax Convention. A number of temporary focus groups will be formed to work on treaty abuse, permanent establishments and consultation procedures. WP2 will continue to be responsible for economic and statistical analyses. WP6, responsible for the TPG, will set up three focus groups to deal the relevant aspects. Lastly, a new working group will be set up to deal with hybrid structures and harmful tax regimes (WP11) and a dedicated Task Force will be established to investigate problems and obstacles in the digital economy. The Netherlands will delegate representatives of the Ministry of Finance and the Tax Administration to take part in these groups.

3.2. EC Action Plan
In the past year, the European Union has seen a number of initiatives in relation to combating tax fraud and tax evasion. On 6 December 2012 the European Commission (hereinafter: the Commission) published three documents:
- the communication from the Commission to the European Parliament and the Council about the Action Plan to strengthen the fight against tax fraud and tax evasion[22];
- the recommendation of the Commission regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters[23]; and

[22] COM(2012) 722 final.
[23] COM(2012) 8805 final.

- the recommendation of the Commission on aggressive tax planning[24].

The communication and the two recommendations of the Commission, for convenience's sake referred to as hereinafter "the EC Action Plan", followed calls from the European Parliament and the Council to quickly work out concrete plans to better combat tax fraud and tax evasion as well as an earlier communication from the Commission of 27 June 2012[25]. The communication of 6 December includes an overview of six existing instruments and initiatives in this field, seven new initiatives from the Commission and 21 new initiatives and actions to be undertaken. The work done by the Netherlands in relation to the Action Plan is documented in a BNC fiche (a special form for the assessment of Commission proposals)[26], to which reference is made here.

Following the publication of the EC Action Plan, the EU finance ministers adopted several conclusions in the Ecofin Council meeting. The European Council discussed tax fraud and tax evasion on 22 May 2013. On these occasions the EU member states urged that concrete steps be taken to fight tax evasion and tax fraud, particularly in the present context of budget consolidation, to protect tax revenues and to retain public confidence in the fairness and effectiveness of tax systems. The EU member states pointed out the importance of combining measures at a national, EU and global level while respecting the powers of the member states with regard to tax matters, the principle of subsidiarity and the EU treaties. They specifically underscored the importance of (automatic) data exchange, both within the EU and globally. Negotiations are taking place on tightening agreements (along the lines of the Savings Directive) with third countries, including Switzerland. In the European Council, the EU member states welcomed the Commission's EC Action Plan, promising to give priority to a concrete follow-up to the EC Action Plan and to continue their discussions of the two Commission recommendations. They also welcomed the BEPS project of the OECD.

To combat VAT fraud, the European Council called on the Ecofin Council to adopt the quick reaction mechanism and the reverse charge mechanism directives by the end of June 2013 at the latest; political agreement was reached on this in the Ecofin Council meeting of 21 June[27]. In the event of sudden, large-scale fraud, the quick reaction mechanism allows the Commission, at the request of a member state, to issue a declaration of no objection allowing the member state to transfer responsibility for payment of VAT in the commercial chains to the purchasing economic operator (the reverse charge mechanism). After the Commission issues this declaration, a member state may apply the measure for nine months, pending decision-making by the Council on a more permanent set-up involving an accelerated derogation procedure (Article 395 VAT Directive). In addition, the list of goods and services for which member states may declare the reverse charge mechanism applicable without requiring a derogation has been expanded. Because reverse-charging of VAT deviates from the principles of the VAT system, both proposals are to terminate by the end of 2018. For the same reason, the list of goods and services covered by the expanded reverse charge mechanism is limited

[24] COM(2012) 8806 final.

[25] Communication from the Commission to the European Parliament and the Council on concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries (COM(2012) 351 final).

[26] Parliamentary Papers II 2012/13, 22 112, no. 1545, fiche 5.

[27] This amendment to the VAT Directive was published on 22 July: Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a Quick Reaction Mechanism against VAT fraud (OJ 2013, L 201).

in scope. In the period until 2018 work will be done to make the VAT system more robust. At the informal Ecofin Council meeting in mid-April 2013 the Netherlands declared itself in favour of speedy adoption of this VAT fraud package.

The Netherlands is enthusiastic about the initiatives taken in relation to the EC Action Plan and which particularly contribute to greater transparency[28]. The government will remain alert to ensuring that these initiatives are in line with developments within the OECD, assuring a level playing field worldwide and preventing work being duplicated. It is important that the EU initiatives are aligned with initiatives developed in the context of the OECD Action Plan. Further-reaching EU tax measures that bind only its member states do not remove opportunities for tax avoidance in constructs with third countries and may also be detrimental to the competitive position of European companies. Initiatives such as those in the Commission's proposed recommendations to promote the use of general anti-abuse measures and to draw up blacklists of third countries that do not meet minimum standards for good governance in tax matters are already in use or are being developed in an international context by the OECD and the Global Forum on Transparency and Exchange of Information for Tax Purposes. The Netherlands will keep a close watch to ensure that further EU initiatives in this regard clearly have added value. When concrete measures are to be taken, the government wants to see them set down in hard law instruments such as EU directives and EU regulations. This makes them binding for all EU member states and assures a level playing field.

3.3. *State of affairs in Country by Country reporting*
The term country by country reporting (CbC reporting) is regularly encountered in discussions of governments and businesses on improving transparency. This term is not always used in the same sense, which can lead to confusion. It is not always the same information that must be reported (all payments to government bodies, tax payments or profits recorded) and the information is not always reported to the same organisation (Tax Administration or publicly consultable sources). In talking about such matters, it is important to keep a close watch on exactly what is meant. Below is a brief overview of several initiatives in this field and the position of the Netherlands.

With the introduction of the Extractive Industries Transparency Initiative (EITI) in 2002, the first steps were taken in relation to transparency of payments (including tax payments) by companies to the government in countries where mining plays an important role. The Netherlands supports this initiative financially. The focus of this initiative is primarily to fight corruption in (developing) countries that are rich in natural resources. Improved government transparency and accountability will allow the entire population to benefit from the natural resources in a country. Participation in EITI is voluntary. In the meantime over 20 countries have joined, more than half of which are African countries[29]. One aspect of the EITI obligations is that mining companies report the payments they make to government bodies. The government then draws up an EITI report on its receipts.

[28] Compare the request of MPs De Vries et al. asking the government to encourage the EU to arrive at a credible European approach to tax fraud and to inform the House before or upon submission of next year's budget of what steps the government has taken or will take shortly, and what progress has been made in a European context. Parliamentary Papers I 2012/13, 33 551, B.
[29] http://eiti.org/countries.

For a number of years the Dodd Frank Act has applied to the United States. The act introduced a country by country reporting obligation for all mining companies listed in the US. The reporting provisions apply to all countries where the listed companies have mining operations.[30] The EU has since included a similar provision in the new Accounting Directive 2013/34/EU[31] and in the proposals to amend the Transparency Directive with a provision similar to that in the US for companies in the extractive industry. The European regulation is somewhat broader: it also covers forestry and it applies to large unlisted companies as well.

The recent new Capital Requirements Directive (CRD IV, Directive 2013/36/EU)[32] includes the provision that country by country reporting will also apply to banks. The preamble[33] states: "Increased transparency regarding the activities of institutions, and in particular regarding profits made, taxes paid and subsidies received, is essential for regaining the trust of citizens of the Union in the financial sector. Mandatory reporting in that area can therefore be seen as an important element of the corporate responsibility of institutions towards stakeholders and society." The provision for CbC reporting in this directive is basically intended to regain public confidence in certain institutions and applies for all countries in which a bank has an office. This makes it possible to see what part of the profits is channelled to countries that levy little or no profit tax. CRD IV comprises mandatory reporting for specific institutions, by member state and by third country in which they have an office, of: a. name and address of the entities, b. business volume, c. number of FTEs, d. pre-tax profit or loss, e. tax on profit or loss and f. subsidies received. Starting on 1 July 201, the details named under a, b and c must be reported every year. The details named under d, e and f must be reported to the Commission in 2014, which will investigate whether their publication leads to negative effects, in which event publication of the details provided to the Commission could be deferred.

In May 2013 the European Council adopted conclusions to include CbC reporting on tax payments in the proposal for a directive on disclosure of non-financial and diversity information[34]. Negotiations on this proposed directive were recently started. Thus far no conclusions have been drawn as to how CbC reporting of tax payments will be treated in this dossier, and how.

The Netherlands has taken note of the French intention to make a proposal to the EU that would expand the transparency obligations in CRD IV for banks to include other sectors. The government will support the French government if it wishes to hold EU consultations about this expansion of mandatory reporting.

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[30] The implementation rules of the Securities and Exchange Commission relating to publication of the information are part of a legal dispute which was lost by the SEC in the first instance (Case 1:12-cv-01668-JDB, US District Court, for the District of Columbia).
[31] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EG of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L182).
[32] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L176).
[33] Recital 52, CRD IV.
[34] COM(2013) 207.

Finally, action point 13 of the OECD Action Plan calls for the development of a new format for mandatory improvements to documentation for a more effective and efficient implementation of the rules on transfer pricing. The idea is to give the tax administrations insight into the worldwide allocation of profits by multinationals over the various countries. With this overview, it will be easier for tax administrations to apply risk selection in relation to transfer prices.

The Netherlands gives its wholehearted support[35] to the growing number of international initiatives to promote transparency through CbC reporting. The Netherlands does wish to call attention to the possible negative economic consequences if this information is made publicly available and to the importance of good coordination with existing transparency obligations. To assure a level playing field, we are not in favour of unilateral introduction in the Netherlands.

3.4. Exchange of information

The American Foreign Account Tax Compliance Act (FATCA) has accelerated developments in the field of automatic information exchange, both in the EU and around the world. In the EU, the Commission has proposed improvements to the Savings Directive. The Netherlands is working to achieve the required progress. The Netherlands gave its support at an early stage to the initiative of the so-called G5 countries (France, Germany, Italy, Spain and the United Kingdom) for a pilot project for automatic data exchange on the basis of the aforementioned FATCA standard. Parallel to this, the Commission has made its own proposal to incorporate this standard in the existing directive on administrative cooperation in the field of taxation[36]. This directive now provides in the possibility to exchange data in relation to various income categories (e.g. salaries, pensions) automatically. FATCA-related details, which primarily pertain to investment-related income such as dividends and interest, would in principle form a good and useful addition.

It is a good idea to place this positive development in the context of OECD initiatives for a worldwide single standard in the field of automatic exchange: the common reporting standard. Supported by the momentum created internationally by FATCA and the aforementioned G5 initiative, the OECD is now working on the technical conversion of FATCA into a single global standard for automatic data exchange. The OECD very clearly links this standard to the most recent version of the Convention on Mutual Administrative Assistance in Tax Matters. This convention has now been signed by 60 countries and the amending protocol to this convention was ratified early this year by the Netherlands and the other countries within the Kingdom. In addition to the possibility of exchange on request, this multilateral convention also offers an excellent legal basis for (optional) automatic information exchange. In line with the example of the FATCA intergovernmental agreement (IGA), the common reporting standard could give further shape to this. At the level of both the G8 and the G20 full support has now been expressed for automatic exchange and the corresponding OECD initiative to arrive at a single (multilateral) standard. The most recent communication from the finance ministers of the G20 countries of 19-20 July 2013 is crystal-clear on automatic information exchange as the new Global Standard. In the G20 communication the OECD is asked to draw up

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[35] As was also requested in the motion by MPs Merkies and Klaver, Parliamentary Papers II, 2012-13, 25087, no. 38.

[36] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

a schedule so that this project can be completed in 2014. The Global Forum on Transparency and Exchange of information for Tax Purposes (Global Forum) has already been designated by the G20 to help supervise the implementation of this new standard. It is clear that worldwide automatic exchange of FATCA-relevant information will be a ground-breaking step forward of unprecedented magnitude. The Netherlands fully supports these developments and the corresponding measures: the fight against tax evasion is well served with a faster and more effective exchange of larger quantities of relevant information. The Netherlands shares the opinion of the Commission that the FATCA standard should also be applied within the EU.

3.5. *Risk analysis of substantial activity requirements for financial service entities*
The decision of 11 August 2004, no. IFZ2004/126M, stipulates under what conditions financial service entities can obtain advance certainty on the tax consequences of their activities. One of the conditions is that they must comply with the substantial activity requirements stated in the annex to that decision. In the General Consultations held on Wednesday, 23 January 2013 on international tax (treaty) policy between the Lower House Standing Committee for Finance and the State Secretary for Finance, questions were asked about the enforcement of the substantial activity requirements by the Tax Administration. The State Secretary promised to ask the Tax Administration to conduct a risk analysis for this purpose[37].

On the basis of the information available to it as well as public information, the Tax Administration used a random sample to investigate whether what was described in the request for advance certainty (including the substantial activity) corresponds with reality. The conditions and the substantial activity requirements turned out to have been met in all cases reviewed.

For financial service entities that do not request advance certainty[38], on the basis of a random sample, using data from the Chamber of Commerce, it was assessed whether the majority of the directors was resident or established in the Netherlands. This was not so in one case.

From an assessment of the corporation tax returns for 2009, 2010 and 2011 it appeared that a number of taxpayers had indicated that they did not meet the substantial activity requirements. Where it is actually the case that they do not, information is exchanged.

On the basis of this analysis we reached the conclusion that there is only a small risk that the substantial activity requirements are not met.

4. Investigation of position of developing countries
Traditionally, the primary purpose of tax treaties is to avoid double taxation. They comprise arrangements on how to divide the right to levy tax between the contracting parties. Generally speaking, one aspect of this is that the source country reduces its tax at source on outbound payments of dividend, interest and royalties. The country of residence prevents double taxation by exempting this

[37] Parliamentary Papers II, 2012-2013, 25 087, no. 48, p. 22.
[38] Strictly speaking, the substantial activity requirements do not apply to them, but information will be exchanged with other countries for which this may be important.

income or by offsetting it against the lower tax at source. The treaties also define who is entitled to treaty benefits in the form of lower tax at source.

Because tax treaties are the result of bilateral negotiations, both the arrangements on tax at source and those on the entitled parties may differ from one treaty to the next. Dutch tax treaties that reduce the tax burden on payments from a source country more than tax treaties of other countries with that same source country can lead to unintended use, such as reallocation of investments by multinationals from other countries via special financial institutions in the Netherlands (treaty shopping), thus causing source countries (the destination countries for the investments) to miss out on tax revenues.

With 12,000 special financial institutions, the Netherlands is an important hub for worldwide investments (participating interests, loans) by multinationals and for the receipt and distribution of income (such as dividends, interest, royalties) on those investments. A variety of tax factors can form a reason to establish an intermediate holding company or link company in the Netherlands – think, for instance of the participation exemption, the absence of tax at source on outbound interest and royalty payments, the Dutch APA/ATR policy, the quality of the Dutch Tax Administration and the broad experience of the tax consultancy industry.

It may be assumed that the extensive treaty network to avoid double taxation plays a role as well. For this reason the Minister for Foreign Trade and Development Cooperation and the State Secretary for Finance commissioned the Amsterdam-based IBFD (*International Bureau of Fiscal Documentation*) to investigate two matters. Firstly, the IBFD investigated to what extent Dutch tax treaties with five poorer developing countries (Bangladesh, the Philippines, Ghana, Uganda and Zambia) comprise risks of unintended use which might cause those countries to miss out on tax revenues. Secondly, the IBFD attempted to measure whether there is a relationship between the existence of a tax treaty and the volume of the financial flows between the Netherlands and the developing country (such as investments via a special financial institution).

4.1. Comparison of tax treaties

The IBFD compared the content of the tax treaties concluded by the Netherlands with the content of tax treaties concluded by the same five developing countries with nine other more developed countries (Belgium, China, Germany, France, Ireland, India, Mauritius, United Kingdom and Switzerland). Tax treaties with Kenya, with which the Netherlands has not as yet concluded a treaty, were also included in the analysis. The study included the amount of the tax at source and the anti-abuse provisions that are to ensure that treaty benefits are solely granted to persons for whom they are intended. Furthermore, the definition of the term ‘permanent establishment’ in the various tax treaties was compared. In general it can be said that a broad definition of this term is to the advantage of developing countries from a budgetary point of view. For further information please refer to the appended report of the study.

The comparison of the tax treaties shows that the Dutch tax treaties with the five developing countries comprise the same provisions as the treaties of these developing countries with the nine other countries. In the Dutch treaties with the five developing countries, the taxes at source can almost always be found in a ‘leading’ group of treaties offering the largest reduction in tax at source (compared to the national rate for tax at source that applies in the developing country under study). The Dutch treaty with Uganda is the only one that is more favourable for certain categories of persons entitled to the treaty benefits than the other tax treaties concluded by Uganda.

The tax treaty between the Netherlands and Zambia, on the other hand, falls in the category of Zambia’s least favourable bilateral tax treaties. This treaty is also striking on account of the absence of a beneficial owner clause, which is the mildest form of an anti-abuse provision. It is the oldest tax treaty (1977) of the five treaties studied. The other four treaties do comprise a beneficial ownership clause, but no specific anti-abuse clauses. However, the Dutch treaties do not deviate in this respect from the overall picture, which is that almost none of the tax treaties studied of the six developing countries (including Kenya) contained any form of anti-abuse provisions with which effective barriers could be set up against unintended use.

This absence of more specific anti-abuse provisions is understandable in the light of the fact that, until a few years ago, the world paid little attention to international tax avoidance. As stated in the Memorandum on Tax Treaty Policy[39], it is now recommended that tax treaties with developing countries incorporate more specific anti-abuse provisions than the beneficial ownership clause so as to limit the risk of unintended use. That memorandum also states that the Netherlands would prefer to see specific measures in that regard that offer taxpayers as much legal certainty as possible. For this reason the Netherlands has a preference for clear limitation-on-benefits clauses: they describe precisely for what types of transactions or companies/corporate relationships the treaty benefits are granted. This is preferable to generic measures such as a general main-purpose test.

The IBFD rightly points out that in itself, the content of the tax treaties cannot guarantee that no unintended use will be made of them. It is crucial that tax administrations in developing countries are adequately equipped to apply anti-abuse provisions in practice, which is often not the case. For the government, capacity building in the tax administrations in developing countries was already a priority, and the Dutch technical support in this field will continue and be intensified if necessary. It is important to note in this context that tax avoidance or evasion is not only the result of unintended use of tax treaties. It seems to be of greater importance that the national tax rules are of good quality and that they are enforced. The Dutch technical support can make a significant contribution in this respect[40].

4.2. Investigation of financial flows
In the second place it was studied whether a quantitative analysis could be made for each developing country of the volume and composition of recent capital flows (investments, primarily by special financial institutions established in the Netherlands, dividends, interest payments, royalties) between the Netherlands and the developing country, on the basis of which it might be possible to find

[39] Parliamentary Papers II, 2010-11, 25 087, no. 13.
[40] See letter to Parliament titled ‘Versterking belastindiensten in ontwikkelingslanden’ [Strengthening tax administrations in developing countries] dated 6 June 2013, where the proposed technical assistance is described more extensively.

indications of unintended use of the bilateral tax treaty. As is explained in the IBFD report, it was not possible to conduct a study for each developing country separately because of insufficient availability of (public) data on matters such as the income flows between the Netherlands and the individual developing countries.

Instead, the IBFD made a comparative analysis of capital flows for the period from 2003-2011 between two groups of developing countries: the group of five treaty partners and a group of developing countries with which the Netherlands has no treaty (Cambodia, Cameroon, Nepal, Kenya and Tanzania). Although this IBFD analysis does not allow hard conclusions to be drawn as to the significance of the tax treaties for the volume and allocation of capital flows, it nevertheless yields a number of interesting insights. While the investments of Dutch companies in the treaty countries show almost no increase and even some decrease in the non-treaty countries, the investments by Dutch special financial institutions in both groups shows strong growth, averaging 23% per year to the treaty partners and 14.5% per year to the non-treaty countries. Both these figures are higher than the average economic growth in both the treaty countries (9.7%) and the non-treaty countries (7.5%). They are also higher than the growth of total foreign investments in those two groups of countries (exclusive of Dutch special financial institutions).

The complete analysis (for which reference is made to the appended report) indicates that tax treaties they can be a pull factor for capital flows via the Netherlands, but also makes it clear that other factors than the tax treaties play a role in the decision to invest via the Netherlands.

The IBFD took a more detailed look at Ghana, for which more data were available. The tax treaty between Ghana and the Netherlands took effect in 2009. The analysis conducted by the IBFD shows that investments via Dutch special financial institutions in Ghana have risen strongly since that year, from € 22 million in 2007 to approx. € 2.2 billion in 2010. Because of this explosive growth, the volume of investments by Dutch special financial institutions in Ghana in 2010 was around one-third of worldwide investments in Ghana. According to the IBFD, these findings strongly suggest that the treaty was the driving force behind the increase in investments in Ghana by Dutch special financial institutions.

In itself, however, the tax treaty does not comprise any non-standard provisions that could explain this growth. Without an in-depth analysis of the motives of the individual companies, it is therefore difficult to explain these financial flows. What might play a role is that by channelling investments via a treaty country, particular types of certainty can be obtained that are not possible when investments are made directly from a non-treaty country. For example, an increase in the national tax rate that is introduced later will have no effect under the treaty with the Netherlands. It is thus possible that the treaty of the Netherlands with Ghana, which has concluded a treaty with only ten countries, can be of relatively great value for investors interested in Ghana who are seeking certainty.

5. Conclusion, Dutch practice and possible measures

5.1. Conclusions

It is apparent from the G20/OECD BEPS report and the OECD Action Plan that a number of possible routes are open to internationally operating companies to influence the basis on which they are taxed. The use of link companies in order to enjoy treaty benefits is just one of the many possibilities. The use of Dutch link companies in this regard is not unusual, and certainly not unique. The action plans of the OECD and the European Commission show that this is a worldwide problem, for which international solutions must be sought.

The SEO report shows that there is a risk of unintended use of treaties and Dutch legislation in a very limited portion of the flows of funds received and paid out by Dutch special financial institutions. Only in cases in which interest or royalty payments are received from a treaty partner and paid out to a creditor in a low-tax jurisdiction is there a risk of avoidance of single taxation. The IBFD investigation of the Dutch treaties with a number of developing countries shows that these countries have generally made the same arrangements with the Netherlands as in their treaties with other countries.

From everything described in this regard, the government concludes that there are no reasons to assume that Dutch tax treaties, Dutch legislation or the practical implementation process create risks, in the form of a haven where organisational structures can exist with which internationally operating companies realise tax savings contrary to the spirit of the legislation. Because the Netherlands also complies with all obligations in the area of transparency and the exchange of information[41], the government rejects the idea that the Netherlands should be regarded as a tax haven[42]. Therefore, and partly in response to the motion of MPs Klaver and Koolmees[43], the government still has a strong preference for measures in an international framework and in a form that is binding for all states. As described in the foregoing, there are international initiatives in which the Netherlands plays an active and constructive role.

5.2. Measures

5.2.1. Starting point

The starting point of the government continues to be that the Netherlands must retain an attractive tax climate for investments. The main structure of our tax legislation, which reserves an important place for the participation exemption, is not a subject for discussion. Nor is the fact that the Netherlands continues to aim for an extensive treaty network to avoid double taxation. Nonetheless, the government understands the criticism of existing practice[44] and acknowledges that the Netherlands has its own responsibility to prevent double non-taxation in which unintended use is made of tax treaties in combination with Dutch legislation. In relation to developing countries, this is also necessary if the Netherlands is to pursue a consistent policy. The government has a preference for internationally

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[41]See e.g. Parliamentary Papers II 2011/12, 25087, no. 28; Letter from the State Secretary for Finance on the Global Forum on Transparency and Exchange of Information for Tax Purposes and the Peer review of The Netherlands.

[42]Parliamentary Papers II 2012/13, 25087, no. 35: motion of MP Van Vliet asking the government to reject the qualification of the Netherlands as a tax haven.

[43] Parliamentary Papers II 2012/13, 31066, no. 168: amended motion 31066/161 of MPs Klaver and Koolmees, asking the government to state what final objective it aims for in an international approach to tax avoidance and what steps it will take to this end, making a distinction between its efforts within and outside of Europe.

[44] As in Parliamentary Papers II 2012/13, 31066, no. 163: motion of MP Klaver, in which he considers that it is not a good idea that the Netherlands levies too little tax from companies that carry out no activities here, but merely channel their money through and asks the government to formulate an action plan to tackle this abuse step by step.

coordinated solutions that are binding for all countries. It is important to include developing countries in the search for these international solutions, primarily because of their importance in (re)formulating transfer pricing principles. The present international initiatives offer good prospects in this regard.

Alongside international efforts, the government also sees scope for initiatives of its own to combat improper use without disrupting the investment climate. For this reason the government now wishes to propose the following unilateral measures.

5.2.2. Developing countries
Further to the findings in the report on the study conducted by the IBFD, the 23 developing countries with which the Netherlands has a treaty or with which it is negotiating will be approached. We will suggest to Zambia that the treaty be updated. We will also approach the four other developing countries studied and the fourteen poorer developing countries[45] with which the Netherlands has a treaty to investigate the possibilities of adding anti-abuse provisions to the tax treaty. For these fourteen countries an internal comparison will also be made on analogy with the IBFD study. This will also be brought up in our current negotiations with Malawi, Mongolia and Kenya. In the very near future we will investigate whether Ethiopia may be interested in this after all. In concluding new treaties, we will consider carefully and in close consultation with the developing countries what anti-abuse provisions should be incorporated. And when new bilateral tax treaties are offered to developing countries, the Explanatory Memorandum will discuss possible risks of treaty abuse that might lead to erosion of the tax base in the contracting country as well as the clauses agreed for inclusion in the tax treaty to offset those risks. The Explanatory Memorandum will include a brief comparison between the arrangements made in the treaty to arrangements made by the developing country in its tax treaties with other countries.

The Netherlands is intensifying the capacity building activities it has with tax administrations in developing countries and if desired, will release extra funds for this. In the near future, in this same context a training course on ‘treaty maintenance’ will be offered to all developing countries with which the Netherlands has a treaty. Where necessary, the training will be followed by technical assistance tailored to each country.

These measures do not alter the assessment framework used for the conclusion of treaties with developing countries[46], but they do give an impetus to combating abuse in the relationship with these countries. They are also in line with the scheduled review of standard criteria for treaties with developing countries[47].

Once more, we have used the term developing country here to refer to countries in the following categories on the OECD’s DAC list of ODA recipients: least developed countries, other low-income countries and lower-middle income countries. This does not include upper middle-income countries.

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[45] These are the following 14 countries: Kyrgyzstan, Zimbabwe, Egypt, Georgia, India, Indonesia, Moldavia, Morocco, Nigeria, Pakistan, Sri Lanka, Ukraine, Uzbekistan and Vietnam. These countries are named in the first three columns (LDCs, OLICs and LMICs) of the list of the OECD’s Development Assistance Committee. See also note 17.
[46] As mentioned in the motion of MPs Omtzigt and Merkies (Parliamentary Papers II, 2012-13, 25087, no. 42).
[47] See the annex to the letter from the State Secretary for Finance dated 18 October 2011 (Parliamentary Papers II, 2011/12, 25087, no. 27).

The government does not now propose any further analysis of the tax revenues developing countries miss out on due to tax avoidance, in view of the initiative that has been taken by the Lower House[48].

5.2.3. APA/ATR in practice

The government feels that tightening of the rules in relation to APAs and ATRs is possible without endangering the attractiveness of the Netherlands for genuine investments that are important for economic growth and employment opportunity. Important here is that these measures should be very specifically directed at the cases in which the risk of unintended use exists and that the measures must be in line with the direction in which it is expected that solutions will be sought in an international context. In doing so, the government will definitely not tinker with the main structure of the Dutch tax system, in line with the Van Vliet motion[49]. The continued existence of the participation exemption, the aim of expanding and maintaining our treaty network and the centralised and coordinated provision of advance certainty by the APA/ATR team are not up for debate.

As described in section 3.4. of this memorandum, the international community has the conviction that states have a joint responsibility for sharing relevant information. This responsibility also rests on the Netherlands. Based on this belief, and within the context of the risks of unintended use of our treaty network, the Netherlands can do more than it now does to prevent our treaty partners from applying the treaty benefits to cases for which they were not intended.

In section 2.2. of this memorandum we showed that this risk primarily occurs where Dutch companies receive interest or royalty payments from a country with which the Netherlands has a tax treaty and pay interest or royalties to a company established in a low-tax jurisdiction. Ideally therefore, measures ought solely to be applicable in those cases. In practice, it is not always easy for the Dutch Tax Administration and for taxpayers to find out how a payment from the Netherlands is taxed in another country. A measure that takes as a criterion the manner in which the interest or royalties paid from the Netherlands are taxed therefore does not have our preference.

A measure that is in line with the activities carried out in the Netherlands is more practicable. That too is a condition that we consider in assessing whether a case involves unintended use. If activities take place in the Netherlands that make it plausible that there are business reasons to pay interest or royalties to the Netherlands and then to distribute these payments from there to other countries, then the case does not involve unintended use of treaties. It is fairly easy to assess what activities are carried out in the Netherlands. The existing substantial activity requirements pertain to this. We therefore sought a way of strengthening these rules. As was remarked in the SEO report, if the substantial activity requirements were to be raised, this would lack effect if companies simply hired more staff to comply with them without this pointing to genuine activities. It would be better to exchange relevant information with the treaty partner about the activities carried

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[48] Parliamentary Papers II 2012/13, 33625, no. 23: motion of MPs Jasper van Dijk and Van Ojik.

[49] Parliamentary Papers II 2012/13, 31066 no. 160: motion of MP Van Vliet requesting that the international approach to unwanted tax avoidance take the enforcement of the good Dutch tax infrastructure as its starting point.

out in the Netherlands. Such an approach is more in line with the relationships between the contracting states and taxpayers and is more effective because it enables the source state to better assess whether, in the present facts and circumstances, the treaty has been relied on with good reason.

For this reason the government will take the following measures. The requirements presently made of companies that ask the Tax Administration's APA/ATR team for advance certainty will also apply to companies that receive interest or royalties from other countries and pay interest or royalties to other countries[50], but which have not requested advance certainty. Companies that rely in another country on the application of a tax treaty with the Netherlands will also be required to state whether they meet these requirements when filing a return. The Netherlands will inform the treaty partners concerned about companies that do not meet the requirements. On the basis of all relevant information, these states can then make their own assessment as to whether the treaty benefits have been correctly relied on.

On another front, the Dutch Tax Administration will exchange with other countries the information on APAs which it concludes with companies operating as part of a group whose activities in the Netherlands only come up to the minimum required substantial activity for financial service entities.

The third measure we will take in this area is not so much a tightening of the rule as it is a reassessment of the deployment of capacity by the Tax Administration. This measure pertains to the so-called holding companies, companies that play a role in an international group in receiving and paying out dividends. Earlier in this memorandum we wrote that from the SEO report the we conclude that the risk that unintended use is made of the Dutch treaty network is lower here, so there is no reason to tighten the rules. However, we find it unnecessary to deploy the capacity of the Tax Administration to investigate companies that add little to the Dutch economy. Requests from holding companies for advance certainty will therefore only be processed if the group in which the holding company operates has sufficient ties with the Netherlands. The requirements that will be made in this respect will be comparable to the requirements made of the financial service entities named above, but requests from groups with a serious plan to comply with these requirements in the near future will still be processed.

This measure is also an answer to questions that have been asked about two other possible ways of limiting the work in relation to APAs and ATRs. The first suggestion was a minimum amount to be paid in corporation tax. This does not seem feasible on the basis of the principle of equal treatment. The sole criterion for corporation tax due must be profits. There is no reason to make companies that do not make a profit pay tax nevertheless simply because they asked the Tax Administration for advance certainty about their position. The second suggestion was to charge a fee for obtaining an APA or ATR. In our opinion, this is not appropriate within the existing relations between taxpayers and the Tax Administration. Besides that, it does not put up any sort of barrier against unintended use. In our opinion, the measure proposed by the government is better suited for this purpose.

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[50] For the exact description see the term financial service entity in the decision of 11 August 2004, no. IFZ2004/126M