Luxembourg / Netherlands

The Proposed Unshell Directive – The Luxembourg and Netherlands Approach

René Offermanns[*]

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In this article, the author presents the features of the Proposed Unshell Directive (COM(2021) 565 final) in the context of the existing legislative framework of Luxembourg and the Netherlands. In particular, the article focuses on the legislative measures taken by Luxembourg and the Netherlands in recent years to reduce the use of empty conduits and the perception of the Proposed Unshell Directive in those two countries.

1. Introduction

In 2006 and 2013, various reports indicated that the use of conduit companies was significant in the Netherlands. In the report from the Centre for Research on Multinational Enterprises (*Stichting Onderzoek Multinationale Ondernemingen*, SOMO) published in 2006,[1] one of the main conclusions was that many conduit companies have been established in the Netherlands, resulting in base erosion in developing countries. In the 2013 report from SEO Economic Research, it was estimated that the use of Netherlands conduits has resulted in a withholding tax loss of approximately EUR 145 million for developing countries.[2] A second 2013 SOMO report found that the Netherlands is used for treaty shopping and, as a result, developing countries annually lose EUR 771 million of withholding tax on interest and dividends.[3]

A news report published by the European Commission on 29 March 2022 indicated that Members of the European Parliament (MEPs) have scrutinized the Netherlands tax regime and regard, as important shortcomings in addressing abuse, amongst others, its attractiveness to conduit companies and loopholes in the withholding tax regime.[4]

It is against this background that the European Commission, on 21 December 2021, presented an initiative to prevent the misuse of shell entities (COM(2021) 565 final, hereinafter the Proposed Unshell Directive or the Directive), which is also known as ATAD 3 (the third anti-tax avoidance directive).[5] This proposal, which aims to contribute to ensuring fair and effective taxation, was announced in the European Commission's Communication on Business Taxation for the 21st Century.[6] The intention is to ensure that entities in the European Union with no or minimal economic activity are unable to benefit from any tax advantages. This is to be realized by amending the Directive on Administrative Cooperation (2011/16) (DAC)[7] and broadening the scope of information subject to disclosure and exchange of information.

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* **Principal Research Associate, IBFD, Amsterdam. The author can be contacted at r.offermanns@ibfd.org.**

1. Centre for Research on Multinational Enterprises (*Stichting Onderzoek Multinationale Ondernemingen*, SOMO), *The Netherlands: A Tax Haven?* (1 Nov. 2006), available at https://www.somo.nl/the-netherlands-a-tax-haven (accessed 5 May 2022).
2. SEO Economic Research (*Stichting Economisch Onderzoek*, SEO), *Out of the shadow of the banking system* (1 Jan. 2013), available at https://www.seo.nl/en/publications/out-of-the-shadows-of-the-banking-system (accessed 5 May 2022).
3. SOMO, *Should the Netherlands sign tax treaties with developing countries?* (June 2013), available at https://www.somo.nl/wp-content/uploads/2013/06/Should-the-Netherlands-sign-tax-treaties-with-developing-countries.pdf.
4. European Parliament Press Release, *MEPs scrutinize Dutch tax system and tax information exchanges with Pandora Papers jurisdictions* (29 Mar. 2022), available at https://www.europarl.europa.eu/news/en/press-room/20220324IPR26138/ (accessed 5 May 2022).
5. Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, COM(2021) 565 final (22 Dec. 2021).
6. Communication from the Commission to the European Parliament and the Council, Business Taxation for the 21st Century, COM(2021) 251 final (18 May 2021). *See also European Commission Presents ATAD 3, EU Single Corporate Tax Rulebook and Business Tax Agenda for Next Years* (19 May 2021), News IBFD.
7. Council Directive 2011/16/EU of 15 February 2011 on Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, OJ L 64 (11 Mar. 2011), Primary Sources IBFD.

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It may be noted that, when drafting its proposal on appropriate measures to tackle the misuse of shell entities for tax purposes, the European Commission, as mentioned in the Explanatory Memorandum, drew on an extensive study conducted by the IBFD (2021).[8]

The EU proposal, in particular, targets Luxembourg, Ireland and the Netherlands, which are famous conduit company locations in Europe.[9]

This article focuses on the legislative measures taken by Luxembourg and the Netherlands in recent years to reduce the use of empty conduits and the perception of the recent EU proposal in those two countries.

2. The Directive Proposal

The Proposed Unshell Directive targets companies that seem to be engaged in an economic activity but, in reality, do not carry out an activity. In determining whether a company lacks substance and must be classified as a shell company with the related tax consequences, such as exchange of information and the non-application of the tax treaty between the country where the shell company is established and the country of the shareholder, the Directive contains several steps, which are described in brief.[10]

Under the first step, included in article 6 of chapter II, undertakings with a lack of substance have to report this to their tax administration if they cross all of the following three gateways:

- more than 75% of an entity's overall revenue in the previous two tax years is relevant income, as defined in article 4 of the Directive, that is not derived from its business activities;
- a company receives more than 60% of its income through transactions linked to another jurisdiction, or passes this relevant income on to foreign companies situated abroad, or more than 60% of the book value of the undertaking's assets was located outside the Member State of the undertaking in the preceding two tax years; and
- the administration of day-to-day operations and the decision-making on significant functions are outsourced.

The scope of the gateways is not entirely clear. A question that arises, for example, is whether the Directive applies to a local holding company of an operational company that distributed dividends received to another company. The answer could be that it is covered because the holding may either receive relevant income from cross-border transactions and/or distribute this relevant income received cross-border. What should be decisive then is whether the holding was mainly established for tax avoidance purposes.

The definition of relevant income is very broad and includes interest and other income from financial assets, including crypto assets, royalties and any other income generated from intellectual or intangible property or tradable permits, dividends and income from the disposal of shares, income from financial leasing, income from immovable property, income from movable property other than cash, shares or securities held for private purposes with a book value of more than EUR 1 million, income from insurance, banking and other financial activities and income from services that the undertaking has outsourced to other associated enterprises.

What is surprising is the inclusion of immovable property, in particular, gains from the sale of immovable property, as it is difficult to see how it can be used for cash flow purposes since it is always taxed in the situs state. It can, however, be used for money laundering purposes.

A carve-out applies, amongst others, for companies that have a transferable security that trades or is listed on a regulated market or multilateral trading facility, regulated financial activities, certain holding activities, and companies that have at least five full-time employees or staff members who only carry out activities generating relevant income. In this context, it must be clarified whether or not these companies are obliged to report, in their tax return, that they qualify for one of the exemptions.

In summary, the carve-outs cover situations with sufficient transparency or substance and situations in which a company most likely is not established for tax avoidance purposes.

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8. P. Pistone et al., *Abuse through the Use of Shell Companies and Arrangements for Tax Purposes in the European Union: Feedback on the EU Consultation by the IBFD Task Force on EU Law*, 4 Intl. Tax Stud. 7 (2021), Journal Articles & Opinion Pieces IBFD.
9. *See* I.K. Krišto & E. Thirion, *An Overview of Shell Companies in the European Union*, European Parliamentary Research Service Study PE 627.129 (Oct. 2018), available at https://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf and J. Damgaard, T. Elkjaer, & N. Johannesen, *The Rise of Phantom Investments*, Fin. & Dev. 11 (Sept. 2019), available at https://www.imf.org/external/pubs/ft/fandd/2019/09/pdf/the-rise-of-phantom-FDI-in-tax-havens-damgaard.pdf.
10. For a detailed description *see* O. Popa, *Proposal for an EU Directive Laying Down Rules to Prevent the Misuse of Shell Entities for Tax Purposes (Unshell): Seven Steps towards Disgrace or Redemption*, 62 Eur. Taxn. 4 (2022), Journal Articles & Opinion Pieces IBFD.

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Under the second step, included in article 7 of chapter II, companies that have met the three gateways have to provide information about their substance in an annex to their tax return. The information to be submitted concerns the premises of the company, its bank accounts, as well as the tax residency of its directors and employees.

The main substance requirements of the Directive include a provision that at least one director be resident in the Member State of the undertaking or live close to that state. That director must be qualified to make relevant decisions regarding the business activities of the entity and to generate income or invest in assets. The director must actively and independently use their authorization and they may not be employed by a non-associated enterprise or be the director of such an entity. The latter requirement means that a directorship cannot be outsourced and that, in order to meet this requirement, a company must have at least one in-house director who makes relevant decisions.

Alternatively, the majority of employees must be resident in the Member State of the undertaking or live in the border region and must be qualified to carry out activities that generate relevant income.

The undertaking must have at least one bank account in the European Union and have premises in a Member State that are intended for its exclusive use.

Article 8 of chapter II concerns the third step, pursuant to which companies that declare that they meet all indicators of minimum substance will be presumed to have a minimum level of substance for the tax year. However, companies that do not meet one of the substance indicators or do not provide satisfactory supporting documentation are presumed to be a shell entity.

The fourth step is included in article 9 of chapter II and grants entities the possibility to rebut the presumption that they are a shell company. Those entities are then granted the chance to prove that they have substance and are not being used for tax abuse purposes. This can be done by presenting additional evidence, for example, concerning a commercial reason for their establishment, the profile of their employees and the fact that important decisions are being taken in their country of tax residence.

If the rebuttal succeeds, it may remain valid for a period of five years, provided the factual and legal circumstances of the company remain unchanged.

Under a fifth step, i.e. article 10 of chapter II, companies that pass the gateways of step one and have a lack of substance may still be relieved of the Proposed Unshell Directive obligations if they prove that they are being used for genuine business activities and that a tax motive is lacking. What is important is that the undertaking performed and continuously had control over, and bore the risks of, the business activities that generated the relevant income or, in the absence of income, the undertaking's assets.

A difficulty may be proof that a company bears the risk of the relevant income and can freely decide whether or not to distribute this income. This may result in disputes with tax administrations.

An exemption remains valid for five years, provided the factual and legal circumstances of the undertaking, including of the beneficial owner(s) and the group, remain unchanged.

The sixth step concerns the tax consequences arising when a company is classified as a shell company. Article 11 of chapter II of the proposal provides that, in that scenario, the entity will not be entitled to tax relief, the benefits of the treaty network of its country of residence and EU benefits, such as the EU Parent-Subsidiary Directive (2011/96)[11] and the EU Interest and Royalties Directive (2003/49).[12] This will be ensured by denying a tax residence certificate or by issuing a tax residence certificate specifying that it concerns a shell company. This could mean that the Luxembourg or Netherlands participation exemption will no longer apply because it constitutes implementation of the Parent-Subsidiary Directive. The Directive does not apply to payments to and by the shell company and income from the shell company will be taxed in the hands of its shareholders.

Another important issue is the denial of treaty benefits.[13] The Court of Justice of the European Union (ECJ) has repeatedly decided that secondary EU law, such as a Directive, supersedes tax treaties.[14] As a next step, however, national law has to apply the same rule, which is the case in Luxembourg and the Netherlands. Under the tax treaties that Luxembourg and the Netherlands have with other EU Member States, a denial of treaty benefits seems possible. All treaties that Luxembourg has signed with other EU Member States are covered by the Multilateral Instrument (MLI), which contains, as one of its minimum

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11. Council Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345/8 (2011), Primary Sources IBFD.
12. Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments Made Between Companies of Different Member States, OJ L 157 (2003), Primary Sources IBFD.
13. I. Panzeri, *Tax Treaties versus EU Law: Which Should Prevail?*, 61 Eur. Taxn. 4 (2021), Journal Articles & Opinion Pieces IBFD.
14. The leading case in this respect is IT: ECJ, 15 July 1964, Case C-6/64, *Flaminio Costa v. ENEL*, Case Law IBFD.

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standards, a provision on the denial of treaty benefits,[15] except for the tax treaties with Cyprus and France, which contain a principal purpose test instead. The MLI is not yet effective for the treaties with Bulgaria, Italy and Romania. The situation is slightly different for the Netherlands. The treaties with Bulgaria, Denmark and Ireland are not covered by the MLI, but those treaties contain a principal purpose test to deny treaty benefits. Spain is also not covered but the Netherlands intends to renegotiate the treaty, which should then contain an abuse provision. A treaty signed with Cyprus in 2021 is not yet effective and not covered by the MLI, but that treaty also contains a principal purpose test to deny treaty benefits.[16] Finally, the MLI is not yet effective for the treaty with Germany, which contains a provision allowing for the application of domestic abuse provisions.

Article 13 of chapter II of the Proposed Unshell Directive provides for automatic exchange of information of the company information received, which is the seventh and last step. This information will be exchanged within 30 days from the date the administration obtains such information. Based on article 15 of the Proposed Unshell Directive, Member States may request that another Member State conduct a tax audit if they believe that the entity has not met its obligations under the Directive.

Finally, the substance requirements of the Directive are a minimum standard because stricter domestic substance rules may be applied with the result that a company will be regarded as having no substance or as not being the beneficial owner of an income flow.

The scope of the Proposed Unshell Directive can be summarized as follows:

15. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (24 Nov. 2016), Treaties & Models IBFD.
16. Cyprus and the Netherlands signed a tax treaty on 1 June 2021 (not yet effective).

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Example 1

Figure 1 – Paying entity and ultimate beneficiary inside the European Union

In this scenario, France may apply its domestic withholding tax if it cannot identify whether the shareholders of the subsidiary are in the European Union. The Netherlands shell company, a Netherlands resident company, has to report the receipt of the payment and may provide evidence on the tax applied on the payment. The shell company may be taxed on the payment under domestic law, but if the conditions are met, the participation exemption may apply.

Based on article 11(2) of the Directive, the dividends are taxed in the hands of the German shareholder as if the payments were directly received by that shareholder. In addition, based on article 11 of the Directive, Member States other than the Member State where the shell company is established, have to disregard tax treaties with the country of the shell company.

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This means that if the French company is aware that the shareholder is a German resident, only the France-Germany Income and Capital Tax Treaty (1959) can be applied.[17] Germany may decide to grant treaty relief for the French withholding tax based on the treaty with France and a deduction will be granted for any tax paid by the shell company based on article 11(2) of the Directive.

Example 2

Figure 2 – Paying entity and ultimate beneficiary outside the European Union

17. *Convention between the Federal Republic of Germany and the French Republic for the Avoidance of Double Taxation and the Establishment of Rules for Reciprocal Administrative and Legal Assistance with Respect to Taxes on Income and on Capital, Business Tax and Land Tax* (21 July 1959), Treaties & Models IBFD.

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In this scenario, the domestic withholding tax rate applies or the withholding tax rate under the South Africa-United States Income Tax Treaty (1997)[18] if South Africa decides to treat the shell company as a look-through entity. The participation exemption may apply. The third country may tax the payment in accordance with its domestic law. It is not obliged to apply any consequences from the Directive, but may decide to provide relief under the treaty with the source jurisdiction and to grant relief for tax paid by the shell company.

18. *Convention between the Republic of South Africa and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains* (17 February 1997), Treaties & Models IBFD .

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Example 3

Figure 3 – Paying entity outside the European Union and ultimate beneficiary inside the European Union

In this scenario, Australia may apply its domestic tax on the outbound payment or decide to grant treaty benefits under the treaty with Spain if it regards the shell company as a look-through entity.[19] The Netherlands shell company is a Netherlands

19. *Agreement between Australia and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (24 March 1992), Treaties & Models IBFD.

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resident and, as such, has to report the receipt of the payment and may provide evidence on the tax applied on the payment. The Netherlands may decide to tax the income received by the shell company under domestic law but, under certain conditions, the participation exemption may apply. The payment is taxed in the hands of the Spanish shareholder because Spain will treat the payment as if it were directly received by the shareholder based on article 11(2) of the Directive. Treaty relief under the Australia-Spain Income Tax Treaty (1992) may be granted. Finally, a deduction will be granted for the tax paid by the shell company, based on article 11(2) of the Directive.

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Example 4

Figure 4 – Paying entity inside the European Union and ultimate beneficiary outside the European Union

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In this scenario, the Italian subsidiary will apply its domestic withholding tax or apply the withholding tax rates under the Canada-Italy Income Tax Treaty (2002).[20] The Netherlands shell company will normally be subject to tax in the Netherlands but, under certain conditions, the participation exemption may apply. In addition, the shell company has to report the receipt of the payment and may provide evidence on the tax applied on the payment. Upon redistribution to the Canadian shareholder, treaty relief will be granted. The Canadian shareholder will be taxed on the dividends and may be entitled to treaty benefits under the Canada-Italy Income Tax Treaty (2002). Furthermore, Canada may decide to grant relief for the tax paid by the shell company.

From the above examples, it appears that shell companies with a lack of substance can be ignored by the EU country of the shareholder. That country has to grant a deduction for the tax paid by the shell company. This, nevertheless, leads to the risk of double taxation because it is unclear whether or not the deduction will be sufficient to neutralize the risk of double taxation, as limitations may apply. If the country of the shareholder is outside the European Union, it is unclear whether that country will grant relief for the tax paid by the shell company.

Also, a minimum penalty for non-compliance will be introduced in line with domestic law. Article 14 of the Proposed Unshell Directive provides that the administrative penalty should be equal to at least 5% of the turnover in the relevant tax year of companies that have to report a lack of substance based on article 6 of the Directive. This penalty applies if the reporting is not made when filing the annual tax return or when a false declaration is made.

3. Reasons for Establishing a Conduit Company in Luxembourg and the Netherlands

3.1. Introductory remarks

The Directive, amongst others, targets Luxembourg and the Netherlands because the tax systems of both countries offer attractive features for establishing a conduit company.

3.2. Withholding taxes

Both countries generally do not impose a withholding tax on outbound interest and royalties.[21] Both states only impose a 15% withholding tax on dividends, which is often reduced under tax treaties for qualifying dividends.

This advantage is complemented by a very good treaty network. Luxembourg currently has 85 tax treaties and, with few exceptions, the withholding tax rates on interest and royalties mostly vary between 0% and 10%. This means that interest and royalties can enter Luxembourg from a third country at a low withholding tax rate and be redistributed tax exempt. For portfolio dividends, the treaty rate is usually 15% while, for qualifying dividends, the rate mostly varies between 0% and 10%.

In order to qualify for treaty benefits, a company must be a resident. Only in that scenario will the reduced treaty withholding tax rates apply. A company is deemed to be resident in Luxembourg if its statutory seat or place of effective management is established there. Such companies are treated as a resident taxpayer in respect of dividends, interest and royalties received even if they have little substance, unless the place of residence is allocated to another state by the tiebreaker rule of a tax treaty. Such a company can obtain a certificate of residence and, as a result, benefit from treaty benefits.

The Netherlands currently has 95 tax treaties and, with few exceptions, the withholding tax rates on interest and royalties also typically vary between 0% and 10%. As in the case of Luxembourg, this implies that interest and royalties can enter the Netherlands at a low rate and be redistributed tax exempt. For this reason, for instance, many artists have established a conduit company in the Netherlands.

The Netherlands treaty policy was always to agree on low withholding tax rates under its tax treaties because the withholding of tax after the imposition of profits tax could result in double taxation.[22] As a result, the Netherlands aims to agree on a 15% rate for portfolio dividends and a 0% rate on qualifying dividends, interest and royalties.

In order to qualify for treaty benefits, a company must be a resident. Only in that case will the reduced treaty withholding tax rates apply. All companies that are established under Netherlands law are deemed to be resident in the Netherlands unless deemed to be resident in the other treaty state under the tiebreaker rule of a tax treaty, for example, when the central

20. *Convention between the Government of Canada and the Government of the Italian Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion* (3 June 2002), Treaties & Models IBFD.
21. From 2021, in related company situations, a conditional withholding tax on interest and royalties may apply in the Netherlands, which will be elaborated on in sec. 6.5.2.
22. NL: *Notitie Fiscaal Verdragsbeleid 2020* [Netherlands treaty policy Memorandum 2020], para. 4.5, available at https://open.overheid.nl/repository/ronl-c4bb77ba-23c2-4156-af23-0592804b05a6/1/pdf/Notitie%20Fiscaal%20Verdragsbeleid%202020.pdf.

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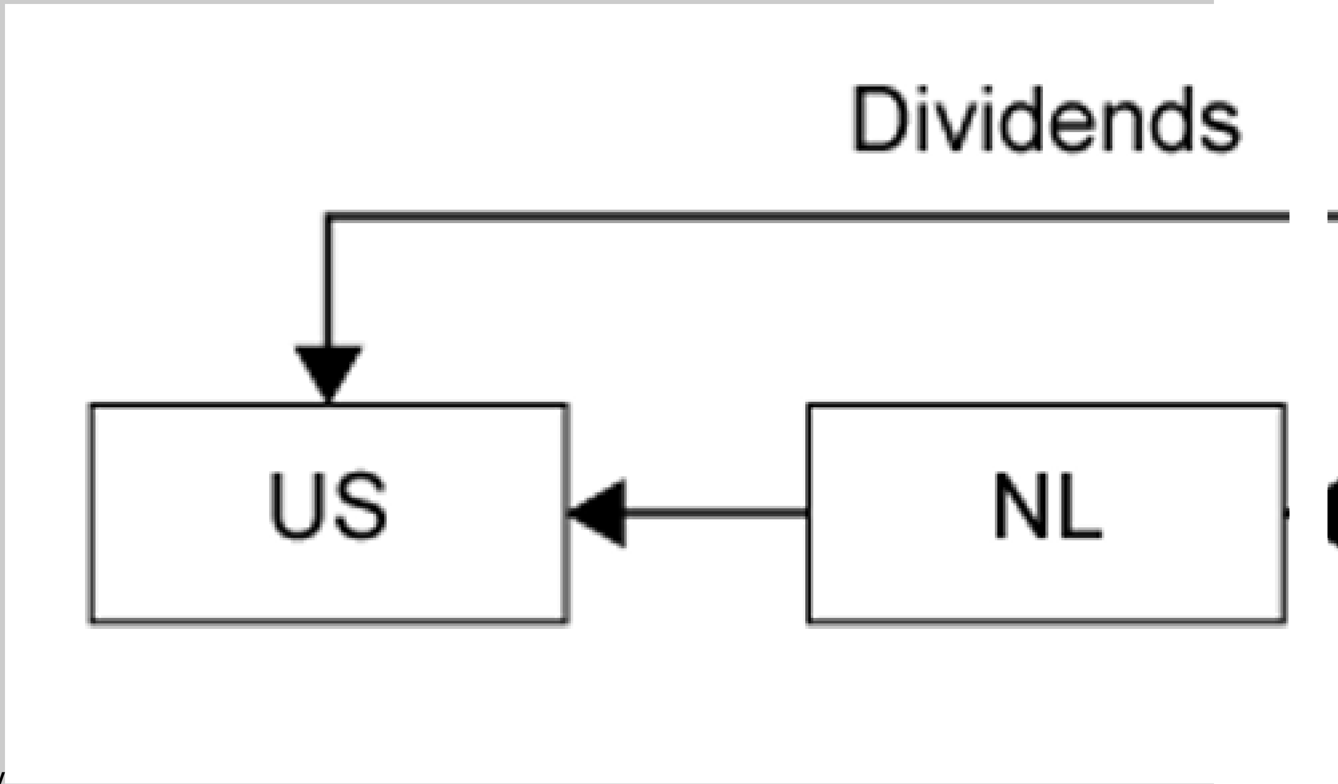
management is exercised there.[23] A conduit company is deemed to be resident, for treaty purposes, in the Netherlands despite having limited substance if the management takes place in the Netherlands, generally at least 50% of the directors are resident in the Netherlands and the meetings of the board of directors are held there. In that case, the Netherlands tax administration will, in principle, issue a residence certificate for the conduit company.

Other countries do not generally want to claim that a conduit is resident therein because the revenue from such entities is limited and a credit must be granted for foreign withholding tax in any event. Only the source country of the dividend, interest and royalty payments has an interest in disputing the place of residence of the conduit because, in that scenario, it may apply a higher domestic withholding tax rate than the treaty rate. If the treaty does not contain an abuse provision, it is very difficult to combat treaty abuse.

This means that such companies, in principle, are entitled to treaty benefits if they are the beneficial owner of the dividends, interest and royalties received. This is the case if they are not under an immediate obligation to redistribute the payments received and can freely dispose of those payments. As a result, the interposition of a Luxembourg or Netherlands conduit often results in lower taxation than when dividends, interest or royalties are paid directly from Country A to Country B.

Example 5

Figure 5 – Dividend withholding tax reduction by interposing a Netherlands company



Qualifying dividends are, under the China-Netherlands Income Tax Treaty (2013),[24] taxed at a rate of 5% and, under the Netherlands-United States Income Tax Treaty (1992), at a rate of 0% in respect of an 80% shareholding. Furthermore, the Netherlands applies its participation exemption to inbound dividends. Under the China-United States Income Tax Treaty (2013), the withholding tax on dividends is always 10%. Interposing a Netherlands conduit, therefore, saves 5% withholding tax.

23. This is based on NL: Corporate Income Tax Act 1969 [*Wet op de vennootschapsbelasting* 1969], art. 2(4).
24. *Agreement between the Government of the Kingdom of the Netherlands and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (31 May 2013), Treaties & Models IBFD.

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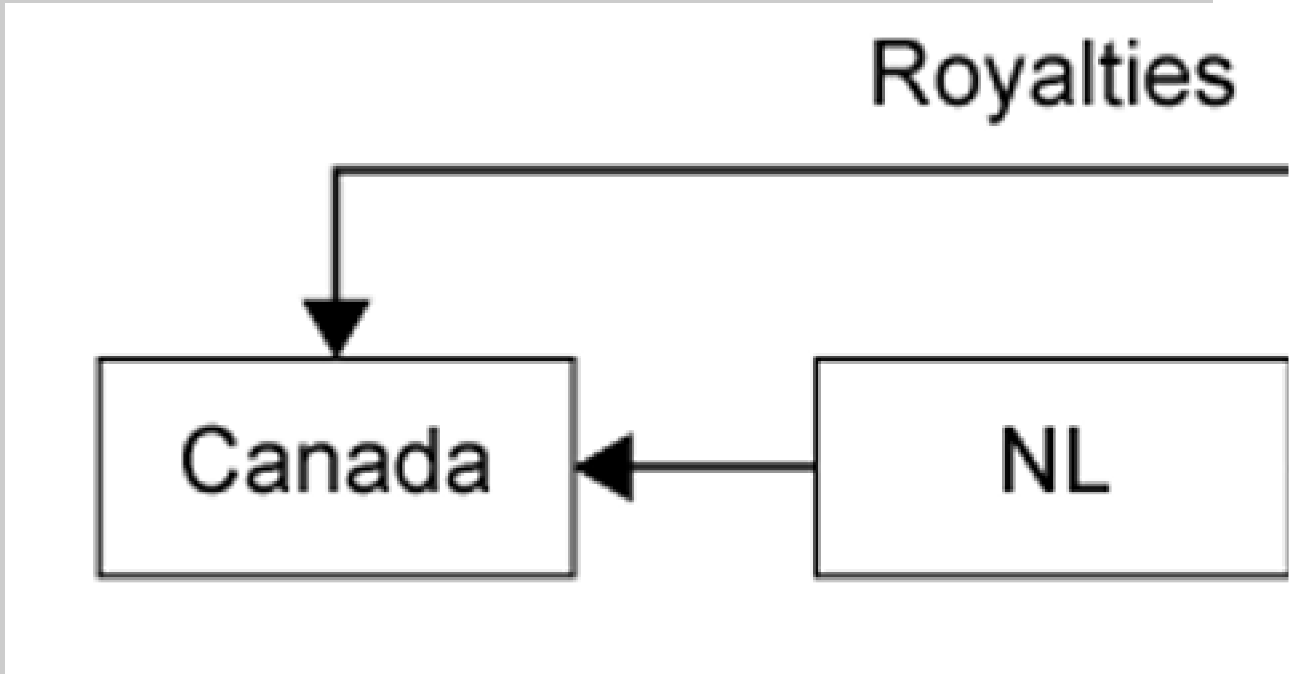
Due to the combination of the Netherlands tax treaty network, the EU participation exemption and international tax restructuring, the dividend withholding tax rate can often be reduced to 0%.

The same effect can be realized in respect of interest and royalties.

Example 6

Figure 6 – Royalty withholding tax reduction by interposing a Netherlands company



The withholding tax rate on royalties under the Japan-Netherlands Income Tax Treaty (2010)[25] is 0%. Outbound royalties are not taxed. No withholding tax is due on royalties paid to Canada. If the payments are made directly from Japan to Canada, 10% withholding tax is due. Interposing a Netherlands conduit, therefore, results in a 10% withholding tax saving.

3.3. Participation exemption

In addition, both countries have a participation exemption under which inbound and outbound dividends are exempt if certain conditions are met.

3.3.1. Luxembourg

Luxembourg grants the participation exemption if, for a period of at least 12 months, a minimum participation of 10% is maintained in a subsidiary or a participation with an acquisition price of at least EUR 1.2 million (EUR 6 million for capital gains) in the capital of the subsidiary.[26] No substance requirements apply, but, under the general anti-abuse rule, artificial arrangements can be disregarded or reclassified.

Under the participation exemption, inbound dividends are fully exempt if they are received from a non-resident subsidiary that is subject to a tax comparable to the corporate income tax applicable in Luxembourg or a company resident in an EU Member State and referred to in article 2 of the Parent-Subsidiary Directive (2011/96). The tax authorities generally consider that a foreign tax is comparable to the corporate income tax applicable in Luxembourg if the rate of the foreign tax is at least

25. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (24 Nov. 2016), Treaties & Models IBFD and the *Synthesised Text of the MLI and the Convention between Japan and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (25 August 2010), Treaties & Models IBFD.
26. *See*, generally, R.H.M.J. Offermanns, *Luxembourg – Corporate Taxation – Country Surveys* secs. 2.2 and 6., Country Tax Guides IBFD (accessed 25 Mar. 2022).

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8.5% and the tax base is computed on the basis of criteria that are comparable to the criteria applicable in Luxembourg. The participation exemption does not apply if the dividends are tax deductible in the country of the paying company.

For outbound dividends paid to a company resident in an EU Member State and referred to in article 2 of the Parent-Subsidiary Directive (2011/96), an EEA Member State, Switzerland or country resident in a country with which Luxembourg has a tax treaty, dividend payments are exempt under the same conditions if the receiving company is fully subject to tax, i.e. corporate income tax or profit tax is imposed at a rate of at least 8.5% and levied on a comparable tax base.

3.3.2. Netherlands

The Netherlands grants the participation exemption in respect of inbound dividends, other profit distributions, currency gains (or losses) and capital gains (or losses) upon the disposal of a qualifying participation or part thereof if the recipient Netherlands company retained a 5% shareholding in a domestic or foreign subsidiary.[27] No holding period applies. Furthermore, the participation must be held for business reasons and may not be kept as a mere investment and the receiving company or permanent establishment (PE) located in the Netherlands must be fully subject to tax. The business reason requirement means that the participation must aim to realize a profit that exceeds mere profit management. A participation is not deemed to be kept as a mere investment if a direct link exists between the activities of the parent company and the subsidiary or when the parent company has a chain function or acts as a top holding. No real significant presence in the Netherlands is required.

If the participation is held as an investment, the exemption nevertheless applies if not more than 50% of the subsidiary's assets typically consist in portfolio investments that do not have a business function. Participations of less than 5% in the capital or voting rights are classified as portfolio investments. The exemption also applies when a subsidiary, 50% or more of the assets of which consist in portfolio investments, is taxed in its state of residence at a statutory rate of at least 10%. This subject-to-tax test is not met if the tax base is very small or the subsidiary benefits from a preferential regime.

The participation exemption ensures that Netherlands companies can compete in foreign countries under the same fiscal conditions as resident companies of that country.

Outbound dividends may be exempt if paid to a company resident in an EU Member State and referred to in article 2 of the Parent-Subsidiary Directive (2011/96), an EEA Member State, Switzerland or a country with which the Netherlands has a tax treaty.

3.4. Ruling practice

Until a few years ago, it was very easy to obtain a ruling in both countries that provided certainty about the application of tax provisions for a number of years.

3.4.1. Luxembourg ruling practice

Until 2015, it was very easy to obtain a ruling on a case-by-case basis. The Luxembourg ruling practice significantly changed in 2015 after LuxLeaks, which brought to light numerous tax avoidance schemes.[28] The tax ruling practice was then codified in article 29a of the Corporate Income Tax.[29] Rulings are now only granted for a maximum period of five years for tax ruling requests concerning the application of Luxembourg domestic and international tax law to one or more specific transactions that are envisaged by the taxpayer requesting the tax ruling. The aim of this codification was to make the practice more transparent and ensure that, in the event the ruling is denied, no recourse is available.[30]

A ruling can still be obtained on the tax treatment of a future transaction or the determination of whether a transaction is at arm's length but no advance certainty can be obtained with respect to the taxable profits derived from inbound and outbound payments.

3.4.2. Netherlands ruling practice

The Netherlands ruling practice, for decades, was based on a General Decree and various related Decrees providing for specific rulings.[31] All standard rulings, however, were abolished in 2001, which meant that tailor-made advance tax rulings and advance pricing agreements could only be issued on a case-by-case basis. Such standard rulings, amongst others, addressed issues regarding the consequences of moneylending, which made the Netherlands an attractive conduit country.

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27. *See*, generally, M. Schellekens, *Netherlands – Corporate Taxation – Country Surveys* secs. 2.2. and 6., Country Tax Guides IBFD (accessed 25 Mar. 2022).
28. P. Mischo & F. Kerger, *After 'Lux Leaks' : welcome changes to Luxembourg's tax ruling practice*, 77 Tax Notes Intl. 13, pp. 1197-1201 (2015).
29. LU: Loi du 4 Décembre 1967 concernant l'impôt sur le revenu [Income Tax Law of 1967], as amended [hereinafter ITL].
30. LU: Law of 19 December 2014 on the pact for the future – first part (2015) [Loi du 19 décembre 2014 relative à la mise en œuvre du paquet d'avenir – première partie (2015)]), Official Gazette 257 (24 Dec. 2015).
31. NL: State Secretary for Finance Letter of 17 Feb. 1995 , no. DB95/761M.

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In 2019, the Netherlands ruling practice, however, was significantly modified.[32] One of the most important features of the new Netherlands ruling practice concerns the economic nexus requirement. In order to obtain a ruling, a company must carry out economic activities in the Netherlands in circumstances in which the Netherlands resident company is responsible for the accounting and assumes the risks. What is decisive is that the number of staff and the level of operating costs reflect the functions of the enterprise. In deciding on a ruling request, the tax administration will monitor which countries the money flows are coming from, which activities are carried out in the Netherlands and to which countries the money flows. Pure conduit companies that are established in the Netherlands mainly for tax saving reasons can no longer obtain a ruling. Furthermore, a ruling will be denied in respect of structures involving a non-cooperative territory or a low-tax country. Rulings will, generally, be granted for a period of five years.

Due to the economic nexus requirement, conduit companies can only obtain an advance tax ruling if the requesting entity is part of a group that operates in the Netherlands on a commercial basis. Second, the operational activities must be at the expense and risk of the requesting party. Finally, there must be sufficient relevant personnel present at the corporate level in the Netherlands to carry out the commercial operations.

An advance tax ruling will not only be denied in the event of insufficient economic nexus with the Netherlands, but also if obtaining a tax savings in the Netherlands or a foreign country is one of the main aims of a transaction or structure or when a low-tax jurisdiction is involved.

3.5. Company law

The main non-fiscal factors for establishing a (conduit) company in Luxembourg and the Netherlands are a reliable (digital) infrastructure, a well-trained workforce, efficient and predictable regulations, legal and political systems that provide security and stability and a large and sound legal infrastructure.

Effective 1 October 2012, the rules for establishing a limited liability company have been simplified in the Netherlands. A company can be incorporated quickly and its corporate structure can easily be amended. There is no longer a minimum capital required (previously, an amount of EUR 18,000 had to be contributed). With regard to contributions in kind, an auditor statement is no longer required.

It is possible to issue shares with a low nominal value or without a profit or voting right, or even with more than one voting right. Furthermore, the profit and voting rights with respect to shares can be split. In that scenario, the voting rights are transferred to a trust office foundation (*stichting administatiekantoor*) while the owner of the shares remains entitled to the profit rights and dividends.

It is also possible to issue different types of shares with different voting rights. It is relatively easy to implement capital changes, such as share premium payments, cancellations and repurchases of shares. Interim dividends may be distributed. The management board can be authorized to issue shares over a longer period.

Luxembourg company law provides for the incorporation of a simplified limited liability company that has comparable flexibility, but such a company may only be used to exercise the profession of a craftsman, merchant or manufacturer, as well as certain liberal professions.[33] The paid-up capital must be between EUR 1 and EUR 12,000.

3.6. Investment protection agreements

Both Luxembourg and the Netherlands have signed more than 90 investment protection agreements (IPAs) to protect investments in foreign countries. Those IPAs provide for non-discrimination, the right of reasonable and fair treatment and a provision that compensation has to be paid in the event of expropriation.[34]

4. Tax Measures in Luxembourg Affecting Conduit Companies

4.1. In general

As a result of the BEPS reports from 2015, such as Action 5 on Countering Harmful Tax Practices[35] and the Anti-Tax Avoidance Directive (2016/1164) (ATAD 1),[36] Luxembourg has introduced various tax measures to combat abuse, such as

32. R. Betten, *Announcement of New Tax Ruling Practice*, 26 Intl. Transfer Pricing J. 2 (2019), Journal Articles & Opinion Pieces IBFD.
33. LU: Company Law Code, arts. 720-1 to 720-6.
34. The investment protection agreements with the EU Member States will be abolished because, in DE: ECJ, 6 Mar. 2018, Case C-284/16, *Slovak Republic v. Achmea BV*, ECLI: EU:C:2018:158, the ECJ held that the dispute settlement provisions in investment protection agreements concluded between EU Member States are incompatible with EU law.
35. OECD/G20, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Action 5: 2015 Final Report* (OECD 2015), Primary Sources IBFD.

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increased substance rules, CFC rules and rules providing for the non-deductibility of interest and royalties. Finally, aggressive planning structures must be reported to the Luxembourg tax administration based on the Amending Directive to the 2011 Directive on Administrative Cooperation [on reportable cross-border arrangements] (2018/822) (DAC6).[37] Many of those measures impact conduits.

4.2. Substance rules

For the substance rules to apply, a company must be deemed to be a resident of Luxembourg. This is the case if its statutory seat or its central administration, i.e. its place of effective management, is located in Luxembourg.[38] Under Luxembourg tax treaties, the state of residence of a company is the state where its place of effective management is located. This means that all important strategic and commercial decisions should be taken in Luxembourg.

Substance rules were, first, clearly described in a circular of 27 December 2016 on group finance companies.[39] This Circular explains that a company is deemed to have sufficient substance if the following criteria are met:

- the majority of the managing directors that have the power to bind the company towards third persons are resident in Luxembourg. Non-resident managers also qualify if they carry out their professional activity in Luxembourg and are taxed in Luxembourg on at least 50% of their professional income. The manager may also be a company that has its statutory seat and head office in Luxembourg;
- the directors must have sufficient knowledge to exercise their functions;
- the majority of the meetings of the board of directors must take place in Luxembourg;
- a company must have sufficient employees to carry out its activities in Luxembourg, including the execution and registration of company transactions. Auxiliary activities, which do not have a significant impact on risk management, may be outsourced;
- the important company decisions must be taken in Luxembourg and at least one general shareholders' meeting must be held annually in Luxembourg;[40]
- the company may not be a tax resident of another country;
- all substantive documentation, including books must be retained in Luxembourg;
- books and records (including detailed minutes) must be kept in Luxembourg;
- signatories to the company's bank accounts must be Luxembourg tax resident directors/persons who are authorized to manage the bank accounts without requiring the approval of non-Luxembourg tax resident directors;
- the company must have a bank account in Luxembourg; and
- the premises must be owned/leased solely for the company (and associated/group entities) and be appropriately equipped with office furniture and equipment and staffed with adequate personnel.

What is decisive is that the company has a sufficient infrastructure, including employees and premises, facilities and equipment.[41] Substance can also be shown through a website, an e-mail address and a business card. Certain activities, including day-to-day management, may be outsourced to qualified Luxembourg service providers, for example, accounting, tax and legal services. In that scenario, the directors and/or staff of the Luxembourg company must monitor the execution of such activities.

With respect to corporate governance, it is vital that important company decisions be taken in Luxembourg, mostly by Luxembourg directors and those decisions must be properly monitored there. Finally, there must be commercial and legal reasons for establishing a company in Luxembourg.

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36. Council Directive 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market, OJ L 193/1 (2016), EU Law IBFD.
37. Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as Regards Mandatory Automatic Exchange of Information in the Field of Taxation in Relation to Reportable Cross-Border Arrangements, OJ L 139 (2018), Primary Sources IBFD.
38. Art. 159 ITL.
39. LU: *Circulaire L.I.R. 56/1-56bis/1* on the taxation of group finance companies.
40. The obligation to organize an annual shareholders' meeting is based on the Company Law Code.
41. For an extensive description of the Luxembourg substance requirements, *see* O.R. Hoor, *The concept of substance in a post-BEPS world*, 95 Tax Notes Intl. 7, pp. 593-606 (2019).

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The Luxembourg substance requirements are more onerous than those of the Proposed Unshell Directive because both the director and employee requirement must be met, while, under the Proposal, these are in the alternative. In addition, the Directive does not contain a bookkeeping requirement and is silent about the organization of board meetings.

4.3. ATAD 1

As required by ATAD 1, Luxembourg, with effect from 2019, has introduced various anti-abuse measures.

4.3.1. The Luxembourg GAAR

Before 2019, the Luxembourg GAAR allowed for transactions that were considered fictitious under the simulation principle to be ignored or reclassified. Consequently, a legal act or an action was ignored for tax purposes if it was considered to be simulated. In that scenario, a legal act was reclassified and taxation was based on the real legal act. Such reclassification also took place when a transaction was considered to be purely tax driven under the abuse of law principle.[42] Consequently, tax avoidance could not be realized through legal forms or structures based on civil law.

Under ATAD 1, the GAAR has been replaced by a new provision. Under this provision, abuse of law occurs if a specific legal route is selected for the main purpose of obtaining a tax advantage that is not genuine considering all the relevant facts and circumstances of the case concerned. The chosen legal route is regarded as non-genuine to the extent that it is not put into place for valid commercial reasons that reflect economic reality. This could imply that the interposition of a conduit company that lacks substance, the purpose of which is to mitigate taxes, can be ignored.

4.3.2. CFC legislation

Another important anti-abuse measure concerns the introduction of the controlled foreign company (CFC) legislation in 2019. This legislation, which does not specifically target conduit companies, attributes the non-distributed income of an entity or PE that qualifies as a low-taxed CFC to its Luxembourg parent company or headquarters if the non-distributed income arises from non-genuine arrangements that have been put into place for the essential purpose of obtaining a tax advantage.

The CFC legislation applies to entities in which a Luxembourg parent holds a 50% direct (or indirect) participation, ownership interest or entitlement in respect of voting, capital rights or profits. A CFC is regarded as low-taxed if the corporate income tax rate is the equivalent of less than 50% of the Luxembourg corporate income tax rate. This is currently 50% of 17%, i.e. 8.5%.

Foreign entities with an accounting profit of less than EUR 750,000 or with accounting profits not exceeding 10% of their operating profits during a taxable period are excluded from the scope of the CFC rules.

4.4. Non-deductibility of interest and royalties

From 1 March 2021, interest and royalties paid or owed to a related enterprise established in a country or territory included in the EU list of non-cooperative countries and territories are no longer tax deductible.[43] The term “interest” in this respect means interest and arrears due in respect of claims of any kind, whether or not secured by a mortgage or a clause regarding participation in the debtor’s profits, in particular, interest and arrears on debt obligations, including premiums and prizes attached to such securities. Penalties for late payment are considered interest within the meaning of this bill.

The term “royalties” used in this context means remuneration of any kind due for the use or granting of the use of a copyright in a literary, artistic or scientific work, including a cinematographic film, patent, trademark, secret design, plan, formula or process and for information relating to experience acquired in the industrial field, whether commercial or scientific. This definition is the same as under the OECD Model (2017).[44]

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42. This principle was included in LU: Tax Adaption law [Steueranpassungsgesetz], art. 6.
43. Currently, this list includes American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, the US Virgin Islands and Vanuatu. The latest list was published by the European Commission on 24 Feb. 2022, available at https://www.consilium.europa.eu/en/press/press-releases/2022/02/24/taxation-council-reviews-list-of-non-cooperative-countries-for-tax-purposes/ (accessed 5 May 2022). Non-deductibility was introduced by LU: Law of 10 February 2021 modifying the law of 4 December 1967 on the income tax [Loi du 10 février 2021 portant modification de la loi modifiée du 4 décembre 1967 concernant l’impôt sur le revenu], Official Gazette A 108 (11 Feb. 2022). The bill resulted from recommendations by the Code of Conduct Group that were approved by the European Council on 5 Dec. 2019, available at https://data.consilium.europa.eu/doc/document/ST-14115-2019-INIT/en/pdf and Economic and Financial Affairs Council meeting of 5 Dec. 2019, available at https://www.consilium.europa.eu/en/meetings/ecofin/2019/12/05/ (accessed 5 May 2022).
44. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.

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4.5. DAC6

DAC6 was implemented by a law of 25 March 2020.[45] The Directive obliges intermediaries or relevant taxpayers to report cross-border aggressive tax planning structures. Reportable structures are listed under certain categories of hallmarks set out in the Directive.

Hallmark 3b of this Directive targets schemes that include circular transactions involving funds passing through interposed entities without a primary commercial function or transactions that offset or cancel each other out or have other similar characteristics. This hallmark is implemented by way of an annex to the law and may also target pure conduit companies that are not established for commercial reasons, but are mainly interposed for tax savings reasons. In these circumstances, after a favourable tax treatment is obtained, payments return to the Member State of origin.

This hallmark applies when a main benefit test is met. In guidance on the law, the Luxembourg administration has announced that the main benefit test is not met when the main benefit obtained from an arrangement, based on the entirety of its components, is in line with the object and purpose of the legislation or consistent with the intention of the legislator.[46]

In determining whether or not the structure in question complies with this intent, all of the components of the structure must be taken into consideration. This means that a structure that, considered as a whole, does not meet this intent, still meets the main benefit test if special features of a tax system are used, or if inconsistencies between two or more tax systems are relied on in order to reduce tax payable. No clarifications have yet been provided, however, in relation to the practical application of any of the hallmarks linked to the main benefit test.[47]

5. Luxembourg Reaction Concerning the Proposed Unshell Directive

In a reaction to the Proposed Unshell Directive, the Luxembourg Minister of Finance indicated that Luxembourg supports measures to combat abuse. They regard the Proposed Unshell Directive, however, as disproportionate.[48] The Minister takes the view that, in the context of the large number of anti-abuse measures introduced in recent years, the proposal does not offer much added value, as the existing measures already combat abuse and the use of structures for tax purposes to a significant extent. The proposal is disproportionate, as the scope is overly broad. This could result in impediments to entering the Luxembourg market and restrictions that could impact the EU internal market in a negative manner and consequently reduce the competition capacity of the European Union with third counties. Therefore, Luxembourg would prefer to introduce a more proportionate and useful measure.

6. Tax Measures in the Netherlands Affecting Conduit Companies

6.1. In general

As a result of the international measures mentioned in section 4 and the fact that the Netherlands position as a conduit has negatively impacted its image, the Netherlands has taken various measures to reduce its attractiveness to conduit companies. These measures are quite similar to those of Luxembourg, but the Netherlands started the process earlier.

The changes to the Netherlands ruling practice was already explained in section 3.3.2.

6.2. Substance requirements in the Netherlands

In an attachment to a letter of 25 June 2012, the State Secretary for Finance indicated that the substance of companies refers to recognition/visibility on account of ownership, the use of tangible assets, or staff. With regard to agreements or facts, this means “economic reality” as opposed to what appears on paper, similar to the substance-over-form doctrine.[49] This means that a company is assessed according to its ownership and use of tangible assets and the functions that individuals perform on the account of and at the risk of that company. Under tax treaties, ownership plays an important role because it is used

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45. LU: Law of 25 March 2020 concerning reportable cross-border constructions [Loi du 25 mars 2020 relative aux dispositifs transfrontières devant faire l’objet d’une déclaration], Official Gazette no. A 192 (26 Mar. 2020).
46. Clarifications concerning the law of 25 March 2020 on reportable cross-border arrangements [Précisions concernant l’implémentation de la loi du 25 mars 2020 relative aux dispositifs transfrontières devant faire l’objet d’une déclaration] (12 Feb. 2021 version), available at https://impotsdirects.public.lu/dam-assets/fr/echanges-electroniques/dac6/Precisions-concernant-l-interpretation-de-la-loi-du-25-mars-2020-Version-PDF-20210212-.pdf.
47. For further details on the main benefit test, *see* R.H.M.J. Offermanns & R. Botelho Moniz, *DAC6 in a Selection of EU Member States: The Practical Application of the Main Benefit Test and Its Hallmarks*, 61 Eur. Taxn. 6 (2021), Journal Articles & Opinion Pieces IBFD.
48. Published text of the Ministry of Finance of 10 February 2022 of an interview of the Luxembourg Minister of Finance with newsmagazine Telecran, *Ein Strauß an Vorteilen* [A bunch of advantages] (10 Feb. 2022), available at https://mfin.gouvernement.lu/fr/actualites.gouvernement%2Bde%2Bactualites%2Btoutes_actualites%2Binterviews%2B2022%2B02-fevrier%2B10-backes-telecran.html (accessed 5 May 2022).
49. NL: State Secretary for Finance Letter of 25 June 2012, no. IFZ/2012/85U.

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in determining residence and an arm's length price, as well as the application of limitation on benefits and main purpose test provisions.

In a letter of 3 March 2015, the State Secretary for Finance indicated that:

> Substance refers to the nexus which a company has with the country in which it is established, so the level of connection it has with that country. Within a corporate structure and between different corporate structures, differences may occur in the form of the various activities.[50] For example, a factory will normally have more assets and staff than a company with predominantly administrative activities. Enterprises that need more staff or more fixed assets are typically less mobile and, in choosing their location, taxation may play a less important role. With regard to more mobile activities, taxation may play a bigger role. "Substance poor" means that a company has little nexus with the pertinent country. When a company is "substance rich", it will instead have stronger ties. [Author's translation.]

The substance requirements were first included in various Decrees on entities with intra-group financial service activities. The first Decrees were issued in 2001 and were updated and replaced in 2004 and 2014.[51]

In order to obtain a tax ruling, service companies, at that time, had to meet the following cumulative requirements:

- at least half of the total number of statutory directors with decision-making powers had to reside or be effectively domiciled in the Netherlands. For this requirement, the decision-making powers of the director or directors resident/domiciled in the Netherlands must have been at least equivalent to those of the director or directors resident/domiciled abroad;
- the board members resident or domiciled in the Netherlands had to have the requisite professional knowledge to properly perform their duties. Those duties were to include, at least, decision-making, based on their own responsibility within the framework of a company group, regarding any transactions to be entered into by the entity, as well as ensuring that the transactions entered into were properly handled. Taking care of day-to-day management was not enough to satisfy this requirement. In addition, the board's responsibility must have concerned the legal settlement of transactions, management of the loans and the associated risks, and the execution of transactions;
- the entity had to have qualified personnel at its disposal to adequately perform and register the transactions to be entered into by the entity itself;
- the board decisions had to be taken in the Netherlands. This condition required that regular board meetings were physically held in the Netherlands, during which (important) board decisions were made;
- the entity's key bank accounts had to be maintained in the Netherlands. This meant that both the entitlement to and the decision-making powers with respect to the key bank accounts must have been vested in the Netherlands entity;
- the bookkeeping must have been kept and maintained in the Netherlands. This condition was satisfied if the bookkeeping and the associated administrative work was physically performed and physically present in the Netherlands;
- the entity had to, until the moment of testing at least, correctly comply with all of its tax filing requirements including corporate income tax, wage tax and/or VAT; and
- the entity's registered address had to have been in the Netherlands and, to the company's best knowledge, the entity could not have been considered to (also) be a resident for tax purposes in any other country.

For ruling requests pertaining to the application of the participation exemption, an additional condition was that the requesting party must have financed the cost of the participation(s), for which an ATR was requested, with equity of at least 15%.

Substance requirements were, for the first time, codified in the Netherlands in 2014.[52] This codification contained the current minimum substance requirements for resident corporate taxpayers subject to corporate income tax, the activities of which mainly (i.e. 70% or more) consist of (in)directly receiving (and paying) interest, royalties, rent or lease payments from (to) non-resident entities that are part of the group to which the taxpayer belongs. It mainly targets financial service companies.

Whether or not a Netherlands resident company is mainly involved in those activities is, inter alia, determined on the basis of the composition of its assets and liabilities, the composition of its turnover, the actual activities carried out and the time allocation of the employees.

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50. NL: State Secretary for Finance Letter of 3 March 2015, no. IZV/2015/170.
51. NL: Decree of 30 March 2001, no. IFZ2001/294M on service companies (*dienstlichamen*), as amended by NL: Decree of 11 August 2004, no. DGB2004/1338M and Decree of 12 June 2014, no. DGB 2014/3101. The special Decree for service companies was abolished on 1 July 2019 as a result of significant amendments to the Netherlands ruling practice.
52. NL: Implementing Decree on Assistance in International Tax Matters [Uitvoeringsbesluit Wet Internationale Bijstand in Belastingzaken], art. 3a.

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The substance requirements are as follows:

- at least half of the statutory board members with decision-making powers must reside in the Netherlands;
- these board members must possess the required knowledge, in short, to execute their tasks;
- there must be qualified staff to execute and register the taxpayers' activities;
- the board decisions must be taken in the Netherlands;
- the key bank accounts must be held in the Netherlands;
- the accounting records must be kept in the Netherlands;
- the address of the taxpayer must be in the Netherlands;
- the taxpayer must, to his knowledge, be a tax resident of another country;
- the taxpayer must assume real risks as regards the loans or royalty/rental/lease agreements; and
- the taxpayer must hold an amount of equity commensurate with the real risk he runs.

Companies have to declare whether or not they meet these requirements. If not, they must provide an overview of the interest, royalty, rental and lease payments received, in respect of which the taxpayer has requested, or could still request, the application of:

- a provision for the elimination of double taxation (for example, a tax treaty);
- the EU Interest and Royalties Directive (2003/49); or
- a national provision implementing the Interest and Royalties Directive.

In 2018, the same conditions were included in the Corporate Income Tax Act.[53]

Effective 2014, the Netherlands spontaneously exchanges information with other countries regarding (financial) service companies with a lack of substance to avoid the abuse of tax treaties and EU directives. The other treaty state can then refuse to apply the treaty withholding tax rates on the basis that the (financial) services company is not the beneficial owner of the dividends and interest or it can apply an abuse provision, such as the principal purpose test.

If such a company claims avoidance of double taxation, the Netherlands will spontaneously provide the necessary information regarding the taxpayer to the relevant treaty partner or EU Member State. This could result in a loss of treaty benefits.

Another important step with respect to the required substance was taken on 7 November 2016, when the government decided to tighten the conditions for obtaining advance tax rulings by adding the following conditions:[54]

- a requirement for a minimum expense amount, which serves as an indicator of presence in the Netherlands;
- a requirement for a minimum number of employees; and
- an increase in the 15% minimum amount of equity currently required for international holding companies.

In addition, the existing spontaneous exchange of information for service companies was expanded to all holding companies. This means that all holding companies established in the Netherlands with a lack of substance now bear the risk that they will no longer enjoy tax treaty benefits. Holding companies now must have sufficient substance to obtain an advance tax ruling and to qualify for tax treaty benefits.

Another important aspect concerns the treatment of international (financial) service companies. Treaty partners are obliged to apply the withholding tax rates on interest and royalties to such companies resident in the Netherlands if those companies are the beneficial owners. In order to qualify for the treaty benefits, financial companies have to meet a risk requirement test. Since 2002, a genuine risk has existed if the company maintains sufficient equity to cover its risks and this equity is at least the lesser of 1% of its outstanding loans or EUR 2 million.[55] This requirement was introduced because financial service companies with limited risk and presence in the Netherlands were entitled to treaty benefits if they were the beneficial owners of payments

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53. NL: Implementing Ordinance to the Corporate Income Tax Act, art. 2d.
54. Parliamentary Document 25087 no. 136 in response to Lower House to Resolution No. 43 to increase the substance requirements for empty conduit companies [Antwoord Tweede Kamer op Resolutie No. 43 om de substance vereisten voor doorstroomvennootschappen te verhogen].
55. This risk requirement is included in NL: Corporate Income Tax Act [Wet op de vennootschapsbelasting] [hereinafter CITA], art. 8c.

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and the principal purpose test did not apply. Their interposition as an intermediary company was often tax driven. Companies running a sufficient risk may add the interest and royalties received to their profit. This means that those companies are entitled to a credit for foreign withholding tax. If no real risk is assumed, those companies are taxed on an arm's length remuneration for their services, which is equal to the operational costs plus a limited markup. In that scenario, no credit for foreign withholding tax will be granted and the entity may not be entitled to treaty benefits because it is not regarded as the beneficial owner of the interest and royalties received.

The management requirement is often met by appointing an expert at a trust office and the risk requirement is also not perceived as onerous.

On 25 January 2017, the parliament adopted another resolution to sharpen the substance requirements for conduit companies.[56] From 2019, this resulted in two additional substance requirements for holding companies. First, holding companies must incur employment costs of at least EUR 100,000 in relation to their intermediary holding functions. However, the employment may be performed by seconded employees or be outsourced to independent contractors. Second, the holding company must (for at least 24 months) have its own office space at its disposal to carry out the intermediary holding functions.[57] These requirements have applied to financial services companies since 2021.

A final important step regarding substance requirements was introduced in 2019. From 1 July 2019, a new rulings practice has become effective in the Netherlands that includes tighter conditions for granting an international tax ruling to companies. The substance requirement has been replaced by an economic nexus criterion. This means that a company must carry on real economic activities in the Netherlands. A ruling will no longer be granted to pure conduit companies that are not or are hardly active in the Netherlands and that are mainly incorporated in order to save domestic and foreign taxes.

Finally, the substance requirements now play a new role in respect of tax. In the past, the requirements functioned as a safe harbour rule, which meant that all tax and treaty benefits were granted to companies meeting these requirements. Since 2021, however, the substance requirements no longer function as a safe harbour but only provide an indication that a company should qualify for tax and treaty benefits. This change stems from the decision of the Court of Justice of the European Union (ECJ) in the Danish withholding tax cases.[58] In these cases, the ECJ decided that the European abuse principle obliges the Member States to deny EU benefits, such as those of the EU Parent-Subsidiary Directive (2011/96) or the EU Interest-Royalties Directive (2003/49) where there is abuse of EU legislation. The ECJ defines the term "abuse" in a substantive manner, which implies that in situations in which all substance requirements are met, based on all facts and circumstances, abuse can nevertheless exist. Consequently, a shift in the burden of proof has arisen because a company will now have to show that no abuse exists.

The Netherlands substance requirements that have developed over time are stricter than those of the Proposed Unshell Directive. A deviation is that the director and employee requirement are not alternatives. Furthermore, the Directive does not contain a bookkeeping requirement.

6.3. ATAD 1

As required by ATAD 1, the Netherlands, with effect from 2019, has also introduced various anti-abuse measures.

6.3.1. The Netherlands anti-abuse concept

Under the Netherlands anti-abuse provisions, artificial or simulated transactions are ignored based on a determination of the actual facts of the case. The "just levy" principle included in article 31 of the General Tax Act[59] allows the tax authorities to ignore legal acts for tax purposes with the prior approval of the Ministry of Finance. This provision, however, is not currently applied. Instead, the abuse of law principle (*fraus legis*) developed under the case law is used.

This principle applies to artificial transactions that are predominantly aimed at avoiding taxation and that violate the object and purpose of a tax law. Under this principle, it is not the wording of a provision that is decisive but its spirit. If the conditions of this principle are met, a transaction is converted into the closest equivalent that does not give rise to abuse. As the *fraus legis* concept is perceived as working well, the Netherlands has not introduced the ATAD GAAR.[60]

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56. NL: Parliamentary Resolution no. 139.
57. These conditions were added to NL: Implementing Ordinance to the Corporate Income Tax Act [Uitvoeringsbesluit Wet op de Vennootschapsbelasting], art. 2d and NL: Implementing Decree on Assistance in International Tax Matters [Uitvoeringsbesluit Wet Internationale Bijstand in Belastingzaken], art. 3a.
58. DK: ECJ, 26 Feb. 2019, Joined Cases C-116/16 and C-117/16, *Skatteministeriet v. T Danmark and Y Denmark Aps*, Case Law IBFD and DK: ECJ (Grand Chamber), 26 Feb. 2019, Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16, *N Luxembourg I, X Denmark, C Danmark I and Z Denmark v. Skatteministeriet*, EU:C:2019:134, Case Law IBFD.
59. NL: General Tax Act, 1959.
60. H-J. van Duijn & K. Sinnige, *Netherlands – Corporate Taxation – Country Analyses*, Country Tax Guides IBFD (accessed 18 Apr. 2022).

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6.3.2. CFC legislation

The Netherlands introduced controlled foreign company (CFC) legislation in 2019 to counter abuse. This legislation, which does not specifically target conduit companies, attributes the non-distributed income of an entity or PE that qualifies as a low-taxed CFC to its Netherlands parent company or headquarters, provided that the non-distributed income arises from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. In addition, the CFC legislation is applied to certain types of income, including dividends, interest, royalties, lease payments, benefits from insurance, bank or other financial activities and income from invoicing activities that add little or no economic value.

The CFC legislation applies to entities in which a Netherlands parent has a 50% direct (or indirect) participation, ownership interest or entitlement to an interest in voting, capital rights or profits. A CFC is regarded as low-taxed if the corporate income tax rate is lower than 9%.[61] The CFC legislation also applies to countries that are on the EU list of non-cooperative states.[62] The CFC legislation does not apply (i) to companies that mainly earn non-tainted income that is not included in the list of qualifying CFC income or to financial institutions mainly receiving income from third parties; and (ii) where the CFC performs a genuine economic activity, which means that the substance requirements must be met.

6.4. Anti-abuse provisions in tax treaties

To reduce the effect of conduit companies, the Netherlands, in 2013, developed a policy to include anti-abuse provisions in its tax treaties.[63] As a result of this policy, the Netherlands approached many developing countries to add such provisions to the existing tax treaties.[64] These clauses mostly take the form of a principal purpose test (PPT), which the Netherlands has also opted for under the MLI. Under this test, tax treaty benefits, such as the treaty withholding tax rates, are denied if the main or one of the main reasons for entering into an arrangement was to obtain treaty benefits. In making this determination, open norms are used, such as the intention behind a structure or arrangement, which should guarantee that real economic activities are not impacted.

In addition, treaty benefits will nevertheless be granted if those benefits would have applied even if the relevant structure or transaction had not been put in place. The Netherlands will always consult the other treaty partner before denying treaty benefits based on the PPT.

6.5. Withholding tax measures

6.5.1. Withholding tax obligation for holding cooperatives

Before 2018, cooperatives were often used as an interposed vehicle in the Netherlands because such entities were not obliged to withhold dividend withholding tax. The shares of a Netherlands holding company were often owned by a Netherlands cooperative. In that scenario, dividend distributions to the cooperative were tax exempt in the Netherlands, whereafter the cooperative could redistribute the dividends to a foreign entity without dividend withholding tax becoming due.

Since 2018, holding cooperatives, the actual activities of which consist mainly in the holding of participations or the direct or indirect financing of affiliated entities or individuals, are, however, obliged to withhold tax.

6.5.2. Conditional withholding tax on interest and royalties

From 2021, a conditional withholding tax on interest and royalty payments applies, which aims to discourage the use of the Netherlands to channel those payments to low-tax jurisdictions or to shift taxable income to low-tax jurisdictions.[65] The Netherlands Bureau for Economic Policy Analysis[66] has established that a conditional withholding tax should make the Netherlands less attractive to conduit companies.[67]

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61. Currently, this concerns Anguilla, the Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, Turkmenistan, Turks and Caicos Islands, Vanuatu and the United Arab Emirates.
62. Currently, this list includes American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, the US Virgin Islands and Vanuatu. The same list applies in respect of the conditional withholding tax. Barbados and Oman, which were originally on the list of low-tax countries, are no longer on the 2022 list. The currrent list was published by NL: Regulation of the State Secretary of Finance of 28 December 2021 amending, among other things, some implementation regulations in the field of taxes and allowances [Regeling van de Staatssecretaris van Financiën van 28 december 2021 tot wijziging van onder meer enige uitvoeringsregelingen op het gebied van belastingen en toeslagen], no. 2021-0000025821 of 28 December 2021, Official Gazette no. 2021-0000025821 (28 Dec. 2021).
63. In para. 3.2.2. of the 2020 tax policy memorandum, the Netherlands indicates that it wants to include a PPT in its tax treaties as a minimum anti-abuse standard as per the MLI.
64. Ministry of Finance Letter of 30 Aug. 2013, no. IFZ/2013/320 U.
65. For details on the conditional withholding tax, *see* F.P.G. Pötgens & P.I.M. Geerse, *Withholding Tax Act 2021: A Split from Historical Trends!*, 60 Eur. Taxn. 10 (2020), Journal Articles & Opinion Pieces IBFD and C. Tolman & M. Molenaars, *The New Dutch Conditional Withholding Tax And Hybrid Entities*, 104 Tax Notes Intl. 4, pp. 427-430 (2021).
66. The Netherlands Bureau for Economic Policy Analysis (*Centraal Planbureau*, CPB) is an independent Netherlands government agency providing economic forecasts and analyses of policy plans for the government and political parties.

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The tax is imposed on interest and royalty payments to related companies established in low-tax jurisdictions with a statutory tax rate of 9% or less or in a country that is on the EU list of non-cooperative states. The reference date for the determination of the 9% criterion is 1 October of each year.

The Netherlands has tax treaties with Bahrain (2008),[68] Barbados (2006),[69] Oman (2009),[70] Panama (2010)[71] and the United Arab Emirates (2007).[72] The treaties with Bahrain and the United Arab Emirates do not authorize the Netherlands to impose any withholding tax on interest and royalties. The treaty with Barbados provides for a 5% withholding tax on royalties, the treaty with Oman an 8% withholding tax on royalties and the treaty with Panama a 5% withholding tax on interest and royalties. For Bahrain, Barbados, Oman, Panama and the United Arab Emirates**,** the conditional withholding tax does not apply until three calendar years after the state is first designated as a low-tax jurisdiction under the applicable ministerial regulations have passed. During this period, the intention is for the Netherlands to renegotiate the treaty.[73] If this does not appear to be possible, the Netherlands may try to invoke the PPT under the MLI. Bahrain, Panama and the United Arab Emirates also have all opted for the PPT under the MLI, which means that this test could by applied by both countries in the event of treaty abuse, as the MLI is effective for those countries.[74]

The conditional withholding tax is only imposed on interest and royalty payments to related companies. A related company is a company in which a shareholding of more than 50% is directly or indirectly owned. This means that it must be possible to influence the decision-making of the related company in such a manner that its activities can be determined. Consequently, withholding tax is due in the following three situations:

- where a recipient owns a controlling shareholding in the paying entity;
- where the paying entity owns a controlling shareholding in the receiving entity; and
- where a third company owns a controlling shareholding in both the paying and receiving entity.

A controlling interest can also be held together with other companies of a controlling group.

The withholding tax is imposed at the highest statutory corporate income tax rate, currently 25.8%. Tax can be due even where payments are made in respect of genuine business activities or when genuine business activities exist in a low-tax jurisdiction.[75] Therefore, the impact this tax will have on the Netherlands business and investment climate remains to be seen. In any event, the fact that genuine situations are also covered indicates that the efforts being made to diminish the reputation of the Netherlands as a conduit country[76] trump any economic considerations, such as avoiding situations of double taxation. In any event, this implies that entities established in a low-tax jurisdiction are always subject to the conditional withholding tax even if they carry on a business with sufficient substance.

The tax is due not only in respect of direct interest or royalty payments, but also in respect of artificial arrangements set up to avoid the tax, such as interposing a company in a high-tax jurisdiction in circumstances in which the ultimate beneficiary is established in a low-tax jurisdiction.[77] In addition, the tax is also due on payments to a hybrid entity, regardless of its

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67. *See also* the State Secretary for Finance Letter of 11 Nov. 2019, Parliamentary Documents II 2019/20, 35 305, no. 8 in response to the CPB research (memorandum from M. van 't Riet & A.M. Lejour), *Netwerkanalyse van een Nederlandse voorwaardelijke bronbelasting op renten en royalty's* [Network analysis of a Dutch conditional withholding tax on interest and royalties], Nov. 2019. *See also* Memorandum of Reply (*Memorie van Antwoord*), Parliamentary Papers I 2019/20, 35 305, C, pp. 2-3.
68. *Convention between the Government of the Kingdom of Bahrain and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (16 April 2008), Treaties & Models IBFD.
69. *Convention between the Kingdom of the Netherlands and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (28 November 2006), Treaties & Models IBFD.
70. *Agreement between the Kingdom of the Netherlands and the Sultanate of Oman for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (5 October 2009), Treaties & Models IBFD.
71. *Convention between the Republic of Panama and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (6 October 2010), Treaties & Models IBFD.
72. *Synthesised Text of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting and Convention between the Kingdom of the Netherlands and the United Arab Emirates for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (8 May 2007), Treaties & Models IBFD.
73. NL: Withholding Tax Act, 2021, art. 1.2(2) of the Explanatory Memorandum, no. 3, p. 5. *See also* Memorandum on Netherlands Tax Treaty Policy 2020, *supra* n. 22, at para. 5.3 and E. Bongers, *Staatsfondsen uit de Golfregio gehinderd in een snel veranderende fiscale wereld* [Obstacles facing state funds from the Gulf region in a rapidly changing tax world], WFR 20, para. 4 (2020).
74. *See* https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf and https://www.rijksoverheid.nl/ministeries/ministerie-van-financien/documenten/brochures/2020/02/17/multilateraal-instrument-mli-en-nederlandse-belastingverdragen (accessed 5 May 2022).
75. Explanatory Memorandum (*Memorie van Toelichting*), Parliamentary Documents II 2019/20, 35 305, no. 3, pp. 2 and 3 and Memorandum Responding to Report (*Nota naar aanleiding van het Verslag*), Parliamentary Documents II 2019/20, 35 305, no. 6, pp. 2, 3 and 19 [hereinafter Memorandum Responding to Report].
76. CPB, Network Analysis of Tax Treaty Shopping using dividend-based weights (2015), available at https://www.cpb.nl/sites/default/files/publicaties/download/cpb-communication-28aug2015-network-analysis-tax-treaty-shopping-using-divided-based-weights.pdf.
77. Art. 2.1(1)(c) WTA 2021.

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location.[78] In the latter situation, the withholding tax is due if an entity is classified as non-transparent in the Netherlands and transparent in the country of the recipient or vice versa. An escape clause applies under which the withholding tax is not imposed if all participants in the hybrid entity are treated as the beneficiaries of the interest and royalty payments and those recipients would not have been subject to the withholding tax had they have received the payments directly from the Netherlands.[79] This escape rule also applies if none of the participants have a qualifying interest in the hybrid.[80]

One month after the end of the calendar year, a tax declaration must be filed along with payment of the conditional withholding tax. The conditional withholding tax is a final levy, which means that it cannot be deducted from the corporate income tax[81] or offset against tax due by a Netherlands PE of the foreign company established in a low-tax jurisdiction.

The tax can apply in conjunction with the interest and royalties deduction restrictions and the abuse provision concerning hybrid entities resulting from the Amending Directive to the 2016 Anti-Tax Avoidance Directive (2017/952) (ATAD 2).[82]

In 2024, a similar tax will be introduced for dividends.[83] This means that a tax, at the highest corporate income tax rate, will become due in the following situations:

- profit distributions within a group of companies to entities established in a low-tax jurisdiction, including distributions by non-holding cooperatives; and
- abuse situations, i.e. a situation in which an artificial structure is set up to avoid the imposition of dividend withholding tax.

6.6. DAC6

DAC6, which imposes an obligation to report aggressive cross-border structures, was implemented in the Netherlands by a law of 27 December 2019, an update to the Implementing Decree relating to the Law on Assistance in International Tax Matters and a Decree of 24 June 2020.[84]

Hallmark 3b of DAC6 targets schemes that include circular transactions of funds through interposed entities without a primary commercial function or transactions that offset or cancel each other out or have other similar characteristics.[85] This hallmark may also target pure conduit companies that are not established for commercial reasons, but are mainly interposed for tax savings reasons in circumstances in which, following a favourable tax treatment, the payments again return to the Member State of origin.

The Explanatory Memorandum to the Law Implementing the EU Directive on Reportable Cross-Border Arrangements includes various clarifications that may also be relevant to conduit companies.[86] The Explanatory Memorandum clarifies that hallmark C.1. on arrangements involving deductions of cross-border payments between associated enterprises applies with regard to:

- payments to companies subject to a rate of zero or almost zero, i.e. a statutory rate of between 0% and 1%;
- an object exemption, under which certain types of payments are exempt from tax; and
- preferential tax regimes.

To provide more clarification and certainty on the practical application of the main benefit test and its related hallmarks, the Netherlands tax authorities have issued guidelines and have also created a knowledge database on mandatory disclosure rules/DAC6.[87]

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78. Art. 2.1(1)(d) and (e) WTA 2021.
79. Art. 2.1(4) WTA 2021.
80. NL: Parliamentary Documents, Upper House, 35 928, no. 7, at paras. 2, 5, and 10-12 (6 Oct. 2021).
81. Art. 10(1)(f) CITA.
82. Council Directive (EU) 2017/952 of 29 May 2017 Amending Directive (EU) 2016/1164 as Regards Hybrid Mismatches with Third Countries, Primary Sources IBFD.
83. NL: Parliamentary Documents II 2020-2021, no. 35779, no. 2, Law on a conditional withholding tax on dividends [Wet conditionele bronbelasting op dividenden]. The Netherlands already imposes a dividend withholding tax at the rate of 15%.
84. NL: Law implementing the EU Directive on reportable cross-border arrangements [Wijziging van de Wet op de internationale bijstandsverlening bij de heffing van belastingen en de Algemene wet inzake rijksbelastingen in verband met de implementatie van Richtlijn (EU) 2018/822], Official Gazette no. 2019, 509 (27 Dec. 2019) and NL: Decree No. 2020-11382, Guidance on reporting obligation for cross-border arrangements [Leidraad meldingsplicht grensoverschrijdende constructies] of 24 June 2020, available at https://zoek.officielebekendmakingen.nl/stcrt-2020-34991.html (accessed 5 May 2022).
85. This hallmark was implemented by NL: Law on International Assistance in Tax Matters (WIB), art. 2d(1)(c).
86. NL: Explanatory Memorandum to Bill proposal 35255 implementing the EU Directive on reportable cross-border arrangements [Toelichtende nota bij wetsvoorstel 35 255 tot wijziging van de Wet op de internationale bijstandsverlening bij de heffing van belastingen en de Algemene wet inzake rijksbelastingen in verband met de implementatie van Richtlijn (EU) 2018/822] (17 July 2019).
87. Directorate-General for Tax and Customs Administration/Corporate Service Professional Technology, Taxation (Directoraat-generaal Belastingdienst/ Corporate dienst Vaktechniek), *Belastingen. Meldingsplichtige grensoverschrijdende constructies* [Reportable cross-border arrangements],, available at https://zoek.officielebekendmakingen.nl/stcrt-2020-34991.html (accessed 25 Mar. 2022).

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This knowledge database indicates that taxpayers may request an advance tax ruling to determine whether or not the main benefit test has been met. What is decisive in applying this test is that the arrangement would not be implemented without the expected tax advantage, or that elements are added to the arrangement that result in a tax advantage and that advantage is the most important advantage or one of the most important advantages of the entire arrangement. Consequently, it must be investigated whether or not the result of an arrangement would have been the same without the application of the tax rules. In that instance, the arrangement is not tax driven.

Whether or not the main benefit test has been satisfied must be assessed on the basis of objective factors. The taxpayer's subjective intention is not relevant here, but the intent of the legislator may be an element to consider when making the assessment.

In addition, the Decree of 24 June 2020 lists various examples in which this hallmark applies. One example concerns a scenario in which an interest payment is made to a foreign parent company that has virtually no business activities, while the interest is taxed at a rate of 0%. A second concerns payments to a country with a territorial tax system that does not tax foreign income.

7. Report of the Ter Haar Expert Committee

On 31 October 2021, an Expert Committee established by the Ministry of Finance (Ter Haar Committee) published its report on possible civil and fiscal law changes regarding the taxation of conduit companies (Ter Haar report).[88] This report responds to international developments concerning the combatting of abuse and the fact that the Netherlands regime for conduit companies is perceived as negative by many countries, as it encourages a significant amount of cash flow through the Netherlands by entities that often lack substance and because conduits can be used to launder money.

The Committee concludes that it is difficult to properly define conduit companies because the definition in the existing legislation has a limited scope. Therefore, the committee has listed the main characteristics of conduit companies. Conduit companies are entities established under Netherlands law that are generally used in international structures for transactions with related parties. In addition, the real presence (substance) in the Netherlands is limited because there is no office building and there are only a few employees. There are often tax, financial or legal motives behind the establishment. Big international cash flows consisting of dividends, interest, royalties, rent and lease payments from and to other countries or balance positions, such as participations in foreign subsidiaries with a high book value, are typically involved.

The reference to international structures is useful from a practical point of view. Theoretically, however, a problem could arise because, under EU law, domestic and cross-border situations cannot be treated differently when the situations are objectively comparable. A holding company in an international group that also has a company with real business activities should not be regarded as a conduit if a relationship exists between the activities of the active company in the Netherlands and the income received by the holding company.

A further gap in this respect is that the Committee does not indicate situations in which the use of a conduit company is undesirable and those in which it is acceptable.

The Committee noted that, in 2019, there were approximately 12,400 conduit companies in the Netherlands with a balance sheet total of approximately EUR 4,500 billion, which is 550% of the Netherlands gross domestic product. The interest, royalty and dividend payments flowing through those entities amounted, in the period between 2015 and 2019, to an average of EUR 170 million per year.[89] The report concluded that the majority of these amounts went to tax havens, while the ultimate beneficiary was often established in the United States.

Taking into account the number of employees and the tax revenue, conduits are of limited importance to the Netherlands economy. The amount of taxes paid by conduits in 2019 was approximately 0.2% of total tax revenue. The phenomenon of conduit companies may have a significant impact on the tax revenue of developing countries and it may result in treaty shopping through the Netherlands treaty network.

As already indicated in section 3., the main reasons for establishing a conduit company in the Netherlands include the participation exemption, the vast Netherlands treaty network, the fact that the Netherlands does not impose a withholding tax on interest and royalties (except in respect of low-tax countries and non-cooperative states) and the ruling practice.

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88. Report of the Ter Haar Committee, *Naar een acceptabele doorstroom* [Towards an acceptable cash flow], available at https://open.overheid.nl/repository/ronl-0816d541-5d35-4413-ae74-f27a7e51a45b/1/pdf/rapport-commissie-doorstroomvennootschappen-op-weg-naar-acceptabele-doorstroom.pdf.
89. Those figures are based on IMF, Capital Income Taxation in the Netherlands *WP21/45*, available at imf.org and a report of the central planning office CPB of 2019, entitled *Doorsluisland Nederland Doorgelicht* [cash flow country the Netherlands screened], available at https://www.cpb.nl/sites/default/files/omnidownload/CPB-Policy-Brief-2019-01-Doorsluisland-NL-doorgelicht.pdf.

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Important non-tax measures for establishing a conduit company in the Netherlands include the good investment climate, the legal infrastructure (expertise), the court system and flexible company law. In addition, the Netherlands has signed many investment protection agreements, which restrict the risk to foreign investors.

In order to address the fact that a number of conduits that lack substance are still being established in the Netherlands, the Committee has outlined various key tax recommendations. First, they suggest abolishing the safe harbour in article 8c of the CITA. The abolition of this minimum risk requirement for financial service companies should make it less attractive to establish a conduit company in the Netherlands. This is because, in particular, companies should be equipped with sufficient functionality to manage such risks.

Instead, the Committee recommends introducing an open norm, under which whether or not a company bears sufficient risks, which is relevant for claiming a credit for foreign withholding tax and tax treaty benefits, should be determined on a case-by-case basis.

In combination with this measure, an increase in spontaneous exchange of information should be introduced for companies that have assumed insufficient risks. This exchange should apply, in particular, to conduits with a connecting function between the activities of group companies in an international structure.

Another addition to spontaneous exchange of information concerns exempt capital gains in respect of a transfer of shares. Under most tax treaties, the residence state of the transferring shareholder has the right to tax those gains unless the source state can apply an anti-abuse provision. In the Netherlands, such gains are tax exempt. Therefore, the Committee recommends informing the source state of such a tax-exempt transfer. This should enable that state to apply an anti-abuse provision if a vehicle is only interposed in the Netherlands to realize a tax-exempt transfer, particularly when the interposed Netherlands company lacks substance.

To reduce the use of conduits with little substance, the Committee further suggests restricting other tax benefits, such as the participation exemption and sharpening the ultimate beneficial ownership definition to avoid a situation in which higher managerial staff is listed as such. Moreover, the reporting obligation should be enhanced, for example, with respect to annual accounts, meaning that conduits should no longer qualify for the reduced reporting obligations applicable to SMEs.

In the international tax field, the Committee advocates an increase in the application of the principal purpose test to the entirety of tax treaties. This is automatically the case in situations in which both treaty partners apply the PPT under the MLI. This increase should also be applied, however, to treaties that the MLI does not apply to.

Another suggestion concerns a clear anti-abuse definition under EU law. This should result in a denial of tax benefits to interposed holding companies, as well as EU benefits, such as under the EU Parent-Subsidiary Directive (2011/96), the EU Interest and Royalties Directive (2003/49) and the participation exemption.

The Committee also advises excluding conduits from the scope of investment protection agreements. Finally, the Committee recommends that the Netherlands endorse the upcoming Proposed Unshell Directive.

The Committee has also proposed several non-tax recommendations. Since 2019, every entity in the Netherlands has to register an ultimate beneficial owner. If the ultimate beneficial owner cannot be identified, a higher management employee must be identified as such. Companies must then document why it was not possible to identify a real beneficial owner. In the Committee's view, this documentation should be included in both the company's administrative records, as well as the UBO register. In this context, it would also be beneficial to improve the search functions in that register and to further the international implementation of UBO registers in as many countries as possible.

With respect to accounting, the Committee reasons that the obligation to publish annual accounts should be extended to all group companies, which should make it harder to use conduits for abuse and money laundering purposes.

In determining whether a company is an SME or large company, what is important is data, such as assets, net turnover and number of employees. This rule is particularly relevant for holding companies.

8. Position of the Netherlands regarding the Ter Haar Report and Proposed Unshell Directive

In a reaction to the Ter Haar report, the former government acknowledged that, in recent years, many measures have been taken to combat abuse, which should result in a broader tax base and more balanced taxation of multinationals.[90] Relevant examples affecting the taxation of conduit companies concern the conditional withholding tax on interest and royalty payments

90. Ministry of Finance Letter of 22 November 2022 in response to the Ter Haar report [*Kabinetsreactie Commissie Doorstroomvennootschappen*].

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to low-tax countries, the planned conditional withholding tax on dividends from 2024, increased exchange of information where companies lack substance, a reduction in the EBITDA with regard to the restriction on the deduction of excessive interest from 30% to 20% from 2022 and the tackling of treaty abuse by means of the PPT. The latter measure should prevent treaty partners from unjustifiably being restricted in their taxing rights. This measure should help restrain undesirable conduit structures.

In addition to attacking base erosion, the emphasis is on measures to fight profit shifting to low-tax countries and measures to increase exchange of information and transparency.

In line with the Committee recommendations, the Netherlands prefers multilateral solutions to combat abuse and profit shifting by conduit companies, including the Proposed Unshell Directive,[91] measures to increase information exchange and measures to restrict the advantages of the EU Interest and Royalties Directive (2003/49) and the Parent-Subsidiary Directive (2011/96).

The Netherlands government has observed that cash flow through the Netherlands during the 2015 to 2019 period amounted, on average, to EUR 170 billion per year, of which EUR 32 billion went to low-tax jurisdictions. This should disappear as a result of the conditional withholding tax on interest and royalties.

The Netherlands government has also noted that, in line with the Proposed Unshell Directive,[92] the Netherlands, since 2014, already exchanges information about (financial) service companies with a lack of substance. Since mid-2019, rulings are only granted to companies that have an economic nexus with the Netherlands. For an exemption from dividend withholding tax, the real presence of a shareholder in his country of residence is decisive. The Netherlands also intends to apply the PPT under its tax treaties.

Because tax avoidance can be combatted most effectively through multilateral measures, the Netherlands regards the Proposed Unshell Directive as indispensable. This is because, in particular, it creates a level playing field and furthers the attractiveness of the Netherlands investment climate for active companies. Consequently, the Netherlands supports the implementation of the Proposed Unshell Directive.

The Netherlands considers that the small amount of revenue it receives from cash flow companies is outweighed by the negative effects for developing countries. The Netherlands regards a key solution to be transparency towards countries with a tax interest in cash flows, which should enable those countries to tax relevant payments. In this context, the government endorses the recommendation of the Ter Haar Committee that the benefits of the EU Parent-Subsidiary Directive (2011/96) and the EU Interest and Royalties Directive (2003/49), as well as treaty benefits, should no longer be granted to conduits.

Therefore, the Netherlands government takes the view that it should be investigated whether or not the current abuse provisions in tax treaties between EU Member States, such as the PPT, suffice to deny such benefits or if further provisions must be included.

The taxing rights regarding cash flows within the European Union are considered to be clear but the government is in doubt regarding structures with related companies that are established in third countries.

The significant number of steps proposed to determine whether there is abuse by means of conduits is regarded as complex, which means that it will not always be possible to exchange information within 30 days. The issues that need attention, therefore, are proportionality and an efficient and practicable exchange of information method. In any event, it should be guaranteed that all Member States of related companies should be informed regarding a structure involving a conduit to ensure that tax is levied by the correct Member State.

Due to the complexity of the Proposed Unshell Directive, the Netherlands government doubts whether implementation by 1 January 2024 is feasible.

As to competence, the Netherlands view is that the European Commission is competent to issue such a proposal based on article 115 of the Treaty on the Functioning of the European Union (TFEU) (2007), which allows the Commission to propose Directives for the adjustment of legal and administrative provisions that influence the establishment and functioning of the internal market. Also, the subsidiarity principle is deemed to be met because abuse situations involving conduits must be combatted at the EU level. The proportionality condition is also deemed to be met, as the proposal clearly defines conduits and the consequences that should be attached to abuse. This should result in a level playing field. The scope of the Proposed Unshell Directive, however, is considered to be very broad, particularly in the area of exchange of information. This may harm implementation. Issues that the government is focussed on include an extension of the 30-day period for information exchange,

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91. Attachment to NL: Parliamentary documents II 2020/21, 21112, no. 3148 (fiche: Announcement/Recommendation Taxation of companies in the 21th century [*Mededeling/aanbeveling Belastingheffing van ondernemingen in de 21e eeuw*]).
92. Parliamentary Document, Fiche 1 on the Directive against the abuse of conduit companies in the tax area and amendment of the administrative cooperation directive [Richtlijn tegengaan misbruik doorstroomvennootschappen op fiscaal vlak en aanpassing van administratieve samenwerkingsrichtlijn] (21 Jan. 2022), available at https://www.rijksoverheid.nl/documenten/kamerstukken/2022/02/21/fiche-1-richtlijn-doorstroomvennootschappen (accessed 5 May 2022).

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increased penalties for taxpayers for non-compliance and a better targeted and more efficient identification and exchange of information system.

Lastly, clarifications are required in respect of some definitions, such as qualified personnel, the secondment of daily management and decision-making, when personnel is involved in generating the relevant income and the implications of the application of tax treaties and audit requests by other tax administrations on issuing residence certificates.

Overall, the proposal should increase the international reputation of the Netherlands as an investment hub for real economic activities. Consequently, the overall view of the Netherlands is positive.

9. Conclusions

In recent decades, conduits have become a widespread phenomenon in Luxembourg and the Netherlands. Until a few years ago, hundreds of those companies were often listed at the same address in the Netherlands. This was due to the attractive investment climate of both countries including, in particular, the participation exemption, the 0% withholding tax on interest and royalties, the Luxembourg and Netherlands well-developed treaty network and the flexible ruling practice. Following several investigations by NGOs, this was perceived as a negative phenomenon. The revenue benefit is disproportionate in comparison to the revenue damage to developing countries.

Several years ago, both countries, therefore introduced unilateral measures to terminate the use of conduits without substance. Both countries required more and more substance in order to grant the residence certificate required to obtain treaty benefits and the benefits of the EU Parent-Subsidiary Directive (2011/96) and Interest and Royalties Directive (2003/49).

In a second phase, cash flows to low-tax countries and non-cooperative states came under attack. In Luxembourg, this was done through EU measures, such as CFC legislation, non-deductibility of interest and royalties and the obligation to report aggressive cross-border structures (DAC6). In the Netherlands, this was accomplished through CFC legislation, the obligation to report aggressive cross-border structures (DAC6) and the unilateral introduction of a conditional withholding tax on interest and royalties that also applies if genuine economic activities are carried out in the low-tax country.

Some of those measures marked a clear departure from trends of the past, such as the Netherlands conditional withholding tax on interest and royalties.

The Luxembourg and Netherlands developments clearly show that both countries intend to improve their image and to avoid being regarded as conduit states by terminating cash flows to low-tax countries.

This also follows from the detailed recommendations of the Ter Haar Committee on conduit companies. In order to bring balance to the discussion, however, the governments should clearly define when the use of a conduit company is not abusive and which companies are classified as a conduit. Using the characteristics proposed by the Ter Haar Committee may be useful from a practical point of view, but there is a risk that a distinction will be made between domestic and cross-border situations. This is not allowed under EU law if the situations are objectively comparable.

The Proposed Unshell Directive marks a further important step in dismantling structures involving conduits with a lack of substance. Because the substance burden is lower than the domestic requirements of both Luxembourg and the Netherlands, it should be easy for those countries to agree to the Proposal.

Despite the work that has been done, more work needs to be accomplished before an agreement on the Proposal can be reached. This is because Luxembourg regards the Proposed Unshell Directive as disproportionate, while the Netherlands regards it as proportionate subject to the need for certain minor amendments.

Important aspects to be discussed during future negotiations by the EU Member States include the scope of the proposal, the definition of relevant income, carve-outs, proof that sufficient risk is borne and the exchange of information obligations.

The proposal to fully ignore shell companies is quite far-reaching and may result in double taxation and the denial of treaty benefits. It also may not be that easy to disregard the application of a tax treaty for countries that do not accept that secondary EU law takes preference over tax treaties. One thing is evident: the use of conduits with a lack of substance is coming to an end.

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