Baker McKenzie.

DUTCH GOVERNMENT PUBLISHES ATAD 2 IMPLEMENTATION BILL

On June 2nd, 2019, the Dutch government published a legislative proposal on the implementation of the EU Anti Tax Avoidance Directive 2 *("ATAD 2")* in Dutch tax law. The main objective of ATAD 2 is to eliminate hybrid mismatches by neutralizing their tax effects. The proposed legislation is to a large extent similar to the Netherlands consultation document published in 2018 and generally seems in line with the provisions of ATAD 2. This alert discusses the main items from the proposed legislation.

ATAD 2 IN GENERAL

Hybrid mismatch situations

The implementation of ATAD 2 covers the following scenarios that may result in either a double deduction **("DD")** or deduction/non-inclusion **("DNI")** outcome:

- **(Reverse) hybrid entities:** one state regards the entity as transparent while the other state regards the entity as non-transparent. The states are not aligned on which state should tax the income of the entity, resulting in non-taxation of the income. An example is the Dutch CV/BV-structure.
- **Hybrid financial instruments:** the states involved are not aligned on the qualification of the instrument and therefore payments could for example be deducted by the payer and exempt at the level of the recipient.
- **Hybrid permanent establishments:** states are not aligned on -for example- the allocation of payments to a permanent establishment or on the recognition of a permanent establisment for tax purposes.
- **Hybrid transfers:** states are not aligned on who is to be treated as the recipient of distributions arising from a financial instrument that is transferred.
- **Imported hybrid mismatches:** in this case a transaction that is taking place between residents of EU member states does not as such result in a hybrid mismatch, but that transaction is connected to another transaction with a third state that does not apply anti-hybrid rules, and so the effect of that non EU hybrid mismatch transaction is "imported" into the EU.

  For a regular transaction to qualify as an imported hybrid mismatch, the regular transaction should be effectively "connected" to the hybrid mismatch transaction with the third state, based on the facts and circumstances. This "connection" remains to be quite vague in the proposed legislation.

  For example, the mere fact that the amounts of the transactions are similar does not appear to necessarily result in the qualification of a transaction as an imported hybrid mismatch.
- **Dual residency:** an entity is treated as a resident in more than one EU member state, resulting in double deduction of expenses, losses etc.

Dutch anti-hybrid mismatch rules

Where any of the above hybrid mismatch situations apply, the Dutch implementation of ATAD 2 in principle results in the following:

- **DNI situations (effective 1 January 2020):** the primary rule states that a Dutch taxpayer being the payor cannot deduct a payment if this payment is not subject to tax at the level of the payee. Under the secondary rule, where the Dutch taxpayer is the payee, any income of that Dutch taxpayer that would normally have been exempt will need to be taxed if the state of the payor allows for a deduction/does not apply anti-hybrid rules. Since ATAD 2 aims at neutralizing effects from hybrid mismatches (i.e. due to the qualification of an entity, payment or permanent establishment, or the allocation of a payment), a DNI situation being the result of a certain countries' tax regime does not fall within the scope of ATAD 2.
- **DD situations (effective 1 January 2020):** the primary rule states that a Dutch taxpayer cannot deduct a certain payment if this payment can also be deducted in another state that can be regarded as the payor state. If the Netherlands is regarded as the payor state, the deduction is allowed at the level of the Dutch taxpayer as long as the other state in fact disallows the deduction. The payor state is the state in which the payment arose or in which the expenses or losses are incurred.
- **Reverse hybrid entity rule (effective 1 January 2022):** Reverse hybrid entities are entities that are considered non-transparent in the state(s) of its participants but transparent in the state in which the entity is incorporated, established or registered. Under the anti hybrid mismatch rules, such entities should be subjected to tax in the state of incorporation, establishment or registration.

All the Dutch ATAD 2 rules apply a pro rata or "to the extent" approach. This means that only to the extent a deduction is not included or deducted multiple times, the deduction should be refused. Furthermore, to the extent a DD situation coincides with dual included income, ATAD 2 generally does not apply.

THE DUTCH PROPOSED LEGISLATION; SPECIFIC CONSIDERATIONS

Distributions by reverse hybrid entity subject to dividend withholding tax

The proposed legislation announces that reverse hybrid entities will become subject to Dutch dividend withholding tax on profit distributions.

The Dutch government indicated that due to the complexity of this rule, they will further investigate the rules to cover these reverse hybrid entities. Ultimately before 1 January 2022, additional rules for reverse hybrid entities will be published in a separate legislative proposal.

Documentation requirement

The proposed legislation includes a requirement for any Dutch corporate income taxpayer to include in its administration support addressing why the anti-hybrid mismatch rules do not apply or how the rules have been applied. Such documentation could for example exist of a worldwide structure chart, an assessment of the financial instruments used and if applicable a substantiated calculation of the applied adjustment following the application of the anti-hybrid mismatch rules. If a Dutch corporate income taxpayer is only involved in transactions within the Netherlands, this will become apparent by its administration which should be sufficient for the Dutch tax authorities to not apply the anti-hybrid mismatch rules. If a Dutch corporate income taxpayer does not (sufficiently) comply with this documentation rule, and the Dutch tax inspector presumes that the anti-hybrid mismatch rules are applicable, an increased burden of proof rests with the taxpayer to demonstrate that the proposed rules do not apply or have been sufficiently applied. This rule seems to grant a significant degree of discretion to the tax authorities and deviates from the regular legal protection mechanisms that restrict shifting the burden of proof to taxpayers.

Uncertainties to date

In the legislative proposal, the combination between the proposed anti-hybrid mismatch rules and certain typical Dutch doctrines, such as the non-business like loans concept ("onzakelijke leningen"), are not addressed. Although such instruments are considered a loan for Dutch tax purposes, Netherlands Supreme Court case law may result in a different tax treatment. Whether this is the result of the arm's length principle (meaning that ATAD 2 rules would not apply) is not entirely clear.

Next steps

The legislative proposal (which may still be subject to some changes) will most likely be adopted in parliament in autumn 2019 and the rules will apply as from January 1, 2020.

Baker McKenzie Tax Practice
Claude Debussylaan 54, 1082 MD, Amsterdam