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Global Tax Alert

Netherlands enacts new CFC legislation: Impact on multinational enterprises

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Executive Summary

In accordance with the first European Union (EU) Anti-Tax Avoidance Directive (ATAD 1), on 18 December 2018, the Netherlands implemented Controlled Foreign Company (CFC) rules in its legislation, applicable to fiscal years starting on or after 1 January 2019. Based on the Dutch CFC legislation, undistributed "tainted" (passive) income (including but not limited to dividend, interest and royalty income) derived from subsidiaries that are tax resident in certain low-tax jurisdictions, is annually included in the taxable basis of the Dutch taxpayer.

The jurisdictions that qualify as low tax are annually listed by the Dutch Government and the first iteration of the list was published on 31 December 2018. Multinationals with subsidiaries in the relevant low-tax jurisdictions that are (indirectly) held by a Dutch taxpayer should therefore review the impact of the Dutch CFC rules (if any).

Detailed discussion

ATAD 1 requires EU Member States to implement one of two options with respect to the inclusion of CFC income in the taxable base. The two options include: (i) Model A – the income approach that results in an annual inclusion of certain types of passive income derived by a CFC; or (ii) Model B – the substance

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approach that results in an annual inclusion of income that cannot be attributed to the CFC under application of the arm's-length principle, but is attributable to the EU Member State based on its functionality.

The Dutch Government is of the opinion that Model B was already implemented in the Netherlands legislation through its application of the at arm's-length principle. Nonetheless, the Dutch Government went beyond what was required under ATAD 1 and introduced supplementary Model A rules for certain abusive situations. These supplementary CFC rules seek to subject certain undistributed (passive) income of a low-taxed CFC to current taxation at the level of the Dutch taxpayer.

Qualification as a CFC

Based on the supplementary rules, an entity will be considered a CFC if: (i) a Dutch taxpayer (in)directly holds an interest exceeding 50%[1] (in vote or value) in a foreign entity or branch; (ii) the income of this entity or branch consists of more than 30% passive income; and (iii) this entity or branch is tax resident in a jurisdiction listed on the EU list of non-cooperative jurisdictions (EU Blacklist)[2] or in a low-tax jurisdiction (i.e., a jurisdiction with a statutory corporate income tax rate below 9%). The relevant EU Blacklisted jurisdictions and low-tax jurisdictions are annually listed by the Dutch Government. On 31 December 2018, the Dutch Government published the final list of low-tax jurisdictions for 2019.[3] This list includes the following jurisdictions:

> American Samoa, Anguilla, Bahamas, Bahrein, Belize, Bermuda, British Virgin Islands, Cayman Islands, Guam, Guernsey, Isle of Man, Jersey, Kuwait, Qatar, Samoa, Saudi Arabia, Trinidad and Tobago, Turks and Caicos Islands, United Arab Emirates, US Virgin Islands, and Vanuatu.

Inclusion of CFC income

If a foreign subsidiary is considered a CFC, the undistributed tainted income of that CFC (i.e., its passive income minus the relevant expenses) that should be included in the Dutch taxable base should be calculated in accordance with Dutch standards. As such, application of the Dutch participation exemption regime, interest deduction limitation rules, transfer pricing corrections and the functional currency of the Dutch taxpayer should be taken into consideration when determining the CFC income.

Exemption

The CFC rules do not apply if the CFC carries on genuine economic activity in the foreign jurisdiction e.g., if it has sufficient relevant substance in the foreign jurisdiction as demonstrated by satisfying a certain set of minimum substance requirements.[4]

In addition to this minimum substance safe harbor, a taxpayer can also demonstrate the existence of a genuine economic activity by e.g., means of organizational, economic or other relevant characteristics of the group as well as the structure and strategy of the group.

Implications

Multinationals with passive activities in the jurisdictions included on the Dutch list of low-tax jurisdictions or the EU Blacklist, (indirectly held by a Dutch taxpayer should: (i) review the impact of the Dutch CFC rules to their group structure; (ii) if impacted, determine a strategy going forward; and (iii) closely monitor the annual updates to the Dutch list of low-tax jurisdictions.

Endnotes

1. Constructive ownership rules apply.
2. See EY Global Tax Alert, *Council of the European Union publishes list of uncooperative jurisdictions for tax purposes*, dated 6 December 2017.
3. Decree of 31 December 2018, DB 2018/216528.
4. The CFC should be considered to carry on genuine economic activity in the foreign jurisdiction if it: (i) meets the Dutch minimum substance requirements in its country of residence; (ii) has at least €100,000 of (internally or externally rendered) labor costs; and (iii) owns or rents an office space that is used to perform its activities for at least 24 months.

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