



STP TAX

New Dutch Transfer Pricing Decree

July 2022





The Dutch State Secretary for Finance (“**State Secretary**”) has published the new transfer pricing decree (the “**Decree**”) on July 1, 2022. The Decree replaces the previous (2018) transfer pricing decree and provides additional practical guidance on the application and interpretation of the arm’s length principle in the Netherlands. The main changes of the Decree relate to:

- Guidance on financial transactions
- An update on Intra-group Services
- Additional considerations on governmental support
- Textual and terminological changes for better alignment with international and national legislation (additional practical guidance)

Introduction

The Decree provides information regarding the position of the Dutch Tax Administration regarding the application of the arm's length principle and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines") in the Netherlands. The Decree provides further interpretation of the arm's-length principle where the OECD Guidelines leave room for interpretation, where there is a need for clarification in practice or to eliminate ambiguities.

Financial transactions

Intra-group loans

In accordance with the OECD transfer pricing guidelines, the State Secretary confirms that the arm's length test for intra-group loans begins with the characterization of the transactions. Once a financial transaction has been characterized as a loan, the conditions applied should be tested in light of the arm's length principle. The result of this test should, in principle, be a price (interest expense/interest income) that meets the criteria of Article 8b of the Dutch Corporate Income Tax Act 1969. If the transaction cannot be made arm's length with an adjustment to the price and/or the other conditions, this may, in extreme cases, lead to the transaction being ignored or reclassified.

Creditworthiness of the loan

Analyses of the parties' perspectives and the realistically available options play important roles in the arm's length test. As it should be expected, a lender will only grant a loan to a party whose credit rating does not fall below a certain level. In this context, the State Secretary takes the position that only in exceptional cases will a lender be willing to accept a credit rating below investment grade (BBB-). On the other hand, a borrower will strive to design the financing of its business activities in such a manner that it is accompanied by the lowest possible cost of capital. An unaffiliated borrower will not take out a loan if this will cause its credit rating to fall below investment grade. If a

loan is provided with a credit rating lower than BBB-, it must be substantiated through additional analyses that it is a loan agreed upon under arm's length conditions. When determining the credit rating, any implicit support of group association should be taken into account and might have impact on the applicable interest rate.

Arm's length interest rate

According to the State Secretary, the preferred method for determining the arm's length interest rate is the CUP method. This method involves the determination of the interest rate of loans based on available data of comparable transactions with borrowers with a similar credit rating. Another method quoted by the State Secretary concerns the "cost of funds approach". This method is mainly applicable in situations whereby loans are borrowed from unrelated parties, and the amount eventually reaches the ultimate borrower via one or more entities within the group, so-called financial services companies (DVL).

Non-businesslike loans in Dutch case law and OECD Guidelines

In line with the previous Decree, the State Secretary quotes the Dutch case law on non-businesslike loans. In case of a non-businesslike loan, the interest rate to be taken into account for tax purposes is the lower of: (i) the rule of thumb/surety analogy and (ii) the economic value of the (imputed or accrued) interest at the moment this interest becomes due.

The State Secretary acknowledges that the approach laid down in the Dutch case law is not completely in line with the OECD Guidelines and, therefore, could lead to conflicting views. When advance certainty is requested, the OECD Guidelines will be the starting point. Unfortunately, what happens in situations where no advance certainty is requested remains unclear.

(Financial Service Companies

If the group entity under review is considered to be a DVL, the remuneration of the DVL should be tested in light of the functions, activities and risks of the DVL. The State Secretary recognizes three different situations:

- (i) The DVL has full control over the credit risks and has the necessary financial capacity;

- (ii) The DVL has no control over credit risk and/or insufficient financial capacity; and
- (iii) The DVL has shared control over credit risk and has the necessary financial capacity to do so.

If the DVL has full control over the credit risks and the necessary financial capacity, an appropriate interest rate should be determined based on a comparability study of the loan. It should be noted that if the DVL has only been able to attract funding with a guarantee from another group company, this funding is regarded as a capital injection by the guarantor into the DVL and does not warrant any interest rate deduction (we also refer to the section on guarantees below). On the other end, the funding attracted does not lead to an increase in the financial capacity of the DVL.

If the control over the credit risks does not lie with the DVL and/or the DVL has insufficient financial capacity to bear the credit risks, the advantages and disadvantages of the risks taken cannot be allocated to the DVL, a reward related to the size of the cash flows is therefore not arm's length and a reward related to the operational costs of the DVL is best applicable.

If both the DVL and another related entity exercise control over the credit risks, an appropriate remuneration should be determined based on the facts and circumstances of the case. The Secretary of State believes that it is not arm's length to contractually limit the risk borne by the DVL to a certain amount.

Cash pooling

In the Decree, the State Secretary addresses a couple of topics to be taken into account. The first topic relates to the term of the debit and credit positions. If a participant holds a certain debit or credit position for a longer period of time, it should be analyzed if this position is in fact not a different type of transaction (e.g., a long term loan). Furthermore, participants are only expected to make use of the cash pool if this does not lead to a disadvantage compared to the other options realistically available. The benefit of participating in a cash pool does not have to consist only of advantageous interest rates. The benefits could also be a more limited requirement to attract external loans, lower administrative burden or a more efficient management of the liquidity position.

Guarantees

Guarantees can have two benefits. Firstly, the benefit to the borrower of a guarantee may be that it can negotiate better terms compared to the situation without the guarantee. The other benefit may be that the borrower is able to borrow more money with a guarantee than without one. The State Secretary prescribes, in line with the current OECD Guidelines, that a guarantee for a group company that is unable to raise all or part of a loan on the capital market on its own, takes place in the shareholder's sphere and no service fee should be charged.

If the guarantee is used to gain better borrowing conditions, the provision of the guarantee can be seen as a service and a guarantee fee should be charged. The guarantee fee cannot exceed the advantage between the interest that could be obtained without the guarantee and the interest that can be obtained with the guarantee. If it is not possible to determine a specific arm's length guarantee fee, the State Secretary approves that the guarantee fee be set at one-half of the benefit enjoyed by the guarantor.

Cross-guarantees

According to the State Secretary, it is difficult, if not impossible, to determine the value and effects of cross-guarantees per individual guarantee between two group companies, while at the same time other group companies also guarantee the same risk. The reason for that is that cross-guarantees will hardly ever exist between unrelated parties. Therefore, it will rarely be possible to establish an arm's-length remuneration for the mutual guarantee of the various affiliated parties. Therefore, the consequences of cross-guarantees are considered shareholders services (for which a charge is not justified)

Intra-group services

Intra-group Services

The Decree stipulates that when applying the arm's-length principle with respect to intra-group services this typically results in the application of a cost-based remuneration based on the Transactional Net Margin Method (TNMM). With regard to on-charging these intra-group services, there is a

clear preference for applying the direct method. The indirect method however, is often applied in practice since the application of the direct method generally leads to practical challenges.

The Decree further includes the view of the State Secretary on certain shareholder costs related to environmental, social and governance (ESG) activities as well as on-charging certain expenses 'at cost'.

Governmental support

Governmental support

Additional guidance on governmental support has been included in the Decree regarding the application of cost-based transfer pricing methods. Subsidies and the like should reduce the cost base if there is a direct connection with the provision of the underlying product / service. If the subsidy or incentive is connected to the company itself and there is no causal connection with the activity for which a cost-based remuneration is being received, these should not be considered in the determination of the cost base. Costs that are only partially deductible according to the Dutch Corporate Income Tax Act should still be fully included in the cost base on which the profit mark-up is calculated. The limitation in the deduction of these costs is effected by adding the non-deductible part of the costs to the profit when determining the taxable profit.

Another part of the new guidance on governmental support relates to government assistance programs (also addressed in the [OECD's guidance on the transfer pricing implications of the COVID-19 pandemic](#)). A Dutch example is the Temporary Emergency Measure Bridging for Employment Preservation (NOW). The Decree mentions that it can be assumed that unrelated parties would renegotiate their terms and conditions (including price) in case of a substantial drop in turnover and/or a temporary stop in production as a result of extraordinary circumstances such as the COVID-19 pandemic. In these renegotiations, the effects of the NOW can be included as well, if this is consistent with what unrelated parties operating under comparable circumstances would do. If a taxpayer desires to change the existing terms as a

result of received or expected governmental support, it is required to demonstrate the arm's-length nature of such a modification. The aim of the transfer pricing policy amendment should in any case not be the realization of a turnover reduction in order to become eligible for a support measure.

Additional practical guidance

Alignment with international and national legislation

Various other topics have been modified, which mainly relate to the textual or terminology changes. The primary aim of these changes is to better align the Decree with the OECD Guidelines and Dutch laws and regulations. These topics relate to (amongst others):

- Aggregation of transactions
- The use of arm's length ranges
- Valuations of (hard-to-value) intangibles
- Cost contribution arrangements
- Centralized purchasing
- Transfer pricing documentation requirements

Key takeaway

The Decree can be considered the source for the Dutch Tax Administration to determine its position in terms of the application of the arm's length principle and the OECD Guidelines. It is therefore of great importance to companies to closely follow the guidance of the Decree. We would therefore advise companies to evaluate their transfer pricing in light of the guidance of the Decree.

Please contact one of our transfer pricing specialists for more information about transfer pricing or this newsletter.



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