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# ATAD II: legislative proposal

*The Netherlands: July 2019*

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## **In Brief**

On 2 July 2019, the Dutch Ministry of Finance published the legislative proposal containing the Dutch implementation of the EU Anti-Tax Avoidance Directive II ('ATAD II'), aimed at combating tax planning that makes use of so-called 'hybrid mismatches'. The proposal includes a bill and a parliamentary explanation including examples of the type of mismatches that are to be captured. A consultation document in relation to this proposal was already published on 29 October 2018. Further guidance in relation to the legislative proposal is expected as part of the parliamentary proceeding.

As required under ATAD II, the proposed legislation is intended to be effective as per 1 January 2020 with an exception for the so-called 'reverse hybrid rule' which is intended to be effective as per 1 January 2022.

We refer to our previous communications in relation to ATAD II for more detail on the directive. In relation to the legislative proposal, please find below our initial observations for the real estate industry.

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## **Proposal in general**

In short, the legislative proposal contains the Dutch implementation of ATAD II and covers situations resulting in double deduction or deduction without inclusion resulting from payments made to or by hybrid entities or in respect of hybrid financial instruments. This includes mismatches resulting from arrangements involving permanent establishments, hybrid transfers, imported mismatches and reverse hybrid entities. The proposal also includes rules on tax residency mismatches.

***PwC observation:** As expected, the legislative proposal is largely in line with the consultation document and provides little new insights. However, the legislative proposal does differ in relation to a number of items such as the exemption for CIV's/AIF's for reverse hybrid entities and the administrative requirements imposed on taxpayers. We will further elaborate on these items below.*

## **Deduction without inclusion**

To the extent that a hybrid mismatch results in a deduction without inclusion, the deduction shall be denied or, as a secondary

rule, the amount of the payment shall be included as taxable income at the level of the recipient. A payment shall be considered 'included' if the payment is subject to a tax levied on profits unless, on the basis of the qualification of the payment, that payment may benefit for an exemption, lower tax rate or credit/refund.

A payment may also be considered 'included' if the payment is not included in the taxable base of the recipient but in the taxable base of a (tax consolidated) group of which the recipient is part. The same applies if the payment is included in the taxable base of another entity under a CFC-regime. It should be noted that this would only be the case if, under the CFC-regime, the income is subject to the general statutory tax rate and no tax credit is granted in relation to the payment.

***PwC observation:** It will be important to gain insight into the tax positions of (deemed or actual) recipients of payments that may be in scope of ATAD II. This to understand whether payments are considered sufficiently included in the income of those recipients.*

## Double deduction

Payments made by hybrid entities may also result in a hybrid mismatch if those payments are made to a third party (such as interest on bank debt and management fees). Such a 'double deduction' scenario may also arise in case a (real estate) asset is depreciated or amortised in more than one jurisdiction.

**PwC observation:** *It is important to monitor the deductibility of (third party) expenses in case they are made by hybrid entities. This may be particularly relevant for US investors that 'check-the-box' on their European entities.*

## Dual inclusion income

In order to avoid double taxation, hybrid mismatches that relate to income that is included in multiple jurisdictions are excluded from an ATAD II correction. This is determined under the same conditions as determining 'inclusion' under the deduction without inclusion rules.

**PwC observation:** *There is still uncertainty as to whether the dual inclusion income escape may apply in cases where the investor jurisdiction provides for a foreign tax credit or double tax treaty relief. This position should be monitored until further guidance is provided.*

## Affiliated entities

The proposal affects hybrid mismatches in case of affiliated entities, i.e. entities with a direct or indirect interest representing at least 25% in the nominal paid-up capital, the statutory voting rights or profit rights (with a 50% threshold for 'reversed hybrid entities'). Structured transactions between unrelated parties are also covered by the proposed rules, i.e. transactions in which the financial benefit of a hybrid mismatch is part of the scheme.

The definition of affiliated entities is expanded under ATAD II to also include entities that 'act together'. This has the aim of preventing taxpayers from avoiding the threshold by splitting up their interest in a hybrid entity. In the Dutch legislative proposal, this is covered by referencing the collaborating group (*samenwerkende groep*) concept, which is an existing concept under Dutch tax legislation<sup>1</sup>.

**PwC observation:** *The inclusion of the collaborating group (*samenwerkende groep*) as already included in Dutch tax legislation is in line*

*with our expectations. There remains little guidance on the application of the concept in common investment structures (e.g. in a joint-venture or investment fund context), which makes it a difficult concept to apply in practice.*

## Investment vehicles

In line with ATAD II, the legislative proposal contains a specific rule for so-called 'reverse hybrid entities'. Under this rule, a reverse hybrid entity shall be regarded as a resident of its jurisdiction of incorporation or establishment and taxed on its income to the extent this income is not otherwise taxed as a result of a hybrid mismatch. ATAD II allows Member States to include an exemption to the reverse hybrid rule for collective investment vehicles. In the legislative proposal, this specific exemption is also included.

**PwC observation:** *In the proposal an exemption is included for both regulated collective investment vehicles and alternative investment vehicles that hold a diversified portfolio of securities. A reverse hybrid entity is in principle a Dutch tax transparent entity (for example a Dutch CV or FGR) whereby this exemption applies to certain Dutch based funds.*

## Administrative requirements

In relation to the implementation of the ATAD II rules, the proposal also introduces new administrative requirements for taxpayers. Under these requirements taxpayers are obliged to maintain documentation that shows to what extent (in relation to qualifying payments) the anti-hybrid mismatch rules are applicable or not. This should include, for example, structure charts (covering the global structure of the taxpayer) and the tax qualification of financial instruments, hybrid entities or PE's in the context of Dutch or foreign legislation.

If the taxpayer does not comply with this requirement, the tax inspector may request (in case he or she suspects that the anti-hybrid rules are applicable) the taxpayer to proof (*doen blijken*) that the rules are not applicable, effectively shifting the burden of proof to the taxpayer. In case a taxpayer would not be able to deliver the required proof, the tax inspector may issue a tax assessment (taking into account the anti-hybrid rules).

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<sup>1</sup> Article 10a Dutch Corporate Income Tax Act 1969

***PwC observation:** The administrative requirements is an additional burden for taxpayers that, if not complied with, shifts the burden of proof to the taxpayer. Additional details on the documentation that should be maintained are not yet available. However, in view of the significant consequences, it is important that taxpayers also take note of this new requirement and prepare the required documentation.*

## **Dutch qualification rules**

As part of the parliamentary explanation accompanying the legislative proposal, the Dutch Secretary of Finance noted that a number of reactions to the consultation document suggested to reconsider the qualification rules for foreign entities (either as tax transparent or opaque) in order to reduce the number of hybrid mismatches. Although the Dutch qualification rules have an impact on the outcome of the ATAD II rules, an amendment to these rules would have a wider impact on the Dutch tax regime. Therefore, the Secretary of Finance indicates that further analysis is required on potential amendments to the Dutch qualification rules and the potential impact thereof in a wider context. These analyses are expected to take place in the context of the expected revision of Dutch partnership law.

***PwC observation:** Amendments to the Dutch qualification rules may obviously have a significant impact particularly in a fund context. Although no changes to the qualification rules are expected in the short term, the qualification of partnerships and funds may be subject to revision in the context of expected future changes of Dutch partnership law. These developments need to be monitored closely to assess the impact on the application of ATAD II rules.*

## **Contacts**

Uwe Stoschek

*Global Real Estate Tax Leader*

Phone: +49 30 2636-5286

[uwe.stoschek@pwc.com](mailto:uwe.stoschek@pwc.com)

Jeroen Elink Schuurman

*EMEA Real Estate Tax Leader*

Phone: +31 88 792-6428

[jeroen.elink.schuurman@pwc.com](mailto:jeroen.elink.schuurman@pwc.com)

## **The Netherlands**

Jeroen Elink Schuurman

*National Real Estate Tax Leader*

Phone: +31 88 792-6428

[jeroen.elink.schuurman@pwc.com](mailto:jeroen.elink.schuurman@pwc.com)

Serge de Lange

*Partner*

Phone: +31 88 792-6390

[serge.de.lange@pwc.com](mailto:serge.de.lange@pwc.com)

Matthijs Vogel

*Partner*

Phone: +31 88 792-4692

[matthijs.vogel@pwc.com](mailto:matthijs.vogel@pwc.com)

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