LOYENS & LOEFF

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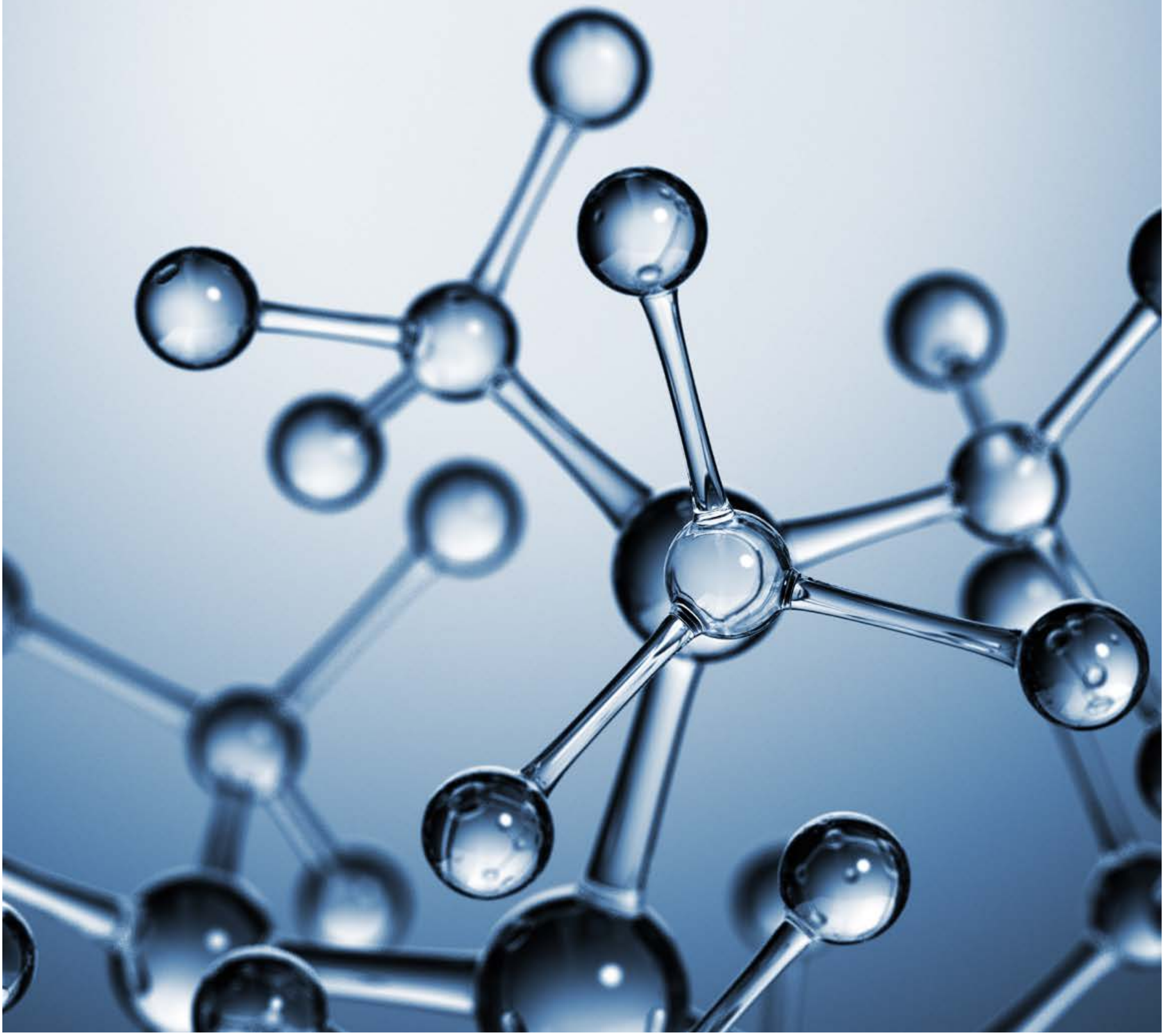
Year-end tax bulletin 2019



LOYENS LOEFF

Introduction

We are pleased to present you our annual year-end tax bulletin summarising the most relevant current tax developments in the Netherlands, Belgium, Luxembourg and Switzerland. It also provides an insight into (ongoing) international developments, mainly at OECD level, with a focus on developments and changes relevant for internationally operating businesses.

Given the general nature of this year-end tax bulletin, the information contained cannot be regarded as legal advice. You are most welcome to contact your Loyens & Loeff adviser if you would like to receive more information on any of the topics included.

Kind regards,

Loyens & Loeff

November 2019

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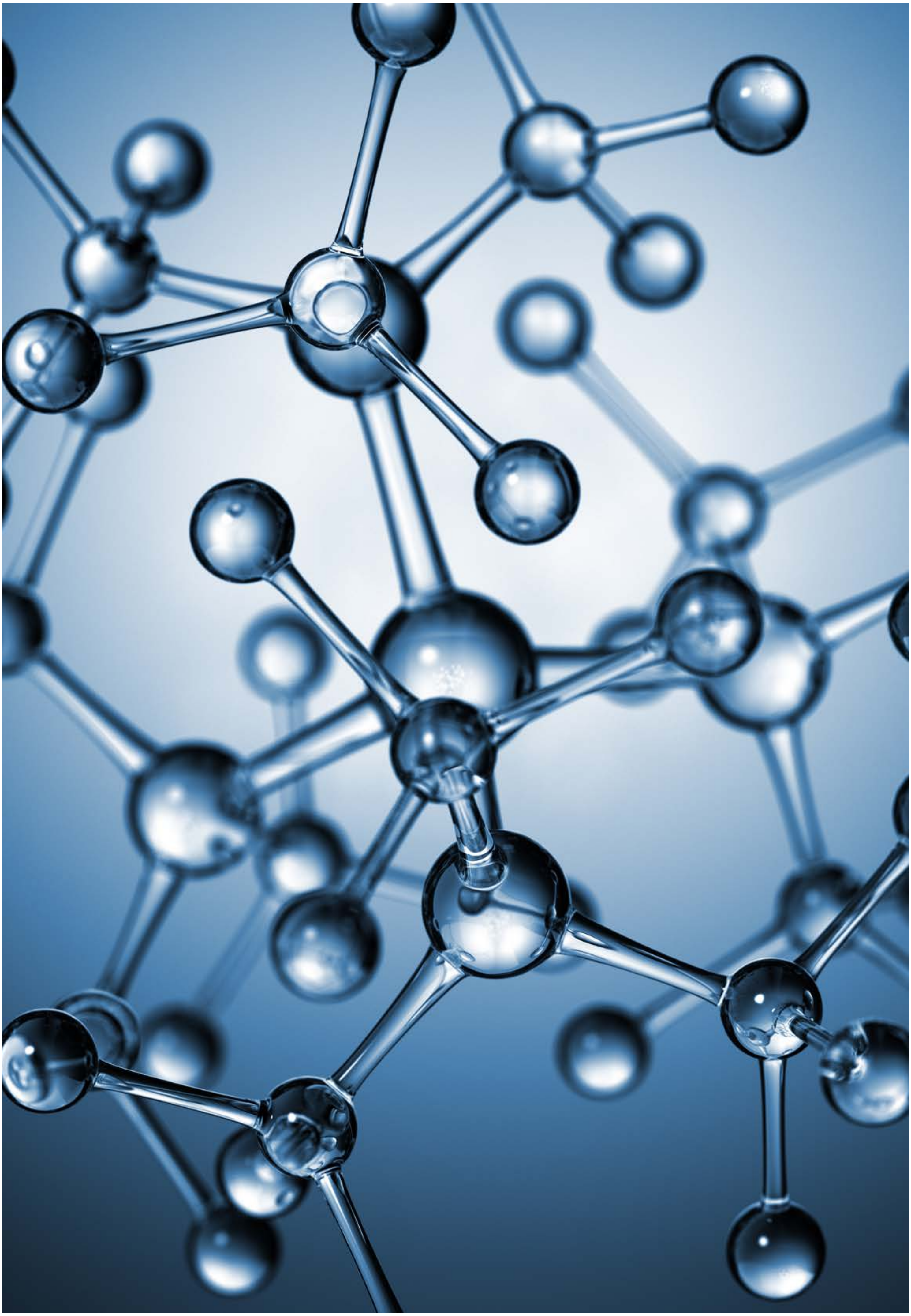

International developments

Main changes in international taxation in more detail

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"Due to the principal purpose test ("PPT") effective in many treaty relationships as from 1 January 2020 and the consequences of the CJEU's so-called Danish cases, MNEs focus even more on substance and economic reality to ensure treaty and EU Directive benefits in the future. MNEs not only align their legal structures with business structures, they also improve their transfer pricing documentation and prepare for full transparency of their tax position.

MNEs give also priority to: control over mandatory disclosure reporting, practical solutions to reduce double taxation due to transfer pricing corrections, unexpected application of multiple anti-abuse rules, more withholding taxes and new interest deduction limitations.

The work of the OECD on taxation of the globalised and digitalised economy will continue in 2020 after having made important progress in 2019. Some MNEs already started preparing for the impact of these plans."

Overview of OECD developments

Multilateral Instrument

The multilateral instrument ("MLI") implements the treaty-related anti-tax avoidance measures of the BEPS project in bilateral tax treaties. A total of 90 jurisdictions have signed the MLI to date, and more jurisdictions have expressed their intention to do so. The number of countries that have ratified the MLI has further increased during 2019, and even more countries are expected to complete the ratification procedure in the near future. The current status is that the MLI has entered into force, or will enter into force as of 1 February 2020, for 37 jurisdictions. A regularly updated overview of the signatories and ratifications is available here. Our four home market countries (the Netherlands, Belgium, Luxembourg and Switzerland) also completed the MLI ratification procedure during 2019. This means that the MLI has now entered into force for the Netherlands (on 1 July 2019), Belgium (on 1 October 2019), Luxembourg (on 1 August 2019) and Switzerland (on 1 December 2019). As a result, many bilateral tax treaties concluded by our home market countries with other countries that have also ratified the MLI will be impacted. The earliest date the MLI will apply in practice for our home market countries is 1 January 2020. The MLI will also affect the tax treaties between each of our home market countries, with the exception of the Switzerland-Netherlands tax treaty, the Switzerland-Belgium tax treaty and the Netherlands-Belgium tax treaty, which have been or will be updated bilaterally to the BEPS minimum standards.

Our home market countries have all opted for the application of the so-called principal purpose test ("PPT"), like all other jurisdictions that signed the MLI. The PPT is an anti-abuse rule that under certain circumstances denies the availability of treaty benefits, such as for dividends and capital gains. It will be increasingly relevant to demonstrate business purposes of an arrangement or

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transaction. For more information on the MLI, including an overview of the MLI choices made by our four home market countries, we refer to our MLI webpage.

Taxation of the globalised and digitalised economy
Also during 2019, tax policymakers have kept on pushing forward the company tax debate. International developments and actions have been taking place predominantly in the international tax policy arena, mostly within the context of the OECD and the Inclusive Framework. Matters have remained a high priority on tax agendas at EU levels too, where voices have been raised to further seek agreement on and implement EU-wide measures if the pursuit of corporate tax reforms were to stagnate at some point at an international level.

Where the debate, which was initiated in mid-2017, started with a focus on multinationals operating digital business models, matters are now tilting towards a discussion on restabilising the entire international tax regime that has come under pressure as a result of the globalisation and digitalisation of our economies. The perception has grown that multinationals do not pay their fair share of corporate tax, regardless of the 2015 BEPS deliverables and their implementation in many countries, including the EU. The discussion is moving beyond the BEPS outcomes and beyond internet companies only, towards assigning the corporate tax basis also to market jurisdictions and securing taxation of business earnings at a certain global minimum tax rate for multinational companies in virtually all economic sectors and industries.

The OECD has published various documents throughout 2019, and hosted webinars and public consultations on them. OECD publications include a policy note on 29 January 2019, a policy outline document on 13 February 2019, a programme of work on 31 May 2019, and two concretising reform proposals on 9 October 2019 and 8 November 2019; see our tax flashes respectively here, here, here, here, and here. The programme of work was endorsed by the Inclusive Framework, however without countries committing themselves politically to any of the possible outcomes of further work. The concretising reform proposals of 9 October 2019 and 8 November 2019 have come from the OECD Secretariat, and do not constitute consensus within the OECD Inclusive Framework. The proposals serve to further discussion within that forum which had come to a standstill during the year. The objective nevertheless remains to reach consensus on a solution to these matters by the end of 2020.

Measures suggested and which are now subject to further assessment and concretisation in pursuit of international political consensus before year-end 2020 are built on two pillars. Pillar One focuses on the nexus and allocation of taxing rights by reference to the so-called ”Unified Approach” and is aimed on reaching consensus within the Inclusive Framework on key elements early 2020. Pillar Two focuses on a further exploration of possibilities to strengthen taxation rights of countries to ensure that multinational business enterprises are being taxed on their corporate earnings at a certain minimum level that is considered sufficient.

The OECD Secretariat’s proposal for a ”Unified Approach” under Pillar One suggests adding an overlay to the existing international tax framework. The overlay, as it appears, would apply to big multinational enterprises (i.e. having revenues that exceed EUR 750 million, for instance) with “consumer facing business models”, or at least to those big multinational enterprises operating business models other than those explicitly carved out (e.g. extractive industries, commodities, financial services having revenues). For these ring-fenced enterprises, first the traditional transfer pricing model would be modified by introducing a presumed level of remuneration for so-called baseline marketing and distribution functions. The presumed level would be determined using a proxy (fixed remuneration) and applied as a basic assumption as jurisdictions that were to make a case for applying a higher remuneration (which would require an effective mechanism for resolving disputes). Second, and on top of this, a newly devised tax base division system (“new taxing right”) would cater for apportioning the tax base – referred to as Amount A – to market jurisdictions. For this purpose, a fixed percentage (possibly with industry-specific variants) would be taken from the multinational’s commercial accounting profits (GAAP, IFRS, etc.) and allocated to market jurisdictions by reference to a quantitative turnover threshold test for nexus purposes and a sales-based formula factor for tax base division purposes. The percentages are yet to be established.

Pillar Two, the so-called Global Anti-Base Erosion (”GloBE”) proposal, is aimed at reducing the incentive to shift profits to low-tax jurisdictions and effectively achieving a minimum taxation on MNE income. The proposal comprises two linked measures: an “income inclusion rule” and a “tax on base erosion payments”. The income inclusion rule would operate as a minimum tax by including the income of a foreign branch or controlled entity in the tax base of the controlling taxpayer if that income was not effectively taxed at a minimum rate. This rule would be more far-reaching than traditional CFC rules. A top up to a minimum (fixed) rate is being considered, as is a so-called switch-over rule for tax treaties allowing the state of residence to apply the credit method instead of exemption in certain situations. The tax on base erosion payments would effectively (i) deny the deduction for corporate tax purposes or introduce a source levy on payments to a related party if that payment is insufficiently taxed in the hands of the recipient involved ("undertaxed payments rule") and (ii) introduce a subject to tax rule that would grant tax treaty benefits only if the beneficiary is "sufficiently taxed" in the other treaty jurisdiction. The OECD acknowledges the need to explore possible carve-outs for regimes compliant under Action 5 on harmful tax practices or other substance-based carve-outs. It also acknowledges the need to consider the compatibility of these rules with the non-discrimination provisions in tax treaties as well as their interaction with the EU fundamental freedoms. The minimum tax rate is yet to be established.

Considering the magnitude of the tax reform initiatives tabled, it is recommended that companies in all economic sectors closely monitor developments in this area and assess the potential impact of the reform proposals on their global business operations. Although the topic has clearly remained a priority throughout 2019, it is still too early to determine at this time whether sufficient political momentum exists for actually bringing about the tax reform initiatives tabled. If the OECD does not achieve a reform of the international tax system, companies should expect EU Member States to further seek to agree on and implement EU-wide measures inspired by the OECD options. An overview of the international developments is available here.

Spontaneous exchange by no or only nominal tax jurisdictions
On 31 October 2019, guidance on the spontaneous exchange by no or only nominal tax jurisdictions was released. As part of BEPS Action 5 to curb harmful tax practices, jurisdictions may only maintain preferential regimes if certain requirements of "substantial activities" are met. In order to ensure a level playing field, these requirements must also apply to jurisdictions with zero or only nominal tax rates. The "Resumption of application of substantial activities factor to no or only nominal tax jurisdictions" requires them to spontaneously exchange information on the activities of certain resident entities with the jurisdiction(s) in which the immediate parent, the ultimate parent and/or the beneficial owners are resident. It is expected that exchanges pursuant to the standard will commence in 2020.

Country-by-Country reporting
On 5 November 2019, additional interpretive guidance was released giving greater certainty to tax administrations and MNE groups on the implementation of Country-by-Country reporting. The new guidance includes questions and answers on, amongst other topics, the treatment of dividends received, the operation of local filing and the use of rounded amounts.

EU Developments

EU Anti-Tax Avoidance Directive
The EU Anti-Tax Avoidance Directive (Council Directive (EU) 2016/1164, also referred to as "ATAD or ATAD1") was adopted on 12 July 2016. Most rules from ATAD1 needed to be implemented in domestic law by 1 January 2019. The domestic implementation in the Netherlands, Belgium and Luxembourg is described in more detail in our Quoted of June 2019.

ATAD was amended by Council Directive (EU) 2017/952 of 29 May 2017, mostly focusing on the topic of hybrid mismatches. These rules (also referred to as "ATAD2") need to be implemented in domestic law by 1 January 2020 and 1 January 2022. Under ATAD2, in essence three types of rules need to be implemented to neutralise the tax effects of hybrid mismatches:

- **Denial of deduction:** payments made by a corporate taxpayer may no longer be tax-deductible if and to the extent such payments, as a result of a hybrid mismatch arrangement, are not regarded as taxable income in the state of the recipient (deduction without inclusion; D/NI) or these payments (or expenses or losses) can be deducted twice (double deduction; DD). This rule is referred to as the "primary rule". As an exception to this primary rule, deduction may in certain hybrid mismatch situations be allowed if and to the extent the deduction is set off against so-called dual inclusion income.
- **Inclusion of income:** income of a corporate taxpayer that would normally be exempt from corporate income tax or not be recognised, as a result of a hybrid mismatch arrangement, is included in the taxable income if the underlying payment was deductible in the state of the payer. This rule is referred to as the "secondary rule".

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- **Taxation of reverse hybrid entities:** reverse hybrid entities (transparent for corporate tax purposes in their own jurisdictions and non-transparent for tax purposes in the residence state(s) of the participants in the entity) will be subject to corporate income tax if incorporated, established or registered in a Member State. This rule is referred to as the ”reverse hybrid rule”.

The primary and secondary rules need to be implemented before 1 January 2020 and the reverse hybrid rule needs to be implemented before 1 January 2022.

EU Directive on Dispute Resolution

On 10 October 2017, the Council of the European Union adopted the Council Directive on tax dispute resolution mechanisms in the European Union. This directive will apply to any complaint submitted from 1 July 2019 onwards with respect to those questions related to a tax year starting on or after 1 January 2018.

The directive introduces improvements to the existing mechanisms intended to resolve disputes between Member States on the interpretation of bilateral tax treaties. The directive makes dispute resolution mechanisms binding and mandatory. Additionally, the directive introduces time limits and obliges Member States to resolve disputes related to double taxation. The directive will result in more legal certainty in that it guarantees final and binding decisions for any dispute.

The directive enables any affected company to submit a complaint to the competent authorities of Member States. Such a complaint can lead to a mutual agreement procedure. If mutual agreement is not reached within two years, a mandatory arbitration procedure will be launched. In this procedure an officially appointed advisory commission will issue a binding opinion. The directive could result in reducing the length of time needed to resolve cross-border disputes.

EU transparency developments

EU Mandatory Disclosure Directive

On 25 May 2018, the Council of the European Union adopted a Council Directive introducing mandatory disclosure rules for EU-linked intermediaries such as lawyers, accountants and tax advisers (“MD Directive”). The MD Directive obliges Member States to implement rules, based on which qualifying intermediaries, and under certain circumstances taxpayers, are required to report certain arrangements to the relevant tax authorities. These arrangements concern potentially aggressive tax planning arrangements with a cross-border dimension and arrangements designed to circumvent reporting requirements such as the Common Reporting Standard and ultimate beneficial owner reporting. The tax authorities will exchange the information received automatically with all other Member States through a centralised database.

The obligation to disclose may not be enforceable on an intermediary due to legal professional privilege (depending on the domestic implementation), or because the intermediary does not have a presence within or link to the EU. It might also be the case that there is no intermediary involved because the taxpayer designs and implements a scheme in-house. In these circumstances, the disclosure obligation shifts to the taxpayer if no other intermediary is involved.

Member States must implement the MD Directive by 31 December 2019 at the latest and apply the provisions from 1 July 2020 onwards. All reportable arrangements of which the first step is implemented within the time frame between 25 June 2018 and 1 July 2020 must be reported by 31 August 2020 at the latest. As a result of this retroactive effect, intermediaries as well as taxpayers should monitor what information they may need to disclose in 2020 about arrangements that are advised or have been implemented since 25 June 2018.

For taxpayers it is advisable to organise themselves to be in control of the consequences of the implementation of the MD Directive. The following suggestions are recommended:

- Discuss and streamline with your advisers the information which potentially will have to be filed with the tax authorities on the arrangement, especially if more than one intermediary is involved;
- Review cross-border arrangements which are developed in-house or where only non-EU advisers are involved whether they are reportable under the MD Directive. If so, or if as a result of the lack of detailed guidelines the position is unclear, include information in a sort of database to ensure that a possible future obligation to report can be properly fulfilled (given the retrospective effect); and
- Be aware whether the intermediary involved is entitled to a waiver, even in the situation in which the formal

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reporting obligation will shift to another intermediary involved in the arrangement. Depending on the local implementation the reporting obligation may shift to the taxpayer. In such a situation it is recommended keeping track of information in the above-mentioned database.

For more detailed information on the MD Directive, see our Quoted of October 2018.

Ultimate beneficial owner register

The EU has put a great deal of effort into tax transparency and anti-money laundering measures. Accordingly, all EU Member States must keep a register containing the details of the individuals that are known as the "ultimate beneficial owners" of legal entities and other entities based in the EU ("the UBO-register").

The introduction of a UBO-register is one of the measures included in the fourth EU Anti-Money Laundering Directive ("AMLD4"). In 2018, the European Parliament, the Council and the Commission reached an agreement on a directive amending the fourth EU Anti-Money Laundering Directive ("the amended AMLD4"). In accordance with the amended AMLD4, all EU UBO-registers must be accessible to the general public.

Additionally, all Member States must provide for a UBO-register for trusts that are established in, are residing in, are managed in (for example because the trustee is residing there) or enter into certain business transactions in that Member State.

The UBOs of a trust are the settlor(s), the trustee(s), the protector, the beneficiaries or classes of beneficiaries and any other natural person exercising ultimate control over the foundation by other means. The UBO-register for trusts will not be publicly accessible, but will only be available to persons who can demonstrate a "legitimate interest".

According to the amended AMLD4, the UBO-register for legal entities should be implemented by 10 January 2020 and the UBO-register for trusts should be implemented by 10 March 2020.

EU State aid and tax rulings

State of play

The EU General Court (first instance EU jurisdiction) has issued three judgments in 2019, annulling the European Commission's decisions in the excess profit ruling (Belgium) and Starbucks (the Netherlands) cases, and upholding it in the Fiat (Luxembourg) case.

The Apple (Ireland), Amazon (Luxembourg), ENGIE (Luxembourg), Gibraltar exemption scheme and tax ruling (Gibraltar/UK) and CFC financing exemption (UK) cases are still pending before the General Court. In the Apple case, the hearing took place on 17 and 18 September 2019. Formal investigations are still ongoing in the Inter IKEA (the Netherlands), Nike (the Netherlands) and Huhtamäki (Luxembourg) cases. In addition, the Commission has opened 39 investigations into individual excess profit tax rulings granted by Belgium to local subsidiaries of multinational groups.

First judgments on substance of cases set framework for Commission's enforcement of the arm's length principle under State aid rules

On 24 September 2019, the General Court issued its judgments in the Fiat [1] and Starbucks [2] cases. In both cases it confirmed that the Commission can review whether tax rulings dealing with transfer pricing comply with State aid rules. The arm's length principle may be used as a tool to verify that the beneficiaries of the tax rulings were not granted a selective advantage. The General Court reached that conclusion based on the premise that standalone and group companies are in a similar position in view of the objective of the general tax system (i.e. taxing profits realised by taxpayers). Companies involved in transactions with related parties should comply with the arm's length principle in order to be taxed in the same way as standalone companies that only perform market-based transactions.

At the same time, however, the General Court recognised that transfer pricing ("TP") entails inherent inaccuracies to approximate a market-based outcome, and therefore the Commission may conclude that there is a selective advantage only if "the variation between the two comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation." [3]

1 Joined Cases T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v. Commission, ECLI:EU:T:2019:670.
2 Joined Cases T-760/15 and T-636/16, the Netherlands and Starbucks Corp/Starbucks Manufacturing Emea BV v. Commission, ECLI:EU:T:2019:669.
3 Fiat, para 144 ; Starbucks, para 152.

The General Court went into the details of the transfer pricing positions. The Commission had challenged various aspects of the respective TP analysis, such as the choice of the TP method, the choice of the profitability indicator, and the selection of comparable companies. The General Court upheld the Commission's decision concluding State aid in the Fiat case, but annulled the Commission's decision finding that Starbucks had received unlawful aid: in the latter case, the Commission did not prove to the requisite legal standard that the TP analysis made by Starbucks was inappropriate. Although the OECD Transfer Pricing Guidelines are not binding, the General Court often refers to them to apply the arm's length principle specifically to the cases at issue. At the same time, the General Court pointed out that methodological mistakes do not automatically entail a selective advantage; what counts is the actual outcome.

For more details on the General Court's TP analysis, please refer to our Tax Flash of 24 September 2019 and our Quoted nr. 129 – The European Commission's Approach towards State Aid in Tax Matters: 2019 Update.

The General Court's judgment in the Belgian excess profit ruling case

On 14 February 2019, the General Court annulled the Commission's decision finding that Belgium had implemented an unlawful aid scheme through its excess profit rulings. The General Court did not address the TP considerations but found that the Commission had wrongly found that these rulings constituted a scheme. The tax rules needed implementing measures (the tax rulings) and the tax authorities had a margin of appreciation, hence the criteria for an aid scheme to exist were not met.

For further details, please refer to our Tax Flash of 14 February 2019. The Commission has appealed against the judgment before the Court of Justice of the European Union (upper level EU court, "CJEU") and, in addition, opened 39 formal State aid investigations into the individual excess profit rulings concerned in September 2019.

New investigations

On 10 January 2019, the Commission opened a formal investigation into five tax rulings granted by the Dutch tax authorities to companies of the Nike group. This case concerns TP and bears some resemblance to the Amazon case: in both cases, the Commission questions the allocation of royalty income of entities that have no employees and are allegedly deprived of any relevant functions, whereas the royalty payers are companies with business functions and numerous employees. For further details, please refer to our Tax Flash of 10 January 2019. In addition, on 7 March 2019, the Commission opened a formal investigation into the tax treatment of Huhtamäki in Luxembourg. The case concerns a TP mismatch between Luxembourg and Ireland. The Irish company had granted an interest-free loan to a Luxembourg related group company. Under Luxembourg TP rules, a deemed (arm's length) interest was imputed and reduced the tax base, whereas no corresponding upward adjustment was reported for tax purposes in Ireland. The Commission argues that Luxembourg's unilateral downward adjustment deviates from the general Luxembourg tax system without appropriate justification. For further details, please refer to our Tax Flash of 7 March 2019.

As mentioned earlier, the Commission also opened 39 formal State aid investigations into individual Belgian excess profit rulings in September 2019.

While these new cases focus on TP issues, it is important to remember that the Commission also looks at other tax rules, such as the anti-abuse rules (as in the ENGIE case, see our Tax Flash of 21 June 2018).

Actions for taxpayers

The CJEU may still overturn the General Court's judgments on points of law, such as the possibility for the Commission to apply a (not clearly defined) arm's length principle as a tool to verify the existence of a selective advantage and thus of State aid. Even if ultimately successful, appeals are, however, unlikely to be ruled on before 2021.

In the meantime, taxpayers that perform State aid reviews to assess the need to book provisions should going from now on apply the General Court's framework of analysis, i.e. an arm's length principle interpreted primarily in the light of the OECD Transfer Pricing Guidelines. In addition, they should continue to properly document all related party transactions and verify that the TP analysis underlying the pricing of intragroup transactions complies with current TP standards (at present, notably the OECD Transfer Pricing Guidelines).

Other EU developments

EU black list

On 10 October 2019, the EU updated the list of non-cooperative jurisdictions for tax purposes (black list). In this context, the Council of the European Union has agreed to remove the United Arab Emirates and the Marshall Islands from the EU's list of non-cooperative jurisdictions for tax purposes. More recently, on 8 November 2019, the Council of the European Union agreed to remove Belize from this list. The EU black list now consists of eight jurisdictions: American Samoa, Fiji, Guam, Oman, Samoa, Trinidad and Tobago, US Virgin Islands and Vanuatu.

CJEU case law

During 2019, the CJEU rendered some relevant decisions in the field of direct taxation.

On 26 February 2019, the CJEU delivered two judgments concerning six cases [4] ("the Danish cases") which deal with the interpretation of the Parent-Subsidiary Directive ("PSD") and the Interest & Royalties Directive ("IRD"). First, these cases have a strong impact on the interpretation of abuse for EU Member States and substance requirements for holding and financing/licensing companies. The CJEU broadened the EU definition of tax avoidance, in which case no protection from the IRD or the PSD can be invoked, and provided indicia as to the elements that may constitute abuse when using intermediate holding companies. It also added the important statement that even in the absence of anti-abuse provisions in national law or tax treaties, Member States should apply a general EU law anti-abuse principle in order to refuse the benefits of the directives.

Second, the CJEU also provided relevant insights on the relevance and interpretation of the term "beneficial ownership" (see for more details the EU Tax Alert 177). The CJEU stated that the term beneficial owner in the IRD, required to be able to benefit from the exemption from tax under the IRD, should be interpreted as the entity which benefits economically from the interest received and accordingly has the power to freely determine the use to be given to that income. If there is a contractual or legal obligation to transfer funds, this is an indication that the funds are not freely available to the beneficiary. However, according to the CJEU, this is just as much the case if such an obligation does not exist, but the beneficiary does not, in essence, have the right to use and benefit from it. This may therefore be the case if income – under whatever form it may be – is up-streamed to non-qualifying beneficiaries. Contrary to the IRD, the PSD does not explicitly contain the condition that the receiving company must be the beneficial owner in order to benefit from the dividend withholding tax exemption. However, the CJEU considers that the dividend withholding tax exemption provided for in the PSD can be refused if the beneficial owner of the distributed dividend is a tax resident of a third state. Such a refusal is not in any way subject to the existence of fraud or an abuse of rights. The CJEU thus appears to import an implicit beneficial ownership requirement in the PSD. Taking into account these considerations, it is important that cash flow models are being reviewed and possibly revisited.

On the same day, the CJEU delivered another important decision with its judgment in case *X GmbH* (C-135/17) which dealt with the German CFC legislation (see for more details EU Tax Alert 179). This case is relevant as the CJEU ruled that, in the context of free movement of capital, the concept of "wholly artificial" is not necessarily limited to the indications of establishing a company that does not reflect economic reality set out in the Cadbury Schweppes case. The CJEU observed that the artificial creation of conditions in order to escape taxation in a Member State improperly can take several forms as regards the free movement of capital. Therefore, the concept may also cover any scheme which has as its primary objective or one of its primary objectives, the artificial transfer of profits made by way of activities carried out in the territory of a Member State to third countries with a low tax rate.

Finally, on 19 June 2019 the CJEU delivered two decisions in cases *Memira* (C-607/17) and *Holmen* (C-608/17). Both decisions are of relevance as the CJEU dealt with the interpretation of the concept of final losses for the purposes of claiming cross-border loss relief under the *Marks & Spencer* doctrine under which only so-called final losses can be deducted. In particular, the CJEU stated that the concept of final losses does not apply to a sub-subsidiary unless all companies between the parent

4 N T Danmark (C-116/16) and Y Denmark (C-117/16) and cases Luxembourg 1 (C-115/16), X Denmark (C-118/16), C Danmark (C-119/16) and Z Denmark (C-299/16)).

company claiming the group relief and the sub-subsidiary carrying the losses are established in the same Member State.

VAT

CJEU: Deduction of VAT on costs made for principal establishment located in other EU Member State
On 24 January 2019, the CJEU delivered its judgment in the case *Morgan Stanley* (C-165/17).This case dealt with the determination of the right to deduct input VAT on costs for the principal establishment in another EU Member State. The French branch of UK-based Morgan Stanley was regarded as a fixed establishment for VAT purposes and performed two types of activities. On the one hand, the branch carried out banking and financial transactions for its local clients, in respect of which it had opted to be liable for VAT. On the other hand, the branch supplied VAT-exempt services to the principal establishment located in the United Kingdom, in return for which it received transfers from the principal establishment. The branch deducted the VAT on all expenditures attributable to either one or both of those two categories of services.

The CJEU ruled that in case a branch exclusively carries out activities for the principal establishment and these activities are both subject to VAT as well as VAT exempt, it is necessary to limit the deductible VAT by applying a fraction the denominator of which is formed by the turnover exclusive of VAT and the numerator of which is formed by the VAT taxed transactions in respect of which VAT would have been deductible if they had been carried out in the EU Member State in which that branch is registered. In the circumstance where a branch carries out transactions both in the EU Member State in which it is registered and in the EU Member State in which its principal establishment is located, it is necessary that, in the numerator of the fraction for determining the deductible VAT, besides the VAT taxed transactions carried out by that branch, only the VAT taxed transactions carried out by that principal establishment, in respect of which VAT would also be deductible if they had been carried out in the EU Member State in which that branch is registered, are included. It goes without saying that this ruling affects all taxpayers with branches in different countries.

CJEU: sale-and-lease back does not lead to adjustment of deducted VAT for lessee
On 27 March 2019, the CJEU delivered its judgment in the case *Mydibel* (C-201/18). This case concerns sale-and-lease back transactions with real estate in continuous use by Mydibel for which VAT used to be fully deducted. Mydibel sold and leased back two buildings for the sole purpose of increasing its liquidity. These sale-and-lease back transactions were not subject to VAT. The Belgian tax authorities took the view that the deduction of input VAT initially applied with respect to these buildings should be adjusted given that the sale and lease back transactions were not subject to VAT. The CJEU ruled that it is apparent that the buildings were used by Mydibel in an uninterrupted and permanent manner for its economic activities. The mere creation of a ground lease and a real property leasing agreement not subject to VAT cannot be regarded as a change in the factors used to determine the amount of the deductions made after the VAT return was made. As such no adjustment of the deducted VAT is necessary. This ruling can have significant consequences, especially for financial institutions active in sale-and-lease back transactions.

CJEU: Providing fuel cards is financial service
On 15 May 2019, the CJEU delivered its judgement in the case *Vega International Car Transport and Logistic* (C-235/18). In this ruling the CJEU confirms that when paying for fuel with a fuel card, the fuel is not supplied to and by the card company. The fuel is for VAT purposes directly supplied by the fuel company to the card holder. The activities of the fuel card company are considered financial services exempt from VAT and the fuel card company is not eligible for a refund of the VAT charged for the supply of the fuel.

CJEU: Supervisory board member is not a VAT taxable person
On 13 June 2019, the CJEU delivered its judgement in the case *IO* (C-42/18) about the VAT status of supervisory board members. In the first place, the CJEU considers that the work of a supervisory director, even if only for one board, constitutes an economic activity provided the activity is carried out on a regular basis for remuneration. However, a supervisory board member is not acting in his own name, for his own account, but rather under the responsibility of the supervisory board. Also, the supervisory board member in this case did not bear the economic business risk, since he received a fixed remuneration that does not depend on his participation

in meetings or on the hours he actually works. Based on those considerations, a supervisory board member does not perform an economic activity independently and hence, does not qualify as a taxable person for VAT purposes.

Developments in the Netherlands

Main changes in Dutch tax in more detail

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"The Dutch fiscal unity is an important facility for many MNEs. MNEs adopted their structures to recent changes to the fiscal unity regime and have to monitor closely future developments, possibly replacing the fiscal unity regime with a group relief system.

In addition, MNEs should review the potential tax impact from a range of new or proposed measures such as the anti-hybrid rules, the conditional withholding tax on interest and royalties, the MLI and potential substance requirements for holding companies. These rules sometimes have an unexpected impact, e.g. in the case of imported mismatch or conduit situations, and may require restructuring. Our team of trusted advisers is fully up to speed with the latest developments and ready to assist you with pragmatic, to the point advice."

Actions to be considered

- Multinational Enterprises ("MNEs") with a Dutch reporting entity are reminded to prepare and file their 2018 Country-by-Country ("CbC") report with the Dutch Tax Authorities before the end of their 2019 financial year. Dutch entities of an MNE with CbC reporting obligations are reminded to notify the Dutch Tax Authorities in which country the MNEs 2019 CbC report will be filed before the end of their 2019 financial year. We recommend verifying whether local filing obligations exist. This is the case if the CbC report is not exchanged with a jurisdiction of a group entity with CbC reporting obligations.
- Structures in which treaty benefits are key, need to be reviewed for the impact of the Multilateral Instrument entering into effect in many treaty relationships as from 1 January 2020.
- Dutch incorporated entities with effective management in a treaty country may face Dutch taxation after entry into effect of the Multilateral Instrument. So revision of structures may be considered.
- The ATAD2 implementation may impact structures with hybrid entities and instruments even potentially leading to double taxation meaning that any structure with such entities or instruments needs to be reassessed.
- Changes to the withholding tax exemption for dividend withholding tax as from 1 January 2020 may have a positive or negative impact in structures meaning that in certain situations it should be considered to distribute dividends before year-end and in others to postpone until next year.
- A conditional withholding tax of 21.7% on interest and royalty payments to certain low tax jurisdictions will be introduced as from 1 January 2021. Not only direct payments to such jurisdictions but also indirect payments and payments to certain hybrid entities will be subject to that withholding tax. Restructuring may

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be required in 2020 to avoid applicability of the new withholding tax.
- Inclusion of income under the Dutch CFC rules can be avoided in case the profits of the CFC are distributed before year-end (assuming book year equals calendar year). This should be considered, if relevant.
- Fiscal unities may be impacted by the Brexit in case UK based entities are involved. So restructuring may be required in case the fiscal unity needs to stay in existence.
- In view of recent developments regarding the OECD transfer pricing principles and EU state aid cases, it is recommended to perform a sanity check on the transfer pricing analysis and documentation.
- Meeting relevant substance requirements (including a EUR 100,000 salary and office space requirement) is important for many Dutch rules such as dividend withholding tax and CFC. These requirements may be expanded to certain financing and royalty flow through companies to avoid exchange of information with treaty countries. It is recommended to check compliance with these requirements before year-end.

Multilateral Instrument

On 29 March 2019, the Netherlands deposited its Multilateral Instrument ("MLI") ratification bill with the OECD. As a result, the MLI entered into force for the Netherlands on 1 July 2019 and will generally enter into effect for the Netherlands' covered tax treaties as of 1 January 2020 (see below). The entry into effect of the MLI is likely to affect the entitlement to tax treaty benefits under covered tax treaties concluded by the Netherlands.

As from 1 January 2020, the MLI will apply in respect of *withholding taxes* for the covered tax treaties concluded by the Netherlands with other jurisdictions that completed the MLI ratification process by notifying the OECD prior to 1 October 2019. With respect to all *other taxes*, such as corporate income tax, the MLI will have an impact on tax years starting on or after at least nine months after the Netherlands or the other treaty jurisdiction has deposited the ratification instrument with the OECD (whichever date is latest). For the Netherlands, the MLI will therefore apply at the earliest to tax years beginning on or after 1 January 2020.

With regard to the contents of the MLI, in principle the Netherlands accepts all MLI provisions, making only a limited number of reservations of a technical nature.

The Netherlands' final MLI choices are in line with the provisional list of choices and reservations notified by the Netherlands to the OECD in June 2017, apart from the amendment made by the Lower House of the Dutch Parliament as part of their approval of the ratification bill (see the overview at our website). This amendment resulted in a (temporary) full opt-out of article 12 MLI, which targets the artificial avoidance of the permanent establishment ("PE") status through anti-commissionaire arrangements.

The Netherlands listed 81 out of its 94 tax treaties to be brought under the scope of the MLI. Based on the (provisional) choices of its treaty partners, the Netherlands expects 56 of its tax treaties to be affected by the MLI. So far, 37 jurisdictions overall have completed their MLI ratification procedures. On the basis of the deposits published as of 30 October 2019, it is expected that the MLI will apply as from 1 January 2020 to the following tax treaties concluded by the Netherlands: Australia, Austria, Canada, Finland, France, Georgia, Iceland, India, Israel, Japan, Lithuania, Luxembourg, Malta, New Zealand, Norway, Serbia, Singapore, Slovak Republic, Slovenia, the UAE and the UK. Over time, more tax treaties will be covered as ratification progresses in other jurisdictions.

For more information on the MLI, we refer to our MLI webpage.

Taxation digital economy

Issues involving the taxation of tech companies have remained in the political spotlights in the Netherlands during 2019. The landscape has been diffuse though.

Voices have been raised in Parliament that the existing tax framework does not deal adequately with the challenges arising from digitalisation. The Lower House of the Dutch Parliament nevertheless has not embraced an informal bill submitted by a Member of the European Parliament ("MEP") to unilaterally introduce a measure in the form of a turnover-based tax on some internet services provided by some internet businesses (digital services tax). The House also did not endorse a joint motion of three MEPs asking the Dutch government to actively make a case within the EU for embracing at EU level the envisaged corporate tax reform measure for a global minimum tax rate under the Global anti-Base Erosion ("GloBE") proposal as developed within the context of the OECD, G20, and the Inclusive Framework.

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The Dutch government endorses the need to properly address BEPS issues, while preserving the attractiveness of the investment climate. Challenges raised by digitalisation go beyond mere BEPS issues and also involve a discussion on whether the corporate income tax base amongst countries should be redistributed. According to the Dutch government, the draft bill released on Budget Day for a conditional source tax on outbound royalty and interest payments to group companies in low tax jurisdictions and in tax abuse scenarios conceptually aligns with the OECD's Pillar Two GloBE proposals. The Netherlands considers itself a frontrunner in this area, and politically teamed up with France and Germany here. The conditional source tax is envisaged to be operational as from 2021. See also page 19 - 20.

The Dutch government adopts a constructive and open-minded stance in the post-BEPS debate and considers the Inclusive Framework to be the right forum for this purpose. No strong political stance has been taken on the direction and exact properties of potential outcomes and solutions. The Dutch government acknowledges that the Pillar One and Pillar Two measures will affect tax revenues in countries, the Netherlands included, the extent of which however is unclear at this time. At the request of a number of countries, including the Netherlands, the OECD is working on an impact assessment to quantify the effects of the suggested measures. The European Commission is assessing the impact for the EU Member States. The Dutch government is conducting an assessment of its own to establish the effects for the country. It acknowledges that much work is still to be done and many questions cannot be answered at this stage of the reform process.

ATAD2 implementation in the Netherlands

On 2 July 2019, the Dutch government published a legislative proposal implementing rules to counter hybrid mismatches, as required by the amended EU Anti-Tax Avoidance Directive ("ATAD2"). The proposal follows to a large extent the rules following from ATAD2, see our Tax Flash of 2 July 2019.

In addition to the rules from ATAD2, the proposal introduces a documentation requirement for corporate taxpayers to include in their administration information that is relevant for determining if and to what extent a payment is affected by the new anti-hybrid mismatch rules. Such information may, inter alia, comprise a (global) structure chart of the group and an analysis of the treatment of financial instruments, hybrid entities and permanent establishments under the relevant Dutch and foreign (tax) laws.

Furthermore, it was announced that the Dutch government will withdraw the so-called CV/BV Decree that deals with the application of the anti-hybrid entity provision in the tax treaty between the Netherlands and the United States. As of 1 January 2020, the tax treaty between the Netherlands and the United States will therefore no longer reduce the Dutch dividend withholding tax rate on distributions to certain reverse hybrid entities (such as certain Dutch CVs).

Dispute resolution mechanisms in the Netherlands

The Netherlands implemented the Directive on tax dispute resolution mechanisms on 10 July 2019 via the Tax Arbitration Act *(Wet fiscale arbitrage)*. This law entered into force on 16 July 2019 and applies to complaints submitted to the competent authorities as of 1 July 2019 regarding disputes on income or capital received during a taxable period starting on or after 1 January 2018. For the Netherlands, the Minister of Finance will fulfil the role of the competent authority. The law ensures the effective resolution of disputes between Member States when those disputes arise from the interpretation and application of agreements and conventions that provide for the elimination of double taxation on income and, where applicable, on capital.

Transparency

Dutch legislative proposal to implement mandatory disclosure rules

On 12 July 2019, the Dutch government published a legislative proposal implementing the Mandatory Disclosure Directive ("MD Directive"). The legislative proposal introduces mandatory disclosure rules, based on which qualifying intermediaries and – under certain circumstances – taxpayers need to report certain arrangements to the Dutch tax authorities.

The legislative proposal applies to arrangements in the context of all taxes except for value added tax, custom duties and social security premiums.

A cross-border arrangement is reportable if it concerns at least one EU Member State and contains at least one of the hallmarks set out in the MD Directive.

The term ”arrangement” is not further defined in the legislative proposal. An arrangement can consist of different elements such as a transaction, action, agreement, loan, commitment, or a combination thereof. The Dutch government has stated that it will publish further administrative guidance on the hallmarks and obligations under the new rules in January 2020.

The list of the hallmarks included in the proposal is fully in line with the list of the MD Directive.

Some of the hallmarks only apply if the so-called main benefit test is satisfied. The explanatory memorandum to the legislative proposal provides further guidance on this main benefit test. The term ”tax benefit”– which is an important element in the main benefit test – can be interpreted in line with the European Commission’s recommendation of 6 December 2012 on aggressive tax planning.

Fully in line with the MD Directive, bespoke arrangements and marketable arrangements will have to be reported within 30 days after the reportable cross-border arrangement is made available for implementation, is ready for implementation, or if the first step in the implementation has been made, whichever occurs first.

The reporting obligation applies in the Netherlands to ”Dutch” intermediaries (natural or legal persons) and in some cases taxpayers. Foreign intermediaries without a link to the Netherlands will have no reporting obligations in the Netherlands under the proposed rules.

Who is considered as an intermediary in a specific case depends on all facts and circumstances. In principle the tax advisory firm is considered the intermediary and not the individual employees of such a tax advisory firm working on the matter. Furthermore, if an in-house tax adviser is employed by a relevant taxpayer, the taxpayer has the reporting obligation and not the in-house tax adviser.

In some situations, the entity employing the in-house adviser(s) (for instance, an in-house tax or legal department) will be considered the intermediary. This is the case if an in-house adviser of an MNE is involved in advising an affiliated group entity on a reportable cross-border arrangement where the group entity that employs the in-house adviser is not involved in the reportable cross-border arrangement itself (i.e. the arrangement relates to a group entity). The entity that employs the in-house adviser is in principle considered the intermediary and not the individual adviser. Hence, MNEs should be aware that they might, as an intermediary, have to disclose information on a reportable cross-border arrangement to the Dutch tax authorities.

This has the advantage that MNEs have the possibility to report themselves and submit proof of the filing to the intermediaries involved as a result of which the intermediaries do not have a filing obligation (i.e. the MNE has better control over the information that is reported).

Intermediaries will be exempt from filing information on a reportable cross-border arrangement where the reporting obligation would breach the legal professional privilege under Dutch law (e.g. Dutch attorneys at law and civil-law notaries). Rather, these intermediaries must immediately notify other intermediaries involved or, if there are no other intermediaries involved, the relevant taxpayer, that they have a reporting obligation.

Fully in line with the MD Directive, in cases where no intermediary is involved (i.e. the arrangement is fully developed in-house), when the intermediary involved does not have a link to an EU Member State or in the case of legal professional privilege, the obligation to report lies with the taxpayer.

Intermediaries and taxpayers who infringe the national provisions may be subject to penalties up to a maximum of EUR 830,000 or, in certain cases, criminal prosecution. For more information, see our Tax Flash of 15 July 2019.

Ultimate beneficial owner register

On 4 April, 2019, the “Act on the registration of ultimate beneficial owners of corporate entities and other legal entities” was submitted to the Dutch parliament for the implementation of the ultimate beneficial owner register (“UBO-register”). In addition, the Netherlands published decrees that, for purposes of the overall implementation of the fourth EU Anti-Money Laundering Directive, include the Dutch UBO definition for various types of Dutch legal entities. Furthermore, it was announced that the implementation of the Dutch UBO-register for trusts and similar legal structures will be done through a separate legislative process and that this register will (also) be publicly accessible.

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State aid

On 10 January 2019, the Commission announced the opening of a formal State aid investigation into five tax rulings granted by the Dutch tax authorities to two Dutch entities of the Nike group between 2006 and 2015. This investigation concerns individual tax rulings and, as such, should not directly impact other taxpayers. Nonetheless, the investigation forms part of the Commission's continuing efforts, focusing on transfer pricing and valuation issues. See also page 9 - 11.

The opening of a formal investigation does not prejudge the final outcome of the case. The Commission will now look in depth at whether the transfer pricing method accepted by the Dutch tax authorities to determine the royalty payments is at arm's length. The Commission's interpretation of the arm's length principle under EU State aid rules in other recent State aid decisions is, at the same time, subject to appeal before the Court of Justice of the European Union.

Changes in tax treaties

At the time of signing the MLI, the Netherlands excluded various bilateral treaties, that were being renegotiated, from the scope of the MLI – in particular the Netherlands' tax treaties with Belgium, Brazil, Bulgaria, Denmark, Ireland, Ukraine, Poland, Spain and Switzerland. This was done in order to incorporate the BEPS minimum standards, as well as certain optional BEPS measures embraced by the Netherlands, directly in a number of ongoing treaty (re)negotiations. In the meantime, amending protocols to the tax treaties with Denmark (2018), Ukraine (2018) and Switzerland (2019) have been signed and a comprehensive new tax treaty has been concluded with Ireland (2019). It is expected that the Netherlands will continue its treaty negotiations with, *inter alia*, Austria, Australia, Belgium, Brazil, France, India, Portugal and South Korea during 2020.

Withholding taxes

Withholding tax on intragroup interest and royalty payments

The 2020 Dutch Budget included a proposal to introduce a conditional withholding tax ("WHT") on interest and royalty payments to related entities (in general, >50% voting rights) in low-tax or EU blacklisted jurisdictions ("LTJ") and in cases of abuse, as of 1 January 2021. Payments to certain hybrid entities can also be subject to the WHT even if these are not located in an LTJ. For more information, see our Tax Flash of 17 September 2019.

If a structure includes any entities in LTJs or any hybrid entities, which directly or indirectly receive interest or royalties from Dutch entities or permanent establishments, a careful assessment of the structure is appropriate. Restructuring of activities, if needed, should be completed in the course of 2020.

Changes to the Dutch dividend withholding tax exemption

The Dutch provisions to qualify for the Dutch dividend withholding tax ("DWT") exemption (or to disqualify as a non-resident corporate taxpayer) will be amended as of 1 January 2020. The amendment is based on the decision of the Court of Justice of the European Union in the so-called Danish Cases (see our Tax Flash of 26 February 2019) and was announced on 14 June 2019 (see our Tax Flash of 17 June 2019).

Currently, satisfying the "relevant substance" criteria [5] functions as a safe harbour for certain foreign intermediate companies located in EU Member States and treaty countries, implying that no abuse will be considered present. Under the proposed amendment, the Dutch Tax Authorities ("DTA") will have the possibility of counterproof to demonstrate that a structure is abusive, even if the relevant substance criteria are satisfied. In that case, the burden of proof rests on the tax inspector. If the taxpayer does not meet the "relevant substance" criteria, the possibility of counterproof will also be available for the taxpayer. In that case, the burden of proof falls on the taxpayer to argue that no abuse should be considered present.

5 In addition to the Dutch "minimum substance requirements", this includes the requirement that the holding company incurs salary costs of at least EUR 100,000 in relation to its intermediary holding functions, and the requirement that the holding company has (for at least 24 months) its own office space at its disposal which is in fact used to carry out its intermediary holding functions.

For more information, see our Tax Flash of 17 September 2019.

If a structure includes a foreign intermediate holding company that currently relies on the satisfaction of the relevant substance requirements, the position after the proposed changes should be assessed before the end of the year. Subsequently, it should be determined whether a restructuring of activities is required.

Corporate income tax

Fiscal unity - repair measures entered into force
On 23 April 2019, the Upper House of the Dutch Parliament approved the pending legislative proposal to change the Dutch corporate income tax ("CIT") consolidation regime ("fiscal unity"), the so-called repair measures. This approval finalises the legislative process and the repair measures will enter into effect retroactively as from 1 January 2018.

Through the introduction of the repair measures, the Netherlands aims to bring the Dutch fiscal unity regime in line with EU law, following the judgment of the Court of Justice of the European Union ("CJEU") of 22 February 2018. In that case, the CJEU ruled that the so-called per-element approach, as introduced in the CJEU Groupe Steria case, also applies to the Dutch fiscal unity regime. The decision of the CJEU was confirmed by the Dutch Supreme Court on 19 October 2018.

Based on the repair measures, the following provisions in the Dutch corporate income tax act ("CITA") and the Dutch Dividend Withholding Tax Act ("WHTA") have been amended, and must be applied as if the Dutch fiscal unity regime does not exist:

- The anti-base erosion rules (article 10a CITA), possibly leading to non-deductible interest expenses for taxpayers with related party debt;
- The Dutch participation exemption rules for low-taxed portfolio investment subsidiaries (article 13, paragraph 9 to 15 CITA) and the anti-hybrid rule in the Dutch participation exemption (article 13, paragraph 17 CITA), possibly disallowing the participation exemption to taxpayers;
- The revaluation provision for low-taxed portfolio investment subsidiaries (article 13a CITA), possibly leading to an annual (taxable) revaluation of low-taxed portfolio investment subsidiaries held by taxpayers;
- The interest deduction limitation against excessive participation interest (article 13l CITA, only applying until the abolishment of art. 13l CITA as from 1 January 2019), possibly leading to non-deductible interest expenses for taxpayers with participations;
- The provision regarding carry-forward losses and a change in ultimate interest in a taxpayer (article 20a CITA), possibly leading to the expiration of tax losses for taxpayers with carry forwards; and
- The redistribution facility for the dividend withholding tax (article 11, paragraph 4 WHTA), possibly leading to a higher Dutch dividend withholding tax burden for taxpayers applying this facility.

The repair measures can have a severe impact on the tax position of taxpayers that currently apply the Dutch fiscal unity regime, as several benefits of the current Dutch fiscal unity regime are no longer available.

For more information, see our Tax Flash of 23 April 2019.

Fiscal unity - consultation procedure for a new future-proof group regime in the CITA
The Dutch State Secretary of Finance is exploring the alternatives to replace the Dutch fiscal unity regime by a new future-proof group regime. In this respect, a consultation procedure started on 17 June 2019. During this consultation procedure, parties could provide their input on the following four alternatives that were published by the Dutch State Secretary of Finance:

- The continuation of the current Dutch fiscal unity regime, including the repair measures;
- The abolishment of the current Dutch fiscal unity regime (without introducing a new group regime);
- The introduction of a group relief or group contribution system (replacing the current Dutch fiscal unity regime); or
- The expansion of the current Dutch fiscal unity regime to a cross-border fiscal unity regime with an object exemption.

The consultation procedure ended on 29 July 2019. Based on the input received, the Dutch State Secretary of Finance aims to send a letter to the Lower House of the Dutch Parliament before year-end, in which the blueprint of the expected new group regime will be outlined. A draft legislative proposal for the new group regime is expected in 2020. This draft proposal should also give more clarity on the expected date of entry into force of the new group regime.

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Changes to the anticipated reduction of the main corporate income tax rate

In the 2020 Budget, it is proposed maintaining the main corporate income tax rate of 25% in 2020 and to lower the rate to 21.7% in 2021, resulting in the below overview for the following years:

	2020	2021
For profits up to EUR 200,000	16.5%	15%
For profits exceeding EUR 200,000	25 %	21.7%

Introduction of a minimum capital rule to limit interest deduction for banks and insurers

In the 2020 Budget, introduction of a minimum capital rule was proposed. The minimum capital rule limits the interest deduction for Dutch corporate income tax purposes for banks and insurers to the extent they have excessive debt. The minimum capital rule will apply to banks and insurers that have a licence or notice for business of banking or insurance issued under the Dutch Financial Supervision Act *(Wet op het financieel toezicht)*. Entities with such license or notice could be banks and insurers established in the Netherlands, foreign banks and insurers with Dutch subsidiaries or foreign banks and insurers with Dutch branch offices.

Other relevant corporate income tax changes

- The Dutch Controlled Foreign Company ("CFC") legislation has a safe harbour exception for CFCs if they meet the so-called relevant substance requirements. If so, they are regarded as performing a substantive economic activity. In the 2020 Budget it was proposed to provide the possibility of counterproof for the Dutch Tax Authorities to establish that a CFC does not have a substantive economic activity, even if all the relevant substance requirements are met.
- In the Dutch CITA, a definition of permanent establishment will be introduced. It will align the Dutch definition of permanent establishment with the definition of a relevant tax treaty.
- On 16 April 2019, three left-wing political parties submitted a preliminary draft bill for public consultation, followed by publication of a revised proposal on 16 October 2019. This proposal would limit the deduction of liquidation losses on subsidiaries in the following ways:
  - A minimum shareholding of, in principle, more than 50% in the equity of the subsidiary would be required;
  - Liquidation losses would only be deductible with respect to subsidiaries that are resident in the EU/EEA; and
  - A liquidation loss would only be deductible if the dissolution of the subsidiary is completed ultimately in the third calendar year following the year in which the subsidiary's activities were terminated (subject to a rebuttal rule).

  Similar amendments are proposed to the rules for deducting losses upon termination of a foreign permanent establishment. Losses on participations and permanent establishments up to EUR 5 million can be deducted without complying with the aforementioned conditions. The changes should become effective per 1 January 2021 with some transitional rules for pending losses. The Dutch government announced on Budget Day that it supports the proposal. This proposal has not yet been submitted to Parliament.

Amendments to the Dutch ruling policy

New ruling policy

The Dutch government raised the bar for taxpayers to conclude an Advance Tax Ruling ("ATR") or Advance Pricing Agreement ("APA"). On 28 June 2019, the Dutch State Secretary of Finance published a Decree on the new ruling policy ("Ruling Decree"), which became effective as of 1 July 2019. This Ruling Decree is in line with the draft decree as published in April 2019, which we referred to in our Tax Flash of 24 April 2019. The most important changes of the new policy are that stricter conditions will have to be met to be able to conclude an ATR or APA and that a summary will be published.

Conditions

As of 1 July 2019, it is no longer possible to conclude an ATR/APA if:

- The group as a whole and the Dutch entity that requests the ATR/APA do not have sufficient economic nexus with the Netherlands;
  - There is sufficient economic nexus if the following two conditions are cumulatively met:
    - the taxpayer that requests the ATR/APA is part of an internationally operating group and engaged in an operating business in the Netherlands; and
    - an operating business activity, that matches the role of the requesting taxpayer within the group,

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is carried out by or for the risk and account of that taxpayer by a sufficient number of relevant employees in the Netherlands.

- The main motive of the taxpayer is to save (Dutch or foreign) taxes; and/or
- The ATR/APA relates to the tax consequences of direct transactions with certain low-tax and/or EU blacklisted jurisdictions. In this regard, a jurisdiction is considered “low-tax” if there is no profit tax or a profit tax has a statutory rate of less than 9%.

Procedure and transparency

The Ruling Decree states that ATRs/APAs will be handled by a newly formed central team, the Dutch Tax Authorities’ Advance Certainty Team *(Behandelteam Internationale Fiscale Zekerheid van de Belastingdienst)* and all ATRs/APAs will be concluded in a standardised form for a period of 5 years (which can be extended to 10 years in exceptional situations). In addition, the Ruling Decree includes a list of (potentially) required information that taxpayers should provide when requesting an ATR/APA, which should include an unambiguous statement on the tax treatment of the case being presented, based on a technical analysis.

Further to the above, as of 1 July 2019, the Dutch tax authorities will publish an anonymised summary of ATRs/APAs that have been concluded. Summaries of requests that are denied will also be published, to clarify the reasons for not concluding an ATR/APA.

The Ruling Decree does not mention anything about existing ATRs/APAs. As the Ruling Decree is only a change of policy and not a change of law, existing ATRs/APAs should remain valid and should not be affected by the Ruling Decree.

Disclosure of fines imposed on tax advisers

The Dutch government has proposed publishing administrative fines that have been imposed on tax advisers. A tax adviser may be anyone who advises on tax matters (e.g. a tax lawyer, an attorney at law, but also a civil-law notary or an accountant).

The Dutch government believes this measure will warn taxpayers against untrustworthy advisers. A tax inspector still has to decide whether publishing the fine is a proportionate measure, given the impact on the tax adviser’s private life. The tax inspector’s decision to publish a fine imposed on an adviser is subject to a right of objection and appeal to the courts.

Disclosure will become final once both the fine and the decision to publish the fine have become final. Therefore, a considerable length of time may have passed between the facts that led to imposing a fine and the moment of disclosure. A fine will be published on the website of the Dutch tax authorities for a period of five years.

Case law

Scope of non-deductible costs in relation to the acquisition or disposal of a subsidiary

Costs incurred in relation to the acquisition or disposal of a participation in a subsidiary are treated as non-deductible ”acquisition or disposal costs” under the Dutch participation exemption.

In a decision published on 7 December 2018 (so after the publication of our Year-end tax bulletin 2018), the Dutch Supreme Court provided rules on how and when to determine which costs will qualify as acquisition or disposal costs. These rules appear to be more stringent on certain elements but more lenient on others when compared to the approaches applied in practice by taxpayers and the Dutch tax authorities. Consequently, taxpayers should carefully review positions taken, and to be taken, by them with respect to costs related to the acquisition or disposal of participations. More information can be found in our Tax Flash of 7 December 2018.

Conditions for liquidation loss relief clarified

Losses on participations to which the participation exemption applies are only deductible upon dissolving the subsidiary and when certain strict conditions are met. One of these conditions is that the activities of the subsidiary need to be terminated or transferred to an unrelated party. In a judgment of 7 June 2019, the Dutch Supreme Court had to decide at what moment in time that condition needs to be fulfilled. In the case in question, activities of a subsidiary were first transferred within the group after which they were transferred to an unrelated party. Years later, the subsidiary was dissolved and the taxpayer wanted to deduct the liquidation loss it had suffered. The tax authorities claimed that the condition in question needed to be fulfilled at the moment of the first transfer of activities within the group, concluding that it had not been fulfilled. The Supreme Court decided that the condition needed to be fulfilled at the moment the subsidiary is dissolved, therefore allowing deduction of the liquidation loss.

VAT

Implementation of quick fixes

On 1 January 2020, the VAT rules for cross-border supplies of goods within the EU ("intra-Community supply") will be further streamlined in line with the four quick fixes adopted by the Economic and Financial Affairs Council ("Ecofin") on 2 October 2018. The quick fixes proposed are:

- For applying the zero rate on intra-Community supplies, the supplier is required, in addition to proof of the cross-border transport, to have a valid VAT identification number of his customer and to submit a correct intra-Community sales listing.
- To prove that goods have been transported to another EU country, a basic set of accepted documents has been listed. In general, if the supplier has at least two non-contradictory items stated on the list of accepted documents, the transport is presumed to be proven. If not, the existing rules will apply and one has to prove in an alternative way that the transport took place.
- For chain transactions ("ABC deliveries"), where a party established in EU Member State B transports the goods from EU Member State A cross-border to EU Member State C, the zero rate can (only) be applied to the first delivery, being the delivery to the party established in Member State B.
- Uniform EU-wide simplifications are introduced for the VAT treatment of call-off stock. The simplifications must prevent VAT registration in the country where the stock is held and delivered to the customer on demand.

Read our brochure for more information about the quick fixes.

Reduced rate for e-publications

From 1 January 2020, the reduced VAT rate of 9% applies to the supply or lending of e-books, e-newspapers and e-journals. This brings the rate in line with the rate for physical publications. This change follows the agreement the Ecofin reached on this topic in 2018.

Modernisation SME regime

The Dutch regime for small and medium sized enterprises ("SME-regime"), as adopted last year in the 2019 Budget, will be amended on a number of essential points as of 1 January 2020. First of all, legal entities too can use the SME-regime from 2020 onwards. Taxpayers who use the scheme are relieved of the obligation to submit a VAT return and can suffice with a simplified VAT administration. To be able to use the SME-regime, a turnover threshold of EUR 20,000 per calendar year will apply. Under the new scheme, no VAT is due on sales or services, but the input tax cannot be deducted either.

Employment & Benefits

Social security | Unemployment insurance contribution

The Balanced Labour Market Act (*Wet arbeidsmarkt in balan*s, "WAB") will enter into force on 1 January 2020. The aim of the WAB is to offer flexible employees greater security, to make dismissal law more unambiguous, simpler and cheaper, and to give the Unemployment Insurance Act (*Werkloosheidwet,* "WW") a more activating effect. To achieve this, the WAB contains various labour law measures, but also legislation that significantly changes the way the unemployment insurance contributions for employers will be calculated. The unemployment insurance contributions form part of the employer's total social security contributions.

The present sectoral unemployment insurance contribution will be replaced by a low or high contribution, dependent on the nature of the employment agreement. The low contribution percentage applies to employment contracts that are laid down in writing and concluded for an indefinite period of time. For all other (notional) employment agreements the high percentage will apply. The difference between the high and low contribution is set at five percentage points, but the exact unemployment insurance contributions will only be published at the end of 2019. An exception is made for people younger than 21 years with fixed-term employment contracts for less than twelve hours a week. The higher unemployment insurance contributions will not apply to them.

Wage tax | Tax-free employment costs budget increased

For all reimbursements and benefits in kind provided to employees by their employer, it must be determined whether these are subject to tax, and if so, the manner in which the tax is imposed according to the Employment Costs Scheme. Under the Employment Costs Scheme a tax-free budget of 1.2% (2019) of total taxable wages is available. From this tax-free employment costs budget an employer can make tax-free payments and allowances to employees. As of 1January 2020, the tax-free budget up to an amount of total wages of EUR 400,000 will be increased from 1.2% to 1.7%. If and to the extent the total taxable wages exceed the threshold of EUR 400,000, the current percentage for the tax-free employment costs budget will remain at 1.2%.

Pension | Agreement future Dutch Pension System
The Dutch parliament, employer representatives and trade unions agreed to a reform of the Dutch pension system on 5 June 2019. Major changes in the long term are, among others, the introduction of a new pension contract and the abolishment of the so-called uniform contribution rate *(doorsneepremies)*. A consequence of the latter will be that each participant in a pension scheme will have age-independent contributions, which also means that the annual pension accrual will vary according to the participant's age. Other changes in the long term will in principle be an improvement in the survivor's pension benefit and the possibility to receive 10% of the individual's accrued pension benefit as a lump sum on his or her retirement date.

Besides various changes in the long term, the agreement reached between the various parties has also led to new legislation with regard to the Dutch state pension ("AOW"). The age at which an individual is entitled to AOW will remain 66 years and 4 months in 2020 and in 2021. It will then be increased in three steps to the age of 67 in 2024.

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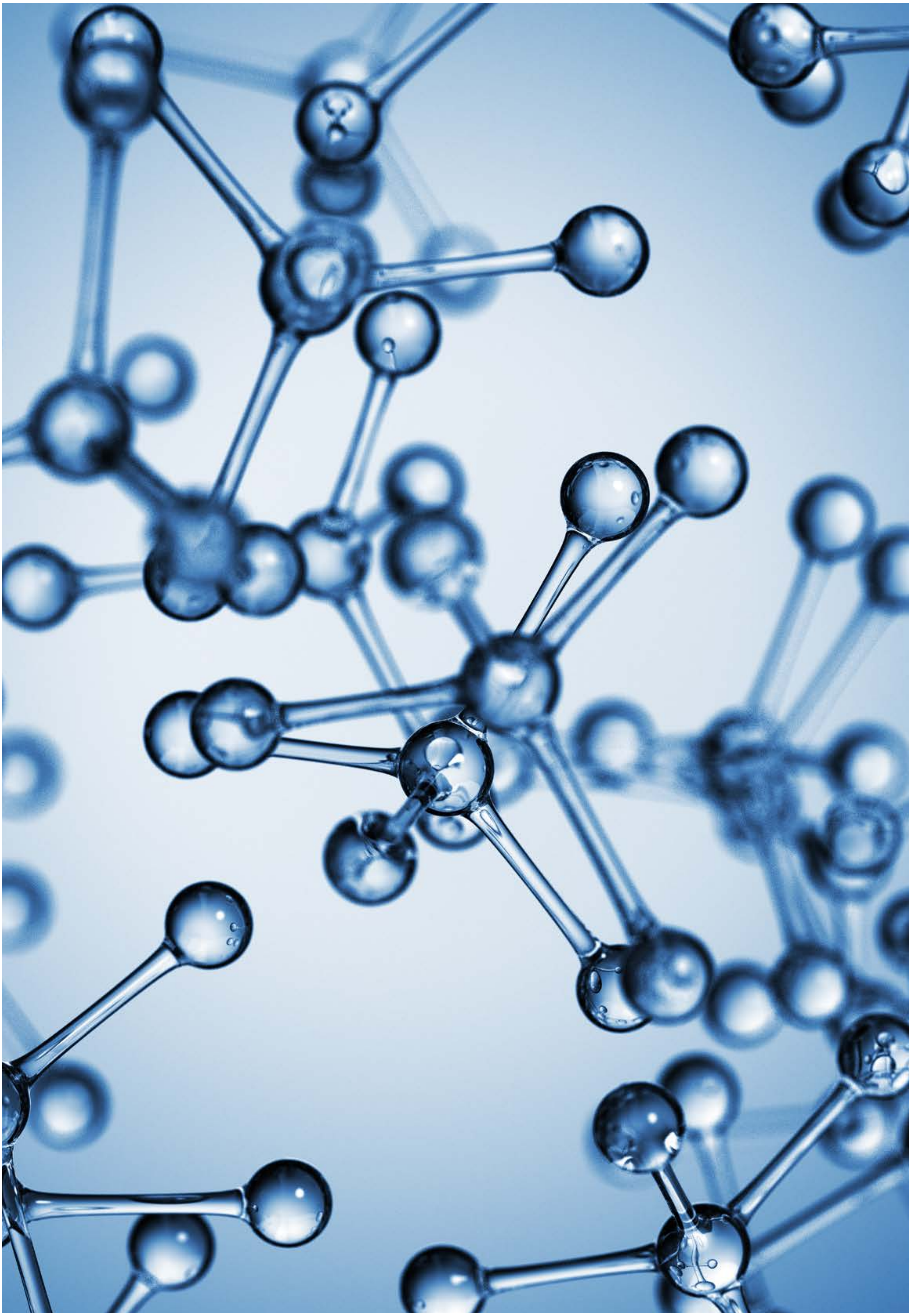

Developments in Belgium

Main changes in Belgian tax in more detail

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"The second step of the Belgian corporate income tax reform, which entered into force in 2019, has created various opportunities to business, such as the tax consolidation regime. At the same time, the reform also emphasised the need to combat tax avoidance and ensure compliance following international tax developments in this respect. As a result thereof, corporate income taxes have become an increasingly complex area.

The entry into force of the MLI, the application of the new transfer pricing guidelines following BEPS, the ongoing increased transparency and the impact of the CJEU case law will be key elements to monitor in 2020. With this in mind, businesses may want to prepare themselves and possibly adapt their structures."

Actions to be considered

- All companies incorporated in Belgium should register their ultimate beneficial owner ("UBO") by 31 December 2019 at the latest. A similar obligation applies with respect to UBOs of foundations, (international) non-profit organisations, trusts and fiduciaries.
- Each Belgian entity that belongs to a multinational group that is obliged to file a Country-by Country ("CbC") report will need to notify the identity and the tax residence of the group entity that will comply with the CbC reporting at the latest on the last day of the reporting period of the group. If the reporting period ends on 31 December 2019 or later, this notification only needs to be made if the information differs from that provided in respect of previous reporting periods.
- Belgian entities that need to file a CbC report and/or a master file should do so within twelve months following the end of the reporting period of the multinational group. We recommend verifying whether CbC filing obligations exist in Belgium. This is the case if the CbC report is not exchanged with a jurisdiction of a group entity with CbC reporting obligations.
- In view of the Danish cases of the CJEU and the entry into effect of the MLI for withholding tax purposes as of 1 January 2020, holding and financing companies should review and possibly revisit their structure and/or cash flow model in order to avoid that the Belgian withholding tax exemption is being refused.
- In view of recent developments regarding the OECD transfer pricing principles and EU state aid cases, it is recommended to perform a sanity check on the transfer pricing analysis and documentation.
- In order to avoid uncertainties as to which company law rules are being applicable, companies should bring their articles of association in line with the new Belgian Company Code before year-end.

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Multilateral Instrument

Belgium deposited the Multilateral Instrument ("MLI") ratification instrument with the OECD on 26 June 2019. The MLI entered into force for Belgium on 1 October 2019. Assuming that the MLI has already entered into force in the other contracting state, the MLI provisions will have effect with respect to withholding taxes on taxable events occurring on or after 1 January 2020 and for all other taxes, including corporate income tax, on taxable periods that begin on or after 1 April 2020.

Although Belgium initially did not opt for the possibility to address the artificial avoidance of the permanent establishment ("PE") status through commissionaire arrangements, it has withdrawn its reservation in the final version of the ratification document. This is in line with Belgian law. The PE concept under national law has recently been extended to include PEs created via commissionaire (or similar) arrangements. This new rule applies as of assessment year 2021 (relating to the taxable period starting on 1 January 2020 at the earliest).

For more information, see our Tax Flash of 2 July 2019. For an overview of the choices and reservations made by Belgium, we refer to our website page "Overview: MLI choices made by the Netherlands, Belgium, Luxembourg and Switzerland".

Transparency

Tax Information Exchange Agreements
The Tax Information Exchange Agreement that Belgium signed with Aruba on 24 April 2014 entered into force on 1 January 2019 and is effective (other than for criminal tax matters) as of 1 January 2020. This implies that information can be exchanged between both parties upon request and the contracting parties may be allowed to perform a tax audit in the territory of the other party.

Ultimate beneficial owner register
All companies incorporated in Belgium have the obligation to collect and hold information on their ultimate beneficial owners ("UBOs"). A similar obligation applies with respect to UBOs of foundations, (international) non-profit organisations, trusts and fiduciaries. Although the registration deadline was set at 30 September 2019, the Belgian tax authorities announced that a tolerance policy will be implemented until 31 December 2019. This means that no sanctions will be imposed until 31 December 2019.

For more information on the UBO-register, we refer to our brochure.

Mandatory Disclosure Directive
Belgium is currently in the process of drafting a legislative proposal. No legislative text is available yet.

State aid

On 14 February 2019, the EU General Court annulled the European Commission's State aid decision of 11 January 2016 on Belgian excess profit rulings on the formal ground that the Belgian rules did not constitute an aid scheme. The General Court did not take a position on whether or not the "excess profit" rulings gave rise to illegal State aid but found that the Commission had failed to establish the existence of a scheme. The European Commission appealed on 24 April 2019 against this decision. Since the General Court argued that the compatibility of the tax rulings with EU State aid rules needs to be assessed individually, the Commission has now also opened separate in-depth investigations into the individual tax rulings granted by Belgium to 39 multinational companies between 2005 and 2014. The procedures are currently ongoing.

On 20 September 2019, the General Court concluded that the aid scheme exempting Belgian ports from corporate income tax constitutes illegal state aid. The law of 29 May 2018 already subjected Belgian ports to corporate income tax as of 2018 and provided for transitional provisions. Since the General Court did not annul the decision of the European Commission, the law remains applicable.

Implementation of the Anti-Tax Avoidance Directive

Belgium has already implemented the measures included in the EU Anti-Tax Avoidance Directive ("ATAD"), which entered into force on 1 January 2019, as well as the measures relating to hybrid mismatches ("ATAD2"). The interest limitation rule initially would enter into force as of 2020. The law of 11 February 2019 has adjusted this date to 1 January 2019. With respect to this interest limitation rule, Belgium opted for a threshold of EUR 3 million of exceeding borrowing costs that are tax deductible. This threshold amount needs to be allocated among the members of a group. Although the interest limitation rule now has entered into force, to date the allocation key has not been determined.

Implementation of the EU Directive on tax dispute resolution mechanisms

Belgium has implemented the EU Directive on tax dispute resolution mechanisms in the law of 2 May 2019, which was published in the Belgian Official Gazette on 17 May 2019. These mechanisms ensure the effective resolution of disputes between Member States when those disputes arise from the interpretation and application of agreements and conventions that provide for the elimination of double taxation on income and, where applicable, capital. The mechanism applies in Belgium to complaints submitted to the Belgian competent authorities as of 1 July 2019 regarding disputes on income or capital received during a taxable period starting on or after 1 January 2018.

Country-by-Country reporting

Following BEPS Action 13, Belgian resident parent companies (or the Belgian company that is appointed as the surrogate ultimate parent company) of multinational groups with consolidated gross revenue equal to or exceeding EUR 750 million must file a Country-by-Country ("CbC") report. In addition, each Belgian entity of a qualifying group will need to notify the Belgian tax authorities that it is either the ultimate or surrogate group company. If it is neither, it must report the identity and the tax residence of the group entity that will comply with the CbC reporting requirements. Originally, this notification had to be done annually. In order to reduce the administrative burden for Belgian entities, the law of 2 May 2019 has abolished this yearly notification procedure. For reporting periods ending on 31 December 2019 or later, the notification by the Belgian group entity should only be made to the extent that the information differs from that provided in respect of previous reporting periods. For more information, see our Tax Flash of 17 May 2019.

Changes in tax treaties

Belgium signed a new tax treaty with Japan on 12 October 2016, which will take effect as of 1 January 2020. As of October 2019, Belgium has concluded 104 tax treaties, of which 95 entered into force.

Main changes to corporate income tax

Corporate income tax reform

Belgium enacted a major corporate income tax reform at the end of 2017. In the meantime, various measures were retroactively modified. The implementation date of the numerous measures varies. Most of the measures took effect in 2018 or 2019. The most important measures that will be introduced as of 1 January 2020 and that might require particular action can be summarised as follows:

- The nominal corporate income tax ("CIT") rate will be further reduced to 25% (20% on the first tranche of EUR 100,000 taxable income).
- Companies with certain tax-exempt reserves will be temporarily (during assessment years 2021 and 2022) encouraged to convert these amounts into taxed reserves at a reduced CIT rate of 15% (further reduced to 10% subject to a reinvestment condition).
- The special exit tax rate for Belgian REITs and SREIFs will be increased from 12.75% to 15%.
- Further increase of the wage withholding tax exemption for scientific research personnel holding a bachelor's degree from 40% to 80%.
- The 120% deductibility of costs will be reduced to 100% with respect to the organisation of common transportation for employees, security costs and company bicycles and electric cars.
- The formula that determines the percentage of tax deductibility of car expenses will be amended. In addition, the tax deductibility of fuel expenses will no longer be determined at a rate of 75% but will be aligned with the regime applicable to the other car expenses.
- A so-called tax on secret commissions is, among others, levied if certain payments (such as commissions, brokerage fees, commercial or other rebates, service fees or benefits in kind or cash) made by a Belgian taxpayer that qualify as professional income in the hands of a beneficiary are not reported on the forms 281.50 and the summary statement 325.50. This tax will no longer be tax deductible.
- Interest will only be deductible to the extent that the interest rate does not exceed the market rate. For non-mortgage backed loans without maturity date the term "market rate" is now defined by law.
- The double declining depreciation method will be abolished and the obligation to depreciate assets on a *pro rata temporis* basis during the year of acquisition will now apply to all companies, including small and medium-sized enterprises ("SMEs").

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For an entire overview of the reform, we refer to our Corporate Income Tax Reform Brochure.

Impact of new Belgian Company Code

On 4 April 2019, the new Belgian Company Code ("BCC") was published in the Belgian Official Gazette. Some major highlights of the BCC include, for example, a reduction of the types of companies, the abolition of the share capital concept for BVs (private limited liability companies) and the introduction of the statutory seat doctrine for company law purposes. The new BCC entered into force on 1 May 2019 for new companies and will enter into force on 1 January 2020 for existing companies. These changes have an important impact on existing tax law provisions as well. In the light of this, amendments to the Income Tax Code ("ITC") have been introduced by the law of 17 March 2019, which was published in the Belgian Official Gazette on 10 May 2019. Most measures entered into force on 1 May 2019. For more information on the BCC and for a more detailed overview of certain aspects to be aware of from a corporate income tax perspective, we refer to our website.

Case law

On 5 September 2019, Advocate General ("AG") issued his opinion in the case of Brussels Securities SA vs. Belgian State (Case C-389/18). Pursuant to the Parent-Subsidiary Directive, Belgium opted for a system of exemption under which, firstly, the dividend distributed by the subsidiary is included in the taxable basis of the Belgian parent company and, secondly, that dividend is deducted from the taxable basis (the so-called dividend received deduction). However, the dividend is only deducted from the taxable basis in so far as a profit remains (otherwise it can be carried forward) and before another tax benefit provided for in Belgian law that can only be transferred within a limited timeframe is applied, such as the notional interest deduction in the case at hand. The Tribunal asked the Court of Justice of the European Union ("CJEU") on 13 June 2018 whether this mechanism is compatible with the Parent-Subsidiary Directive.

According to the AG, it is not incompatible as such with the Parent-Subsidiary Directive if a national rule first includes the dividend in the taxable basis and afterwards allows a deduction instead of immediately excluding it from the taxable basis. The directive only prescribes the result to be achieved, i.e. avoiding double taxation, not how this should be achieved. However, this only applies to the extent that the mechanism gives a completely neutral result. The Belgian mechanism does not appear to be neutral since the order of deductions may result in a higher taxable burden (due to the loss of another tax advantage) compared to a mechanism that directly excludes the dividend. The AG thus concludes that article 4(1) of the Parent-Subsidiary Directive must be interpreted as precluding an arrangement of a Member State according to which, on the one hand, the dividends received by a parent company are included in its taxable basis and subsequently deducted, in so far as a profit remains during the relevant or any later taxable period, and, on the other hand, these dividends must be deducted before another tax benefit provided for in national law, the transfer of which is limited in time.

It is yet to be seen whether the CJEU will follow the reasoning of the AG. Companies that applied a dividend received deduction may, however, already want to verify whether they suffered a disadvantage due to the order of deductions applied.

VAT

Electronic register for VAT debts

As from 1 April 2019, any unpaid VAT will automatically be reported in an electronic collection and recovery register which forms an enforceable title based upon which the VAT authorities can claim payment of that VAT. The register replaces the old enforcement order which required the intervention of both the taxation and collection & recovery authorities in order to claim payment of VAT when the VAT was not spontaneously paid. With the new electronic collection and recovery register the Belgian State aims to harmonise and modernise the Belgian tax debt recovery system and to speed up the collection and recovery process.

Even though the recording of the VAT debt in the register is automatic, the taxpayer should be notified. The VAT authorities are required to inform the taxpayer of the reasons why a VAT debt exists and will be recorded in the register, at least one month before that VAT debt is actually recorded in the register. This waiting period of one month can be ignored if the VAT claim is nearly time barred or if certain facts necessitate the immediate recovery of the debt, such as insolvency.

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Optional VAT system for immovable letting

As of 1 January 2019, a new VAT regime for non-residential immovable letting was introduced in Belgium. Long-term immovable letting can be subject to VAT and short-term letting must be subject to VAT. The introduction of this new VAT regime in the Belgian VAT Code aims to boost the real estate and construction sector and reduce the competitive disadvantage of Belgium compared to some other EU Member States.

In order to charge VAT on long-term immovable letting in Belgium the following conditions need to be met: (i) the letting concerns buildings, or parts thereof, including the accompanying land, (ii) the premises are exclusively used for the (taxable or exempt) economic activity of the tenant and (iii) the option to apply VAT must be jointly exercised by the landlord and the tenant. It is important to note that the option to charge VAT on long-term immovable lettings may only be exercised for buildings for which VAT on construction costs has become chargeable for the first time on 1 October 2018 at the earliest, which means that currently only new or heavily refurbished buildings are in scope of the new regime.

For the optional VAT regime, Royal Decree no. 3 was amended to include rules on the newly introduced adjustment period of 25 years because it can concur with the normal adjustment period of 15 years in certain situations.

The obligation to subject short-term immovable letting to VAT applies if (i) the duration of the lease does not exceed 6 months and (ii) the property is not leased to an individual who uses it for private purposes or a non-profit organisation. This obligatory regime mainly aims to tax short-term leases of non-residential immovable property. The VAT authorities have also issued guidance regarding the VAT regime for short-term letting.

VAT exemption “vessels for navigation on high seas”

As from 29 November 2017, the Belgian VAT Code no longer refers to ”sea-going vessels” but instead mentions ”vessels for navigation on high seas”, in accordance with article 148 of the VAT Directive and the view of the European Commission. On 29 May 2019, circular letter 2019/C/44 was published which provides guidance on the impact of this new wording. The new wording limits the scope of the VAT exemption since the application of the VAT exemption now depends on the use that is made of the vessel.

Previously, the Belgian VAT authorities applied a broad interpretation of ”sea-going vessels” which included every ship capable of going out to sea and being used for an economic activity. For the future, the new wording ”vessels for navigation on high seas” restricts the application of the VAT exemption as it requires a ship to be used for 70% on the high seas for paid passenger transport or for an industrial, commercial or fishing activity. The 70%-rule introduced by the circular letter can be based on the number of journeys, the distance travelled or the time spent on the high seas. The term ”high seas” refers to the part of the sea outside the territorial waters of any country and beyond the 12 nautical mile limit.

The new wording of the VAT exemption (together with the guidance provided by the Belgian VAT authorities) affects not only the VAT treatment of the supply of “vessels for navigation on high seas” but also the VAT treatment of services and supplies provided to these vessels such as maintenance and bunkering.

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Developments in Luxembourg

Main changes in Luxembourg tax in more detail

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"Despite efforts by the Luxembourg legislator to clarify the impact of ATAD 2 on the investment management industry, like in other EU member states some aspects remain unclear. Our expert advice may assist taxpayers in making resulting risks manageable.

When adopting various EU directives measures in the field of transparency like the UBO-register and mandatory disclosure, Luxembourg commits to the highest standards possible. Openly-phrased norms in these legislative measures set by the EU result in practical challenges and uncertainty. While some of these measures do not immediately impose requirements on the taxpayer, we generally recommend that taxpayers remain in control of what is being filed or submitted by whom."

Actions to be considered

- Review structures in view of implementation of ATAD2 in Luxembourg as of 1 January 2020. Hybrid instruments or entities may trigger adverse tax consequences. Fund managers, especially when setting up new investment funds, should consider adapting disclosure language in fund documentation (notably the limited partnership agreement, the private placement memorandum and the subscription document).
- In view of Brexit, review of structures involving UK entities, for example those with a head of fiscal unity in the United Kingdom.
- The entry into effect of the Multilateral Instrument as of 1 January 2020 for withholding tax purposes might lead to reduced withholding taxes or nil rates being denied for structures vulnerable to the principal purpose test.
- In view of recent developments regarding the OECD transfer pricing principles and EU state aid cases, it is recommended to perform a sanity check on the transfer pricing analysis and documentation.
- Multinational Enterprises ("MNEs") with a Luxembourg reporting entity are reminded to prepare and file their 2018 Country-by-Country ("CbC") report with the Luxembourg Tax Authorities before the end of their 2019 financial year. Luxembourg entities of an MNE are reminded to notify the Luxembourg Tax Authorities whether they are reporting entities in Luxembourg for the purposes of the 2019 CbC report before the end of their 2019 financial year. We recommend verifying whether local filing obligations exist. This is the case if the CbC report is not exchanged with a jurisdiction of a group entity with CbC reporting obligations.
- Tax rulings granted prior to 1 January 2015 will expire as from 1 January 2020. Taxpayers who currently rely on pre-2015 tax rulings should consult their tax advisers to assess:
    - the ongoing need for additional comfort; and

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    - the exposure to a potential challenge by the tax authorities as from tax year 2020, or even earlier in case of diverging financial/tax years.
- Luxembourg companies with a permanent establishment abroad should verify whether they have to attach to their 2019 tax returns a certificate of the foreign tax authorities confirming the presence of a permanent establishment.

Multilateral Instrument

On 14 February 2019, Luxembourg Parliament adopted a law ratifying the Multilateral Instrument ("MLI"). The vote confirmed the limited options taken by Luxembourg upon signature. The main impact on the tax treaties will be triggered by the inclusion of a principal purpose test ("PPT"). Pursuant to the PPT, Luxembourg might deny treaty benefits when one of the principal purposes of an arrangement or transaction is to obtain tax treaty benefits. For more details on the options taken by Luxembourg see our Overview, and for more information on the ratification see our Tax Flash of 15 February 2019.

As Luxembourg deposited its ratification instrument with the OECD on 9 April 2019, the MLI entered into force on 1 August 2019 for Luxembourg. Accordingly, the entry into effect will be 1 January 2020 for withholding taxes and 1 January 2021 for other taxes.

The entry into force of the MLI for a given treaty still depends on the other signatory having notified the relevant treaty and having deposited their ratification instrument prior to 30 September 2019 for the MLI to apply to withholding tax as of 1 January 2020. For other taxes the treaty partner will have until 31 March 2020 to deposit its ratification instrument for entry into effect as of 1 January 2021. Luxembourg taxpayers should assess whether this entry into effect will have an impact.

Anti-Tax Avoidance Directive

Interest deduction limitation - amendments to the fiscal unity rules

The Luxembourg budget law for 2019 published on 26 April 2019 provides some flexibility for taxpayers with respect to the interest deduction limitation rules (the "IDL Rules") introduced by the domestic law implementing the EU Anti-Tax Avoidance Directive ("ATAD") applicable as from 1 January 2019. These rules cap the deductibility of so-called exceeding borrowing costs (i.e. the positive difference between borrowing costs and interest income) at the highest of 30% of the EBITDA or EUR 3 million. The implementation law did not include the option to apply the IDL Rules at fiscal unity level, but taxpayers were given the possibility to do so pursuant to the Luxembourg budget law for 2019 with retroactive effect as from 1 January 2019.

Taxpayers in a fiscal unity will have the option to maintain the application of the IDL Rules at individual entity level. The choice made will be binding for the whole duration of the fiscal unity. For more information, see our Tax Flash of 5 March 2019.

Due to some uncertainties on the potential application of the IDL Rules to certain situations (for instance, investments in distressed debt portfolios), additional clarifications are expected to be given (e.g. concept of "interest equivalent").

ATAD2 / hybrid mismatches

ATAD was amended by Council Directive (EU) 2017/952 of 29 May 2017, mostly focusing on the topic of hybrid mismatches (also referred to as "ATAD2"). Luxembourg published a legislative proposal [6] (the "Legislative Proposal") which would implement ATAD2 on 9 August 2019. The Legislative Proposal reflects an awareness at the level of the legislator of the impact ATAD2 may have on the Luxembourg investment management industry. It intends to resolve practical issues specific to this industry and adapt ATAD2 to Luxembourg tax law concepts.

In a nutshell, the Legislative Proposal will extend the scope of existing anti-hybrid rules to mismatches with third countries and to a wider array of hybrid mismatches. These rules will have effect for tax years starting on or after 1 January 2020, except for the reverse hybrid rules which will apply only as of tax year 2022.

Scope of the new rules

ATAD2 rules seek to prevent mismatch outcomes that arise as a consequence of the hybridity of a financial

6 At the time of this contribution, the Legislative Proposal has not yet been voted on and may be amended prior to the approval, which can be expected towards year-end.

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instrument, legal entity or permanent establishment ("PE"). For the "ordinary" hybrid rules to apply, the mismatch must arise between associated entities or as part of a structured arrangement. Targeted mismatch outcomes are deduction non-inclusion, double deduction and double non-taxation. The main concern in Luxembourg will be:

- Potential denial of deduction of a payment made under a hybrid instrument or made by/to a hybrid entity; and
- Application of corporate income tax on all or part of Luxembourg transparent entities' income (such as an SCS or an SCSp).

Acting together concept

Pursuant to ATAD2, a hybrid mismatch or a reverse hybrid should only arise between associated enterprises (or structured arrangement for hybrid rules). When a person acts together with another person with respect to the voting rights or capital ownership in an entity, their participations in such an entity will be aggregated in order to determine whether they are "associated" with that entity. The acting together test may be detrimental especially for investment funds (i.e. investors deemed to act together due to common management).

The Legislative Proposal provides that, in the absence of evidence to the contrary, an investor who owns (directly or indirectly) less than 10% of the interests in an investment fund and is entitled to less than 10% of the profits of said fund will not be considered as acting together with other investor(s) in the same fund.

Reverse hybrid rules

A reverse hybrid is a transparent entity for Luxembourg tax purposes, but is regarded as opaque in the jurisdiction(s) of (some of) its investors. If associated investors resident in such jurisdiction(s) hold at least a 50% interest in a Luxembourg reverse hybrid entity, the latter will be treated as a resident taxpayer and subject to corporate income tax on its income to the extent it is not taxed otherwise (either in Luxembourg or in a foreign jurisdiction, or under Luxembourg non-resident taxation rules). Luxembourg reverse hybrids will, however, not become subject to net wealth tax. Luxembourg has opted to implement the carve-out for collective investment vehicles as provided for by ATAD2. Reverse hybrid rules will not apply to Luxembourg regulated investment funds (UCITs, Part II UCIs (2010 law), SIFs and RAIFs), and any AIF that is widely held, holds a diversified portfolio and is subject to investor protection rules. The impact of this carve-out remains to be further analysed.

Exempt investors / payees

In line with ATAD2, the commentary to the Legislative Proposal clarifies that the mismatch rules denying the deduction at the level of the Luxembourg payer should not apply if the absence of a corresponding inclusion at the level of the foreign investor/recipient is due to its tax status (e.g. tax exempt investment fund or sovereign wealth fund) or due to a special tax regime.

Burden of proof

Taxpayers will have to provide the tax administration, upon request, with relevant documentation reasonably proving the absence of hybridity or that another country has already tackled the hybrid mismatch. Relevant documents include tax returns and certificates from foreign tax authorities.

Interim carve-out for banks

Luxembourg plans to implement the optional carve-out for hybrid instruments issued by banks to meet loss-absorbing capacity requirements.

Treaty override (intra-EU)

In a case where a disregarded permanent establishment ("PE") of a Luxembourg company is located in another Member State and the tax treaty concluded by Luxembourg with that Member State requires Luxembourg to exempt the income allocable to the PE, the ATAD2 rule will prevail over the treaty and Luxembourg will have to include income of the disregarded PE in the taxable basis of the Luxembourg head office. It should have a (very) limited impact, as this kind of mismatch is rare between Luxembourg and other EU Member States.

Further information is available in our Tax Flash of 9 August 2019.

Implementation of the EU Directive on tax dispute resolution mechanisms

On 11 April 2019, the Luxembourg government introduced a bill of law, which implements the European directive on tax dispute resolution mechanisms. The bill is currently still under discussion.

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The bill aims to provide for an effective resolution of disputes between Luxembourg and other Member States as regards the interpretation and application of agreements and conventions providing for the elimination of double taxation on income or, where applicable, capital. The bill also states the rights and obligations of the affected person when such a dispute arises.

In its current version, the bill states that complaints submitted to the competent authorities in Luxembourg as of 1 July 2019 regarding disputes on income or capital regarding taxable period starting on or after 1 January 2018, will be subject to the new tax dispute resolution mechanisms.

Transparency

Implementation of the UBO-register
The law of 13 January 2019 introduced in Luxembourg a national register of ultimate beneficial owners ("UBOs") of companies and other legal entities (e.g. Luxembourg foundations and Luxembourg branches of foreign entities) that are registered with the Luxembourg register of trade and companies. These entities are required to identify their UBO(s) and collect information about the latter, electronically, file such information with the UBO-register, keep the information up to date and provide it to the national authorities (e.g. the public prosecutor or the Luxembourg tax authorities) upon request. Non-compliance may result in a criminal fine for these entities ranging from EUR 1,250 to EUR 1,250,000. The same sanction may apply to a UBO that does not comply with its obligation to cooperate. The UBO-register is publicly available but there are some safeguards to protect the UBO's right to privacy. The law of 13 January 2019 provided for a 6-month transition period (1 March 2019 up to and including 31 August 2019) to comply with the new requirements. On 29 August 2019, the period for which the filing can be done free of an administrative fee was extended until 30 November but the covered entities could still potentially be subject to the late filing fines.

The draft bill regarding the creation of a UBO-register of fiducies (fiduciary agreements) has not yet been adopted.

For more information, see our Tax Flash dated 30 August 2019.

Legislative proposal to implement mandatory disclosure rules
On 9 August 2019, the Luxembourg government published a legislative proposal to implement the Mandatory Disclosure Directive ("DAC 6"). In line with DAC 6, a cross-border arrangement is reportable if it concerns at least one EU Member State and contains at least one of the hallmarks set out in DAC 6. The term "arrangement" is not further defined in the legislative proposal. Lawyers will be subject to limited disclosure obligations: they will have to report information of a general nature only and may in some cases only have to notify other intermediaries and/or the taxpayer of their obligations. The explanatory notes expressly provide that a taxpayer subject to such reporting obligation may mandate his lawyer to do the reporting on his behalf.

The reporting obligations apply as from 1 July 2020, but will also retroactively cover arrangements that started being implemented after 24 June 2018. For the reporting of cross-border arrangements, the first step of which is to be implemented between 25 June 2018 and 30 June 2020, the reporting deadline is 31 August 2020. In addition, each relevant taxpayer will have to annually disclose in his tax return how he has used the arrangement. Intermediaries and taxpayers who infringe the national provisions may be subject to penalties of up to EUR 250,000. Further information is available in our Tax Flash dated 12 August 2019.

Exchange of information
Under the exchange of information procedure, Luxembourg tax authorities can request information to a Luxembourg holder of information. In a second stage, if the holder does not provide such requested information, the tax authorities will issue an injunction decision which may allow in a third stage to fine the holder if the information is still not provided. The Luxembourg law of 14 February 2019 introduces an appeal against the pecuniary sanction imposed on a holder of information following non-compliance with such injunction decision. Moreover, when receiving a request for information, the tax authorities must not just verify the formal elements of the request, but must ensure that the information requested is not lacking likely relevance for the purpose of the tax investigation. Hence taxpayers should not hesitate to verify whether the questions asked are relevant in the context of the request for information.

State aid

In 2019, the European Commission opened a new State aid investigation concerning Luxembourg: the Huhtamäki case. The Commission questions the deduction of a deemed (arm's length) interest on an interest-free loan granted to the Luxembourg company by a sister Irish company that is not correspondingly taxed on a deemed interest income.

The EU General Court also upheld the Commission's decision in the Fiat case, maintaining that Luxembourg had granted unlawful State aid to a Luxembourg treasury company of the Fiat group. The General Court criticised specific aspects of the transfer pricing position. In particular, it questioned the amount of equity deemed at risk, which was seemingly much lower than the equity actually at risk.

Various other State aid cases concern Luxembourg taxpayers:

- The Amazon case concerns the arm's length nature of a royalty paid by a Luxembourg company to a (hybrid) Luxembourg partnership. It is pending before the EU General Court.
- The ENGIE case concerns the tax position of three companies involved in a domestic "hybrid" instrument structure and whether Luxembourg should have applied its domestic anti-abuse rule.

For further details on EU State aid developments, we refer to the State aid section in the "International Developments" part of this publication on page 9 - 11 and to the Quoted dedicated to State aid developments.

Tax treaty changes

As of 1 January 2019, the following bilateral tax treaties entered into force:

- Luxembourg – Cyprus; and
- Luxembourg – Senegal.

Furthermore, as from 1 January 2020 the new Luxembourg – Kosovo tax treaty as well as the Protocol to the Luxembourg – Uzbekistan treaty and the one to the Luxembourg - USA tax treaty regarding exchange of information entered into force.

The new France - Luxembourg tax treaty signed 20 March 2018 was ratified by the Luxembourg Parliament on 2 July 2019 so that it should be effective as of 1 January 2020. The new treaty will facilitate various types of investments in France, especially in real estate through Luxembourg fund entities. It introduces significant changes compared to the previous treaty, notably concerning the taxation of income received by Luxembourg entities from French real estate investment funds (e.g. OPCIs and SIICs). Luxembourg taxpayers should have assessed whether they need to restructure existing investments in French real estate before the new treaty enters into force. For more information, see our Tax Flash of 5 July 2019.

The Luxembourg government approved on 27 September 2019 the new tax treaty concluded with Argentina on 13 April 2019.

As of 1 January 2020, Luxembourg is party to 84 bilateral tax treaties which are in force. Furthermore, Luxembourg is renegotiating the existing bilateral tax treaty with the United Kingdom. In addition, tax treaties with the following 16 countries are still under negotiation: Albania, Botswana, Cabo Verde, Chile, Egypt, Ethiopia, Ghana, Kyrgyzstan, Kuwait, Lebanon, Mali, New Zealand, Oman, Pakistan, Slovakia, South Africa and Syria.

Permanent establishment proof

As of 1 January 2019, the Luxembourg tax authorities might challenge the applicability of the exemption of income allocable to a PE under the applicable tax treaty pursuant to a new Luxembourg law provision regarding the domestic interpretation of the PE concept. The Luxembourg tax authorities may ask for proof of existence of the PE from the treaty partner jurisdiction. Such proof is mandatory if the tax treaty does not have a clause that allows Luxembourg to deny the exemption under the applicable treaty if the other treaty partner is not taxing the income. Administrative guidance from the Luxembourg tax authorities has made clear that the absence of such confirmation would result in the PE exemption being denied. Obtaining such proof should be closely monitored in view of 2019 corporate income tax returns.

Corporate income tax – rate changes

The 2019 budget law reduced the corporate income tax to 17% (instead of 18%). This means the consolidated corporate tax rate (including solidarity surcharge and municipal business tax) decreased from 26.01% to 24.94% for companies having their seat in Luxembourg City. Furthermore, the budget law increased the threshold up to which profits are taxed at the reduced corporate income tax ("CIT") rate of 15% from EUR 25,000 to EUR 175,000. The rate is applicable with retroactive effect as of 1 January 2019.

Advance tax agreement procedure

The 2020 budget bill of law, filed with Parliament on 14 October 2019, provides for the automatic expiration of pre-2015 tax rulings upon completion of the 2019 tax year. The bill also provides that affected taxpayers may request a new ruling (valid for five years) under the current procedure.

The Luxembourg government's reason for the proposed measure is to bring the term of validity of pre-2015 rulings in line with that of rulings granted under the current ruling procedure. With effect from 1 January 2015, Luxembourg has formalised such procedure, such as by establishing a ruling committee, introducing an administrative fee and limiting the validity of tax rulings to five years. It also laid down the requirement that advance tax rulings can only be obtained before the transaction in question is carried out.

The 2020 budget bill of law indirectly confirms that taxpayers should still be able to rely on their pre-2015 tax rulings for the tax years up to 2019, as long as they have not already expired. Should taxpayers want similar comfort for subsequent tax years, a new request may be filed under the current procedure. The proposed explicit language to that effect seems to imply that the fact that a new ruling request would be filed only long after the transaction had occurred should not be an obstacle to obtaining such a ruling.

For companies with financial years diverging from the calendar year, the proposed measure – as currently worded - would effectively be retroactive to the *beginning* of their financial/tax year that started during 2019. For example, if a taxpayer has a financial/tax year running from 1 April to 31 March, the 2019 tax year ended on 31 March 2019. If the proposed measure is enacted without amendment, the tax ruling would no longer be binding for the tax year that started on 1 April 2019.

The proposed measure also impacts the annual net wealth tax. If Parliament accepts the provision as worded in the bill of law, it would take effect on 1 January 2020. This would also mean that it is immediately relevant for net wealth tax since it is due as per 1 January 2020 and the ruling will expire as of this date.

Taxpayers who currently rely on pre-2015 tax rulings should consult their tax advisers to assess:

- the need for additional comfort brought by the tax ruling; and
- the exposure to a potential challenge by the tax authorities as from tax year 2020, or even earlier in case of diverging financial/tax years.

Case law

On 19 June 2019, the Administrative Tribunal of Luxembourg ruled that a transaction consisting of a novation of the dividend claim into a loan agreement following a dividend distribution does not constitute a hidden distribution of profits but may constitute an abuse of right.

Here, the tribunal first excluded the characterisation of a hidden distribution by considering that there was no advantage granted by the company to its shareholder since the remuneration of a loan and the granting of an annual interest cannot be considered as an advantage, unless a disproportionate interest rate is applied. Subsequently, the tribunal considered that the transaction constituted an abuse of right by noting that there had been (i) use of novation (a private law instrument), (ii) reduction of the tax burden through deductible interest, (iii) use of an inadequate method mainly to avoid withholding tax on capital income and (iv) no extra-tax grounds.

Individual taxation

Luxembourg has developed a favourable tax environment for attracting highly skilled workers through the implementation of a beneficial tax regime applicable to (i) carried interest, (ii) stock-options and (iii) impatriate workers. These tax regimes are commonly and conjointly

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used by Luxembourg employers in order to optimise the remuneration paid to their executives.

Carried interest

A distinction should be made between two categories of carried interest income earned by the employees of alternative investment fund managers ("AIFMs") or management companies of alternative investment funds ("AIFs"):

- carried interest not structured under units, shares or representation issued by an AIF; and
- carried interest structured under units, shares or securities issued by an AIF.

The return on the first type of carried interest arrangement is taxed at a progressive income tax rate up to 45.78%. Capital gains on the second type of carried interest realised are subject to the same progressive income tax rate. However, if the gain is realised after a period of six months it is not subject to taxation, unless the carried interest represents a substantial stake in a tax-opaque AIF. Such a substantial stake is generally present if the carried interest directly or indirectly represents more than 10% of the AIF's capital. In this case, gains are taxed at half the progressive income tax rate (maximum tax rate of 22.89%). To ensure that the income paid under the second type of carried interest arrangement benefits from this exemption, the carried-interest holder should dispose of its carried interest rather than receive a distribution from the AIF, which would generally entail a buy-back of carried units by the AIF.

Stock-options

Transferable options are subject to taxation at the granting date whereas individual/virtual options are taxed at the date of exercise. For transferable options granted on or after 1 January 2018 which are not listed, nor are valued in line with a recognised financial method, the benefit is determined at 30% of the value of the underlying shares. In addition, all stock-options granted as of 1 January 2018 have to be notified to the Luxembourg tax authorities at each granting date of the stock-options. For Luxembourg social security purposes, contributions are due on the granting of options. However, where the annual remuneration of the employee already exceeds the Luxembourg annual social security ceiling (EUR 125,385 for the year 2019), no additional Luxembourg social security contributions would be due (except for the insurance dependence contribution at the rate of 1.4%).

Impatriate tax regime

Under certain conditions, the Luxembourg impatriate regime consists of an exemption from Luxembourg personal income tax on certain expenses and allowances paid to or on behalf of impatriate workers due to their impatriation (travel expenses, home staging expenses, etc.). Those qualifying expenses and allowances remain deductible from the Luxembourg company's taxable basis for corporate income and municipal business tax purposes.

VAT

VAT implications of transfer pricing adjustments

On 18 January 2019, the Luxembourg VAT Authorities released VAT Circular no. 790 regarding the application of normal value to certain transactions taking place between related parties. These new rules are a point of attention for groups of entities, whereas the Luxembourg-based group entity does not have a full VAT deduction right. This circular clarifies existing transfer pricing rules applicable in Luxembourg since 2018. It states that the VAT taxable basis of certain transactions performed between related parties should be determined based on the normal value of these transactions at the moment when the remuneration has been agreed or effectively invoiced.

Rent-free periods in real estate leasing agreements have no impact on input VAT deduction right of the lessor

In 2019, the Luxembourg Tribunal delivered decisions where it invalidated the approach widely used by the VAT Authorities, which implied a partial non-deductibility of input VAT incurred in the framework of leasing of real estate due to the granting of a rent-free period to lessees. In the view of the VAT Authorities, rent-free periods were to be considered as transactions falling outside the scope of VAT, triggering a partial regularisation of the input VAT deducted by the lessor.

The tribunal held that the lease agreements were to be considered as a whole, without artificial breakdown of specific periods. On that basis, the tribunal ruled that such rent-free periods should not trigger the lessor's obligation to regularise the input VAT initially deducted. These decisions are currently being appealed by the VAT Authorities.

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Developments in Switzerland

Main changes in Swiss tax in more detail

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"In 2019, we have been assisting MNEs with Swiss operations in reorganisation projects triggered by the Swiss corporate tax reform package ("TRAF"), European tax developments and the US tax reform. We are currently working with clients on inbound restructuring projects, simplification of group structures, transfer of financing activities and R&D functions to Switzerland as well as tax-neutral step-up transactions.

In January 2020, the Swiss corporate tax reform package will enter into force. MNEs with Swiss operations are required to implement and apply beneficial measures such as tax-neutral step-up transactions, incentives for income from patents and R&D activities and capital tax relief. We are ready to assist our clients with tailor-made multi-jurisdictional solutions in order to make this transition as smooth and efficient as possible, both from a Swiss and international tax perspective."

Actions to be considered

- **Measures to cushion adverse tax effects due to abolishment of preferential tax regimes:** In 2020 Swiss businesses are recommended to review the impact of the Swiss corporate tax reform and to consider beneficial measures to the extent that such analysis has not yet been completed or implemented.

- **Step-up upon abolishing of preferential tax regimes:** Swiss businesses are particularly urged to prepare a business valuation and review their tax position without delay in order to determine a preferred step-up model if any. As most cantons will require taxpayers to decide in the 2019 tax return which is to be prepared and filed in 2020, the time for action is limited.

Multilateral Instrument

On 29 August 2019, Switzerland deposited its instrument of ratification for the Multilateral Instrument ("MLI"). The MLI enters into force on 1 December 2019 for Switzerland.

As Switzerland follows the "amending view" with respect to the effect the MLI has on covered tax agreements, covered tax agreements for Switzerland will only be affected once the relevant double tax treaty has been successfully renegotiated (reservation for separate notifications pursuant to article 35(7) MLI). Accordingly, Switzerland is now in the process of amending the covered tax agreements. For certain treaty partners, Switzerland has opted to amend the double tax treaty without including the agreement under the MLI (e.g. the revised double tax treaty with the UK).

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Corporate income tax

On 19 May 2019, the Swiss corporate tax reform package (Tax Reform and AHV Financing; “TRAF”) was approved by referendum. The reform will enter into force on 1 January 2020 and is mainly aimed at replacing preferential tax regimes, such as the holding company, mixed company or finance branch status, with new tax incentives as of 2020.

TRAF will notably introduce step-up mechanisms applicable to most companies that currently apply a preferential tax regime as well as incentives for income from patents and R&D activities. Separately, most cantons have announced significant tax rate reductions as of 2020, resulting in a typical range of effective tax rates of 12-15%.

Contents of TRAF

Measure	Description
Patent Box	- 90% reduction of income from patents (excluding software) - Allows outsourcing to related parties in Switzerland or third parties (anywhere)
R&D Super-deduction	- 50% additional deduction on R&D (salary) expenses - Includes expenses for outsourced activities within Switzerland
Step-up in basis upon relocation to Switzerland	- Tax neutral step-up upon migration or transfer of business operations/ functions to Switzerland
Step-up in basis for regimes	- Transition mechanism for companies if an applicable tax regime ends - Two different models available: Depreciation Model (depreciation on built-in gains/goodwill) and Separate Rate (taxation of income at a separate, reduced rate)
Notional interest deduction	- Deduction on "excess equity financing” up to an arm's length interest rate for intra-group financing operations, resulting in an effective tax rate of approx. 11% (canton of Zurich only)
Capital tax relief	- Capital tax relief on qualifying share investments of at least 10%, patents and intra-group loans
Base-erosion limitation	- Deductions under the above measures (except step-up upon relocation) cannot exceed 70% of total income
Abolishing preferential tax regimes	- Preferential tax regimes abolished as of 1 January 2020
Foreign withholding tax credit	- Swiss branches of non-resident entities will benefit from a foreign withholding tax credit (subject to certain conditions)
Changes to withholding tax free share premium for Swiss listed groups	- Groups listed on the Swiss stock exchange will be subject to a 50:50 priority rule when distributing capital reserves free of Swiss withholding tax
Increase in dividend taxation for Swiss tax resident individuals	- Dividends from substantial investments (at least 10% shareholding) will be taxed at a larger portion for personal income tax purposes (minimum 50% on cantonal level, 70% on federal level)

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The below provides an overview of the main effects of the reform on Swiss businesses and explains the mechanics of the new tax incentives:

- **Step-up upon abolishing of preferential tax regimes:** As of 1 January 2020, preferential tax regimes such as mainly the holding, mixed company, principal company and finance branch tax regimes will cease to exist. In order to allow for a phasing-in, the majority of companies or branches which previously applied one of these regimes will be allowed to benefit from a tax neutral step-up in basis. In most cantons, two different models will be available for taxpayers. The first model allows for a tax-neutral step-up in basis on built-in gains and goodwill followed by a subsequent tax-effective depreciation which will allow Swiss businesses to maintain the effective tax rate that was applicable under the regime for a further 5 to 10 years, depending on the canton ("Depreciation Model"). Alternatively, all cantons also offer to tax income at a lower rate for the next 5 years to the extent that such income would have been reduced or exempt under the previous regime ("Separate Rate Model"). Both options will in principle require taxpayers to conduct a valuation of the business in order to determine the amount of the step-up or income subject to separate taxation. The tax impact under the two models varies depending on the individual case and canton. Swiss businesses are therefore urged to review their tax position at their earliest convenience. As most cantons will require taxpayers to decide in the 2019 tax return which is to be prepared and filed in 2020, the time for action is already limited.

- **Impact on IFRS and US GAAP accounting:** Due to the tax-neutral step-up in basis under the Depreciation Model, the financial and tax accounts will show significant differences in basis. For groups also required to produce financial accounts under a fair view standard such has IFRS or US GAAP, the Depreciation Model would lead to a temporary difference and the creation of a deferred tax asset for the duration of the step-up/depreciation. As the Separate Rate Model pertains to a difference in tax rate only, no such deferred tax asset will be recognised. The Swiss association of fiduciaries, audit and tax experts has issued detailed guidance on the IFRA/US GAAP accounting impact of TRAF.

- **Patent box and R&D super-deductions:** As of 1 January 2020 Switzerland will also allow business to apply an OECD-compliant patent box regime which aims at reducing income from patents and similar rights by 90% as a boost to innovation. A new entry into the patent box will however be linked to a re-capture of tax-deductible R&D expenditures from the previous 10 years. Due to this entry cost, most taxpayers are expected to rely mainly on low overall effective tax rates. Separately, taxpayers may claim an additional deduction of incurred R&D salary expenses of 50%. This deduction will essentially function as a tax subsidy on salary costs for R&D activities (such as scientific research, science-based innovation including development of new products, methods, processes and services).

- **Capital tax relief:** As the Swiss tax system also consists of an annual capital tax (tax on the overall equity of a legal entity levied on an annual basis) and companies which previously applied a tax regime (e.g. mixed company regime or holding regime) were able to apply a reduced tax rate, the tax reform will introduce relief for capital taxes for certain asset classes such as investments in subsidiaries, patents and intra-group loans. Equity on such assets will thus essentially benefit from an exemption from capital tax. Many cantons also provide for a partial or full tax credit of corporate income taxes against capital taxes.

- **Notional interest deduction:** The canton of Zurich has opted for the introduction of a notional interest deduction on "excess equity" ("NID"). The NID can be claimed not only by a legal entity incorporated in the canton of Zurich but also by branches of a company resident in another canton or resident outside of Switzerland. The main focus of the NID is on interest rates on intra-group loans and related party receivables. Due to the fact that the NID does not apply at a federal level and the minimum tax basis for the purposes of the NID is 30% of net income, effective tax rates in the city of Zurich would be in the range of 12.30% for 2019 and 11.75% for 2020 onwards.

- **Base-erosion limitation:** All deductions and other incentives under the reform are subject to a limit of 70% of the net profit, i.e. resulting in a minimum tax basis of 30% of the net profit subject to tax (with the exception of the step-up in basis upon the transfer of assets/functions to Switzerland and the Separate

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Rate Model). Cantons may introduce a higher limitation (i.e. a minimum tax basis of 60% of the net profit, meaning a maximum deduction of 40% of the net profit), which could be the case, for instance, if the overall effective tax rate of a canton without any special tax incentive is already 12-13% and thus at the lowest end of any tax burden in Europe.

In 2020 Swiss businesses are recommended to review the impact of the reform if such an analysis has not yet been completed or implemented.

The impact of TRAF on withholding taxes and individual income taxes is summarised below.

Withholding tax

Switzerland notably levies a 35% withholding tax on dividends. As an exception to this rule, a repayment of nominal share capital and the distribution of profits from so-called reserves from capital contributions (essentially additional paid-in capital recognised as capital reserves) are exempt from withholding tax provided certain formalities are met. Most importantly, this also applies to payments to non-Swiss resident shareholders regardless of the individual treaty position of the beneficiary. In a domestic context, payments made out of such reserves are not subject to individual income tax.

TRAF will introduce a limited priority rule under which companies listed on the Swiss stock exchange (including dual listings) will at all times be required to distribute taxable retained earnings for the same amount as the distributions of capital reserves. There are numerous exemptions, such as for qualifying capital reserves created as part of a cross-border reorganisation (e.g. contribution of shares to a Swiss entity). As the priority rule only applies to companies listed on the Swiss stock exchange, its impact is limited.

Income tax

As outlined above, TRAF will also bring about a change to the taxation of dividends for individual income tax purposes.

Under current rules, dividends from a qualifying investment (at least 10% shareholding) paid to Swiss tax-resident individuals are taken into account at 60% for the federal income tax basis and typically 50-60% for the cantonal tax basis (depending on the canton). The income so calculated is taxed together with all remaining income at ordinary tax rates. Some cantons apply a tax rate reduction instead of the reduction of the tax basis.

Under TRAF the minimum tax basis for dividend payments on qualifying investments (10%) held by an individual is increased to 70% at federal level and to at least 50% at cantonal level meaning that overall income tax on dividends from substantial investments is going to increase. The increase is made due to the fact that most Swiss cantons are reducing their effective corporate income tax rates and business profits will be subject to a much lower tax burden as of 2020.

Second, aside from the income taxation of dividends under the new priority rule described above, TRAF also amends income tax rules pertaining to the transfer of an investment held by an individual to a business or legal entity held by the same individual (transfer of an investment to a self-controlled legal entity). Under current rules, such a transfer can trigger income tax if the investment transferred pertains to at least 5% in the capital of a legal entity if not structured properly. Under revised rules, the 5%-rule is abolished and any transfer will thus trigger income tax. The tax impact can still be mitigated if the transfer is structured properly. Swiss tax residents should also take into account that these rules apply regardless of whether a transfer pertains to a Swiss or non-Swiss legal entity.

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You are most welcome to contact your regular Loyens & Loeff adviser if you would like to receive more information on any of the topics in this year-end tax bulletin.

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Closing date of publication

This publication closed on 15 November 2019. This means that later developments have not been included in this publication. Please note that many of the developments and changes addressed in this year-end tax bulletin are based on relevant legislative proposals, some of which are expected to enter into force on 1 January 2020 and others at a later date. As some of these proposals still need to be adopted by the relevant legislative bodies in the Netherlands, Belgium, Luxembourg and Switzerland, it is uncertain whether and which of these proposals will enter into force. Moreover, if these proposals do enter into force, this may be in an amended form.

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