COUNCIL OF
THE EUROPEAN UNION

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NOTE FROM THE CHAIR

to :	Code of Conduct Group (Business Taxation)
on :	8 November 2001
Subject :	Code of Conduct (Business Taxation) - Draft report to the ECOFIN Council on 4 December 2001

Introduction

1. The Council and the Representatives of the Governments of Member States, meeting within the Council, adopted on 1 December 1997 a Resolution on a Code of Conduct for business taxation. That Resolution provides for the establishment of a Group within the framework of the Council to assess tax measures that may fall within the Code.

2. The Council subsequently confirmed the establishment of the Code of Conduct Group on 9 March 1998.

3. The Group reported regularly on the measures assessed and these reports were forwarded to the Council for deliberation. Two interim reports of the Code of Conduct Group were presented to the ECOFIN Council on 1 December 1998 and 15 May 1999 respectively (12530/98 FISC 164 and 8231/99 FISC 119) and, subsequently, the Group reported to the ECOFIN Council on 29 November 1999 setting out the results of the Group's work on the assessment of 271 tax measures under the Code (SN 4901/99) where 66 measures were considered harmful by the Group.

4. In November 2000, the Code Group presented a progress report on its work to the ECOFIN Council meeting on 26-27 November 2000 (13563/00 FISC 193).

5. A further progress report on the Code Group's work under the Swedish Presidency was presented to the ECOFIN Council on 5 June 2001. The Council, in its conclusions on the tax package (9553/01 FISC 106), and with regard to the Code of Conduct, took note of the report and:

Approved the work programme on transparency and exchange of information on transfer pricing as set out in Annex 1 to the Group's report and asked the Group to take forward its work on standstill and rollback and to report to the Council by the end of the year on the progress achieved.

6. As required by the ECOFIN conclusions of 9 March 1998, the Group's report to the 29 November 1999 ECOFIN reflected either the unanimous opinion of the members of the Group or the various opinions expressed in the course of the discussion. References to 'the Group' in that report reflected the broad consensus where unanimity was not achieved and alternative views were shown in the notes as appropriate. Consistent with the Group's report to the 29 November 1999 ECOFIN, references to 'the Group' in this report should be construed in the same way.

Progress of work

7. Since the Council meeting on 5 June 2001, there have been four meetings of the Code Group on 28 June under the Swedish Presidency, and on 26 September, 17 October and 8 November under the Belgian Presidency.

8. At its meeting on 28 June the Group agreed its timetable and the main elements of its future work programme under the Belgian Presidency:

- transparency and exchange of information in relation to the agreed elements of transfer pricing;
- further work on standstill;
- rollback.

9. The Group subsequently also agreed to discuss the possible interaction of its work on standstill and rollback with State aids procedures in respect of 13 of the 66 measures listed in the Group's 1999 Report. It also agreed to receive a report from the Commission services on their work on business taxation measures in the accession countries which are potentially harmful under the Code of Conduct.

10. On 26 September, Mr Hatry, personal representative of the Finance Minister in Belgium, honorary Senator and former Finance Minister (B) and Mr Rodríguez-Ponga y Salamanca, Secretary of State in the Ministry of Finance (E) were confirmed as first and second Vice-Chairs for the period up to the end of the Belgian Presidency.

A. Transparency and exchange of information in relation to the agreed elements of transfer pricing

11. As noted in paragraph 5 above, the ECOFIN Council of 5 June approved the Group's work programme on transparency and exchange of information in the area of transfer pricing as set out in Annex 1 of the Group's Report (9553/01 FISC 106).

12. Exchange of publicly available information on a yearly basis: As explained in paragraph 14 of that Report, as far as publicly available information was concerned, the Group hoped to be able to reach agreement with a view to an annual exchange process being put in place during 2002. To enable the Group to take forward this work, the Group invited Member States, in the first instance, to provide information relating to the exchange of information on a yearly basis. Specifically, each Member State was invited to provide a written report setting out:

- the information which is publicly available in their country concerning the agreed elements of transfer pricing as set out in paragraph 17 of Annex 1 to the Report to the ECOFIN Council on 26-27 November 2000 (13563/00 FISC 193);

- the ways in which they would use similar information if available from other Member States;

- any impediments to the exchange of their publicly available information.

13. The Group considered these reports and also heard oral reports provided by all Member States. These indicated that relevant legislation, circulars, administrative provisions, guidance and policy rules that are publicly available could be made available to other Member States.

14. Some members of the Group indicated that they had doubts about the usefulness of annual exchange of publicly available information. Others indicated that such information might help improve understanding of other Member States' legislation and practices. The issue of whether the cost of translation of lengthy rules and guidance would be justified given the use of the information in practice was raised.

15. It was agreed that the objective should be to keep Member States fully informed and up to date whilst avoiding costly or unnecessary circulation of information. Accordingly, the Group agreed to provide access to all the relevant publicly available information in their country and then, subsequently, provide annual updates indicating what, if anything, has changed.

16. Exchange of information in individual cases: Noting that Paragraph 17 of the Group's guidance note on rollback and standstill in the areas of finance branches, holding companies and headquarters (Annex 1 of the report to ECOFIN on 26-27 November 2000 (13563/00 FISC 193) envisaged the exchange of information in summary form (number and type of cases) and of specific information in certain cases, the Group agreed that it would need information from Member States relating to the second part of the work programme, namely the exchange of information in individual cases.

17. The Group noted that, from the initial discussion of the factors which needed to be taken into account in such exchanges which had been carried out in a subgroup under the Swedish Presidency, there were a number of complex issues that needed further consideration. It was agreed that Member States would need time to prepare their responses. Accordingly, Member States have been asked to provide by 30 November 2001 written reports setting out relevant information.

B. Further work on standstill

18. As envisaged in paragraph 21 of the Group's Report (8789/01 FISC 83), the Group took forward its work on the assessment of Germany's holding companies regime and the measures under the Fiscal Framework for the Netherlands Antilles.

19. Germany - Holding Companies: The Group agreed the description of Germany's holding companies regime (**Annex A**) and took the view that the report from the German delegation on the effective level of taxation for the measure did not provide a satisfactory degree of certainty that the measure could not, at least in some circumstances, provide for a significantly lower effective level of taxation. The Group considered that the measure did not meet any of the criteria in paragraphs B1-B5. Adopting an approach consistent with paragraphs 29-67 of the Group's Report to the ECOFIN Council of 29 November 1999 (SN 4901/99), the Group considered whether the measure affects or may affect, in a significant way, the location of business activity within the Community. On the basis of its evaluation overall, the Group decided that the measure should not be given a positive evaluation. But the Group noted that there were complexities as regards the interactions with effective Controlled Foreign Companies (CFC) legislation. The Group also agreed that there was no need for further general work on holding companies.

20. Netherlands - Fiscal framework for the Netherlands Antilles: The Group agreed the descriptions of the two measures under the Netherlands Fiscal Framework (NFF) **(Annex B)** in the name of the Netherlands:

- the tax treatment of holding companies; and
- the tax treatment of exempt companies.

21. The Group considered and agreed an assessment against criteria 1 to 5 of paragraph B of the Code proposed by the Commission Services.

22. [The Group examined a report provided by the Netherlands delegation on the effective levels of taxation for the measures in their name.]

C. Rollback

23. The Conclusions of the 10 July ECOFIN Council meeting (10768/01 FISC 130) include the following statements relating to the timetable of work on the tax package for the ECOFIN Council in December 2001:

As far as the Code of Conduct is concerned:
To consider the report to the Council by the Code of Conduct Group on progress achieved on standstill and rollback, including:

- *a review of measures which Member States are ready to implement in order to fulfil their commitment in the Conclusions of the ECOFIN of November 2000 regarding new entrants, and*

- *an assessment on whether Member States who have footnotes to the November 1999 Report wish to maintain those reservations in light of the Group's subsequent work.*

24. The work programme on rollback under the Belgian Presidency as agreed by the Code Group at its meeting on 28 June 2001 was in line with this wording.

25. Accordingly, the Group invited Member States to provide up-to-date information on rollback, including information relating to Member States' commitment on new entrants and details of whether Member States with footnotes in the November 1999 report still wished to maintain their reservations in the light of the Group's subsequent work.

26. The summaries from Member States appear at **Annex C**.

27. The Group noted that there had been further progress in terms of the number of harmful measures which had already or were in the process of being rolled back. The Group also noted that progress had been made towards fulfilling the commitment regarding new entrants and that, in the light of work done by the Group since November 1999, a number of reservations to the November 1999 report were no longer being maintained.

D. Possible interaction between the work of the Code of Conduct Group and the State aids procedures

28. [To be added]

E. Potentially harmful measures in the accession countries

29. Following the distribution by the Commission services of their report on *Enlargement and Direct Taxation* to Working Group IV on 17 September, the Group heard an oral report from the Commission services on their work on potentially harmful measures in the candidate countries.

30. The Group, while noting the Commission's report, expressed the view that the criteria applied by the Commission in relation to this work should not go beyond the criteria set out in the Code. In particular, the scope of the Code was confined to assessing business tax measures rather than tax systems.

Further work

31. The conclusions of the 10 July ECOFIN Council meeting (10768/01 FISC 130) include the following statements relating to the timetable of work on the tax package for the ECOFIN Council in April and June 2002:

April 2002: The ECOFIN Council:

...

As far as the Code of Conduct is concerned, to take note of:

- *progress achieved on the work of the Code of Conduct with regard to Member States;*
- *reports on progress achieved on discussions between Member States concerned and their dependent or associated territories.*

June 2002: The ECOFIN Council

...

As far as the Code of Conduct is concerned, to assess the adequacy of the envisaged legislative or administrative measures to rollback the harmful features of the measures identified in the Code Group's November 99 Report and to finalise the work relating to standstill and to the possible extension of benefits for certain measures beyond 2005.

32. Accordingly, the Group agreed to complete its current work on standstill and rollback and to report to the ECOFIN Council on the outcome in May 2002. The Group also agreed to take forward its work programme on transparency and exchange of information (Annex 1 to the Group's report to the ECOFIN Council of 5 June 2001 (8789/01 FISC 83) in the context of paragraph 17 of Annex 1 to the Group's report to the ECOFIN Council of 26-27 November 2000 (13563/00 FISC 193).

DESCRIPTION OF GERMANY'S HOLDING COMPANIES REGIME

In connection with the ongoing tax reform Germany has introduced new rules concerning the tax treatment of dividends and capital gains, principally, replacing the formerly applied imputation credit system with exemption method for (inter-company) dividends and exempting capital gains from disposals of shares held in other companies. The bill introducing these and many other changes were passed in 2000 and subject to certain transitional exceptions the new rules entered into force as of 1 January 2001.

At the same time changes were also made to the rules under which controlled foreign corporations' income may be subjected to 'current' taxation in the hands of their German shareholders. Other rules (or amendments) introduced in connection with the tax reform (and which can be of relevance to holding structures) are, by way of example, those concerning the deductibility of interest paid to shareholders where interest payments are not subject to tax in Germany and the abolition of the possibility of writing off a permanent decrease of the value of a shareholding.

Conditions Attached

The new rules on the tax treatment of inter-company dividends and capital gains are applied to German companies, German permanent establishments of foreign corporations and to corporations which hold shares in other corporations, through a German resident partnership. With respect to corporate shareholders, the application of the new rules is not conditional upon any participation thresholds.

As regards dividends received, the new rules are applicable to both domestic and foreign source dividends. Domestic and foreign dividends are subjected to the same taxation regime, except the non-deductibility of expenses. With respect to capital gains on disposals of shareholdings, no differentiation is made between shares that have been held in German or in foreign companies. The exemption of capital gains in the hands of corporate shareholders is equally available without any participation thresholds. The exemption of dividends and of capital gains is available irrespective of the nature of the activities of the company from which the dividends are received or of which the shares are disposed off.

However, CFC rules do apply to any given German resident shareholder of a foreign corporation which is controlled by German resident shareholders and certain other shareholders provided that the foreign corporation is subject to low taxation (see annex). CFC rules also apply to any given German resident shareholder holding at least 10 % of the share capital of a foreign corporation where the income of the foreign corporation is of a capital investment nature. A controlled foreign corporation is considered to be subject to such a low taxation where it is subject to corporate income tax at an effective rate that is lower than 25% (the tax base being determined according to the German corporate income tax rules). The CFC rules are applied to the extent that such controlled foreign corporation has tainted income as defined in § 8 of the "Außensteuergesetz" which covers unfair tax practices abroad. In general terms there is a presumption of tainted income when it is derived exclusively from intra-group activities (transactions with related parties). These CFC rules are currently under further consideration.

Tax Benefits

Inter-company dividends paid by non-resident companies to other companies are exempt from tax in order to avoid double taxation. No imputation credit is attached to the dividends received under the new rules; the 'advance corporate income tax' of 20% that is withheld upon distribution will be credited against the recipients' corporate income tax due. The withholding tax payable upon distribution (at the rate of 20%) is refundable to the extent that the recipient company does not have taxable income in Germany or that the credit exceeds the corporate income tax due by the recipient of the dividend.

With regard to dividends received from foreign companies, 95% of such dividends is exempt (as provided under the rules of the parent-subsidiary directive). The remaining 5% is considered to represent a non-deductible expense related to income from the holding and, as a result will be subject to tax in the hands of the recipient corporate shareholder while the recipient shareholder is entitled to deduct any expenses incurred in view of acquiring such foreign dividend income without limitation. Should the CFC rules apply in respect of the foreign company in question, the corporate shareholder would be taxed on the undistributed tainted income derived by the foreign corporation.

In such a case the 95% exemption is not applied to the deemed dividend but only to the actual dividend distributions received from such foreign corporations. With regard to dividends received from domestic companies, all expenses directly related to the acquisition or holding of the shares in the distributing company which are exempt from tax are non-deductible (Sec. 3 c Income Tax Act).

Capital gains derived through disposals of shares held in domestic or foreign companies are exempt in order to avoid double taxation and capital losses suffered due to such disposals are not deductible. Under the new rules, the previously possible tax-effective write-off of permanent decrease of the value of a shareholding is no longer recognised for tax purposes. However, to the extent that such a write-off had been made (prior to the entry into force of the new rules) a subsequent increase in the value of such a shareholding, or a capital gain realised upon disposal of such shares, will be recaptured and thus subject to tax.

The new thin capitalisation rules impose stricter limits to the deductibility of interest payments, to the extent that the payments are made to foreign and domestic shareholders. The following debt/equity ratios are considered to be acceptable:

- 3/1 for companies whose main activity is the holding of participations in corporations and the financing of such corporations or, of whose balance sheet assets more than 75% consist of participation's in corporations; and
- 1.5/1 for any other companies.

In situations where the proportional share of debt financing is considered to be excessive, a reclassification of such interest payments as constructive dividends is undertaken.

Annex

I. Further information on the operation of CFC legislation

1. What income is covered by the *Hinzurechnungsbesteuerung*? (*translator's note: = income of the foreign company to be added to the taxable base in Germany*)

   Article 8(1) of the Foreign Tax Act (*Außensteuergesetz* - AStG) specifies the type of income that is not subject to the *Hinzurechnungsbesteuerung* as essentially income stemming from active business activity of a foreign company, i.e. from participation in general economic activity. The income to be added to the basis of assessment in Germany therefore includes all income that does not result from an active business activity abroad, such as dividends, royalties and interest. Only the examination of the particular situation determines the demarcation line between active and passive income. The functions fulfilled by the foreign company in obtaining the income are decisive in this regard. For a correct classification of the income it is necessary to analyse the income of the foreign company according to the list of activities in Article 8(1) of the Foreign Tax Act.

2. Relationship between the *Hinzurechnungsbesteuerung* and double taxation agreements

   The *Hinzurechnungsbesteuerung* does not apply if the actual distribution of profits is exempt under a double taxation agreement. Profits distributed by a foreign company to a company based in Germany may be exempt under (usually old) agreements if the German-based company owns at least 10% of the stock of the distributing company (application of the exemption method for profit distribution). The tax exemption is subject to the condition that the foreign company derives its income from active business.

Double taxation agreements do not provide for tax exemption for “capital investment income” (income derived from ownership, management, maintaining or increasing the value of as means of payment, debt claims, securities, holdings in other assets or similar assets). This restriction of the aforementioned exemption applies if the yields on the basis of the "capital investment income" account for more than 10% of the total income of the foreign company which form part of the intermediate profit, or exceed DEM 120 000. Regardless of the existence of a double taxation agreement, income (interest) from finance companies is included in the additional amount to be incorporated unless they derive from an activity which contributes to an active business (other than financing activity) of the foreign company. However, only 80% of the income derived from the financing of companies belonging to a group are charged to tax. This results in an effective taxation of about 30%. This rate corresponded roughly to the relevant tax charge triggering the *Hinzurechnungsbesteuerung*.

Income from a foreign-based company, in which a German company owns at least 10% of the capital does not constitute "capital investment income", if the income has been taxed at least 25%.

3. How is the intermediary revenue determined?

The *Hinzurechnungsbesteuerung* is based on the amount of passive income to be added to the taxable base in Germany ("Hinzurechnungsbetrag"). The amount to be added is the total passive income of the foreign company after the deduction of taxes on that income. Total income is determined in accordance with German tax legislation. If the foreign company has both active and passive income, the income from active business must be deducted from the total amount. If active business and passive income are so closely connected that the income from the former cannot be isolated, the total income must be divided in relation to the turnover, provided no other more appropriate apportionment criterion is available.

4. "Low" taxation

Taxation is not considered "low" if the income from the foreign company determined according to German tax legislation is subject to an income tax charge of at least 25% either in the country where the foreign company has its place of effective management or in the country where the foreign company has its head office (seat).

The Tax Reduction Law (*Steuersenkungsgesetz* - StSenkG) clarifies Article 8(3) of the Foreign Tax Act but does not change its substance. It now reads as follows

> "Low taxation … exists, if the income in the state of effective management and in the state where the foreign company has its head office (seat) is respectively subject to a corporate tax charge of less than 25%,…"

This means that where a foreign company has its head office/seat (= registered in the trade register) in one country and its effective management in another- in other words has dual residence, a rare case in practice - and the same income is taxed in both foreign countries, *Hinzurechnungsbesteuerung* should only apply if taxation is "low" both in the country where the head office/seat is situated and in the country in which its place of effective management is situated. In other words, there is no *Hinzurechnungsbesteuerung* if the income in question is taxed "highly" in at least one country.

Examples are given in the following table:

	Taxation of income in		Application of *Hinzurechnungs-besteuerung*
	Country of head office/seat in %	Country of management in %	
1	0	0	Yes
2	0	24	Yes
3	0	25	No
4	10	20	Yes
5	10	25	No
6	24.9	24.9	Yes

5. Rate of taxation

The tax charged on the amount to be added is 38% and this is added to the ordinary statutory corporation tax. Article 8(b) of the Corporation Tax Law (*Körperschaftssteuergesetz* - KStG) on the exemption of dividends is not applicable to the amount added.

6. Further anti-abuse provisions (Article 42 of General Tax Code)

If the legal structure, form or scheme chosen is clearly artificial - for example if there are no material non-fiscal reasons for the particular structure, form or scheme, and if the net economic result is the same as that of the directly taxable event - the tax liability arises in the same way as in a legal structure, form or scheme which is appropriate to the economic operations in question. In case of abuse via an inadequate (artificial) legal structure, form or scheme, taxation is not based on the actual events but rather on the deemed more appropriate legal structure, form or scheme.

II. Article 8(b) paragraph 5 of the Corporation Tax Law (5% of foreign dividends considered as non-deductible business expenses)

Under Article 8(b) paragraph 5 of the Corporation Tax Law, a flat rate of 5% of dividends are considered as non-deductible business expenses. If the business expenses exceed 5% of the dividends, the collection of dividends from foreign subsidiaries are treated more favourably than that of dividends from domestic subsidiaries; where the business expenses are lower, however, the collection from domestic subsidiaries are treated more favourably than the collection of dividends from foreign subsidiaries. It is impossible to say which receives a more favourable treatment as a result, domestic or foreign subsidiaries.

The application of a flat rate of deductible business expenses is a simplification measure consistent with Article 4(2) of the parent-subsidiary directive, which fixes the flat rate of 5% of profits distributed by the subsidiary.

DESCRIPTIONS OF THE TWO MEASURES UNDER THE NETHERLANDS FISCAL FRAMEWORK (NFF)

Netherlands Antilles – Tax Treatment of Holding Companies under the NFF

Background

In December 1999 the Netherlands Antilles (NA) enacted a series of tax changes, amending the Profit Tax Ordinance and introducing a new Dividend Tax Ordinance, under a New Fiscal Framework (NFF). The new tax ordinances, aiming at improved transparency, entered into force on 1 January 2000 and the provisions are scheduled to become applicable with retroactive effect from 1 January 2001.

The new Dividend Tax Ordinance introduced a dividend withholding tax payable at a rate of 10% of the gross dividend. However, the dividend withholding tax is not yet effective[1].

In December 2000 the Netherlands and the NA concluded an agreement, which contains inter alia the promise of the NA to bring (and keep) its legislation in conformity with principles of (international) taxation of the EU and the OECD, to commit itself to the OECD harmful tax competition process (NA gave such a commitment in November 2000), and the promise to co-operate in achieving the principles behind the Savings Directive. Furthermore, the agreement entails an amendment in the Tax Regulation for the Kingdom of the Netherlands. This amendment has to be accepted by the Parliament of the Netherlands. The amendment has recently been sent to the Parliament and it is expected that the Parliament will accept the amendment by the end of 2001. The NA has from the start made the application of the NFF dependent on the acceptance of the amendment in the Tax Regulation by Parliament.

[1] The date of commencement of the Dividend Tax Ordinance is dependent on various aspects, amongst others the treaty policy of the NA.

Conditions Attached

1. The participation exemption requires neither that the non-resident company is subject to profit tax including profit tax in its country of residence, nor that the participation should be held for a certain period of time before the benefits are available.

2. A reduction in the dividend withholding tax is available when dividends from abroad flow through the NA company to its foreign shareholder, provided the dividends have been subject to a foreign withholding tax of at least 5%.

3. A number of dividend distributions are exempted from the dividend withholding tax, including dividends paid on a liquidation and those paid by

- companies whose shares are listed on a recognised stock exchange
- an exempt company
- offshore companies
- companies that qualify for the Shipping Registration Ordinance

4. Furthermore, exemptions from the dividend withholding tax are granted for dividend payments by a NA company to a foreign company which holds 25% or more of the shares or voting power in the NA company for an uninterrupted period of at least one year.

5. The dividend withholding tax is not yet effective[1] but when it does come into force, taxpayers will be able to opt for a twelve-month "grandfather" rule.

1 The date of commencement of the Dividend Tax Ordinance is dependent on various aspects, amongst others the treaty policy of the NA.

Tax Benefits

NA companies are exempt from profit tax on all benefits (dividends, capital gains, profit distributions etc) connected with a qualifying shareholding in a resident company and on 95% of the benefits derived from a participation in a non-resident company. A shareholding in a "Netherlands Antilles Exempt Company" is treated as an interest in a non-resident company.

Reduction of and/or exemption from the dividend withholding tax (statutory rate: 10% of the gross dividend) is available under specific conditions (relating for instance to the origin and destination of the dividend, type of the distributing company and the size of the shareholding) as referred to above.

Netherlands Antilles – Exempt Companies under the NFF

Background

In December 1999 the Netherlands Antilles (NA) enacted a series of tax changes, amending the Profit Tax Ordinance and introducing a new Dividend Tax Ordinance, under a New Fiscal Framework (NFF). The NFF, aiming at improved transparency, entered into force on 1 January 2000. The effective date of applying the provisions of the NFF has been extended for another year from 1 January 2000 to 1 January 2001. In this context it should be noticed that most provisions are scheduled to become applicable with retroactive effect from 1 January 2001[1].

The amended Profit Tax Ordinance introduced a new regime, the "Netherlands Antilles Exempt Company". The exempt company is not intended as a replacement of the existing offshore regimes F020 and F023. The existing offshore tax regimes were not abolished with effect from 1 January 2000. The offshore regimes continued in force and effect and will be abolished (except for grandfather clauses) at the time the NFF enters into force and becomes applicable.

In December 2000 the Netherlands and the NA concluded an agreement, which contains inter alia the promise of the NA to bring (and keep) its legislation in conformity with principles of (international) taxation of the EU and the OECD, to commit itself to the OECD harmful tax competition process (NA gave such a commitment in November 2000), and the promise to co-operate in achieving the principles behind the Savings Directive. Furthermore, the agreement entails an amendment in the Tax Regulation for the Kingdom of the Netherlands. This amendment has to be accepted by the Parliament of the Netherlands. The amendment has recently been sent to the Parliament and it is expected that the Parliament will accept the amendment by the end of 2001. The NA has from the start made the application of the NFF dependent on the acceptance of the amendment in the Tax Regulation by Parliament.

[1] The date of commencement of the Dividend Tax Ordinance is dependent on various aspects, amongst others the treaty policy of the Netherlands Antilles.

Conditions Attached

1. The management of a NL Antilles Exempt Company must maintain a register comprising the names and addresses of all shareholders who have more than 5 % of the paid-up capital in the company.

2. Participation in the management of an exempt company is limited to residents (individuals and certified trust offices) of the NA. Under certain conditions non-residents may participate in the management.

3. The books and accounts must be audited by an independent expert who must issue a qualified auditor's opinion.

4. The company can not be a bank or other financial institution subject to the supervision of the bank of the NA.

5. The company's objective, both in its articles of association and in practice, should exclusively, or almost exclusively, consist of

- providing credit and investing funds
- providing financial services
- performing any and all acts associated with its stated objectives

6. The exempt company regime is available to both residents and non-residents.

Tax benefits

A NL Antilles Exempt Company under the new regime is exempt from both the profit tax of which the statutory flat rate is 30% (34.5% including the island surcharge of 15%) and the dividend withholding tax of which the statutory rate is 10%. The aforementioned rates are applicable under the NFF.

SUMMARY OF UP-TO-DATE INFORMATION PROVIDED BY MEMBER STATES ON ROLLBACK, INCLUDING INFORMATION RELATING TO MEMBER STATES

AUSTRIA

An (Firma) / To:
Ms Sue Babiker

Datum / Date:
9. Oktober 2001

Von / From:
Dr. Kuttin

Betreff / Subject:
Rollback

Dear Sue,

we have already announced the measures envisaged by Austria in our letter of April 26, 2001.

The amendments in respect of Section 10 (3) of the Corporate Income Tax act have been initiated, so that there will be no new entrants after 31 December 2001.

With kind regards

BELGIUM

SN 4315/01

MINISTRY OF FINANCE

PAUL HATRY

Votre correspondant : Paul Hatry
Tel. : 02 660 00 67
Fax : 02 660 72 27

Brussels, October 2001

Avenue de la Colombie, 8
10100 Bruxelles

Madame PRIMAROLO
Présidente du Groupe Code de conduite
c/o Sue Babiker
H.M. Treasury
Parliament Street
LONDON SW1P 3AG
United Kingdom

Madam,

In reply to your request dated 26 September 2001, please find below a description of the measures which Belgium is willing to take in order to honour its commitments with regard to rollback at the Ecofin Council on 26 and 27 November 2000.

- Preliminary remark

The Belgian government has recently launched a vast reform of corporation tax. This reform of which the most prominent aspect is a reduction in the nominal rate from 40,17% to 33,99% was adopted by the Council of Ministers in early October 2001. The bill incorporating this reform will soon be placed before the Belgian Parliament. Two of the rollback measures described below are to form the subject of a law and could therefore be included in the reform bill tabled by the Belgian Government or take the form of a parliamentary initiative bill more or less accompanying the reform of corporation tax.

- Rollback

The report from the Code of Conduct Follow-Up Group of 23 November 1999 (SN 4901/99) identified 5 Belgian tax measures with harmful characteristics: coordination centres, distribution centres, service centres, United States Foreign Sales Companies and "informal capital" rulings.

- Coordination centres

The rollback of the coordination centres regime requires the adoption of a law. However, the proceedings brought by the European Commission against Belgium under cover of State aid prevents us from engaging in any cooperation within the framework of the Code of Conduct Follow-up Group. Belgium is currently faced with two sets of proceedings. On the one hand legal proceedings which will in all likelihood end up before the Court of Justice of the European Communities and on the other political proceedings within the Code of Conduct Follow-up Group. It is impossible for Belgium to make a full commitment with regard to both sets of proceedings as any approval on its part of measures to roll back the Code of Conduct could constitute an unfavourable aspect in the context of the discussions on useful measures in the framework of the State aid legal proceedings. Belgium therefore does not consider it advisable at this stage to consider rolling back the coordination centres regime.

- Distribution centres and services centres

The administrative circulars establishing these two regimes will be amended as follows:

- "cost plus" will be calculated on a case-by-case basis depending on the real or effective situation of the company requesting application of the regime;
- the basis on which "cost plus" is calculated will include all expenditure incurred by the centre.

- United States Foreign Sales Companies

It appears from recent developments within the World Trade Organisation that the United States will be forced to amend their FSC regime so as to comply with that organisation's rules. As soon as the World Trade Organisation has taken a final decision on the American FSC regime and the United States have complied with it, Belgium will abolish its accompanying fiscal regime.

- "Informal capital" rulings

At the time of the adoption of the report from the Code of Conduct Follow-up Group of 23 November 1999 (SN 4901/99), Belgium consistently denied that this regime was harmful in nature, as the principle of informal capital is in the process of being adopted as an IAS standard (International Accounting Standards). Belgium nevertheless intends to provide an undisputed legal basis for this regime. A new law (see preliminary remark) is to replace the Regent's Order of 1831. As regards the tax regime as such, it is henceforth to be granted on a case-by-case basis depending on the company's real or effective situation and the decision to grant this regime will be notified to the Member State in which the parent company is located.

Complimentary close.

Paul Hatry
Personal Representative of the Minister
for Finance to the EU
Former Minister for Finance
Honorary Senator

Copy to: Mr Michael Graf, Secretariat of the Council of the European Union

DENMARK

25 October 2001

AAM 21 Holding Companies

Law no 282 of 25 April 2001 has amended the holding regime with effect from 1. July 2001. The new rules encompass "existing beneficiaries" as well as "new entrants".

Under the general rules, dividends paid by a Danish resident company are subject to a withholding tax at a rate of 28 per cent. The rate may be reduced under a Double Tax Agreement.

However, dividends are exempt from withholding tax, if they are paid to a parent company, which owns at least 25 per cent of the distributing company's share capital for a continuous period of at least one year, during which the dividends are paid.

According to the rules in force up to 30 June 2001, the exemption was applicable for dividends paid to a parent company regardless of whether that company was a resident of Denmark or a resident of any another foreign state.

The amendment implies that the exemption applies only for dividends paid to a foreign parent company if Denmark shall refrain from taxation or reduce the taxation of the dividends according to the EU Parent/Subsidiary Directive or a Danish Double Tax Agreement.

Dividends paid by a Danish subsidiary to its foreign parent company are therefore now subject to a withholding tax of 28 per cent if the EU Parent/Subsidiary Directive or a Danish Double Tax Agreement does not encompass these dividends with this effect.

Denmark has no Double Tax Agreements with tax havens jurisdictions.

The new rules came into force for dividends distributed on or after 1 July 2001, regardless of when the foreign parent company acquired the shares in the Danish subsidiary.

Thus Law no 282 of 25 April 2001 has no rules on grandfathering. The new rules also apply to foreign parent companies, which derived benefits from the previously existing rules.

Denmark does not wish to maintain footnotes 22 and 27 of the November 1999 Report.

FINLAND

25 October 2001

CODE OF CONDUCT - ROLLBACK

The Code of Conduct Group has requested the Member States to assist the Group with information concerning the measures which they are ready to implement in order to fulfil the commitment in the conclusions of the ECOFIN of November 2000 regarding new entrants.

Please find below Finland's report on above mentioned issue:

New entrants

As far as Finland is concerned, there is only one measure in the 1999 Report that is considered to be potentially harmful (B008, Åland Islands – Captive Insurance). According to the Provincial Government of Åland Islands there are no companies which the benefits of the Captive Insurance regulations are applied to.

As we have stated also earlier, the Provincial Government has indicated that it does not in this situation consider itself politically bound by an amendment of its captive insurance legislation. As a justification for this opinion the Provincial Government has mentioned that the handling of Code of Conduct rules has not been sufficiently open so that the Provincial Government would be able to evaluate the contents of the work. Moreover, the Provincial Government is of the opinion that the decision made at this stage concerns only tax measures that are potentially harmful.

However, the Provincial Government has indicated its willingness to have further political discussions on the amendment of its tax measure. The Finnish Government will continue having political discussions with the Provincial Government also regarding possible (new) entrants after 31 December 2001.

FRANCE

STATE SECRETARY FOR THE BUDGET

Madam,

At the meeting of the Code of Conduct Follow-up Group on 26 September and in order to prepare the meeting on 17 October and a forthcoming report to ECOFIN, you requested further information on the planned rollback measures.

France forwarded full replies on the amendments that it might consider in order to honour its commitments regarding rollback of the measures appearing on the list of harmful regimes subject to Parliament's position (see previous communications dated 22 March 2000, 19 October and 20 April 2001).

A start has already been made in France on rolling back as the Finance Act for 2001 introduced amendments to the scheme concerning provision for renewal of oil and gas reserves which in our view remove its harmful effects. In this spirit, it would be advisable for the Follow-up Group to examine in detail the measures taken or envisaged by the Member States to roll back their regimes or their characteristics that are considered harmful.

As regards rollback and the question of new entrants, these two subjects are, in our view, closely linked and will be dealt with simultaneously with effect from 1 January 2002. We would be able to make the necessary arrangements before the end of the year. However, the initiation of proceedings relating to State aid is likely to disrupt this timetable. We do not in fact expect to have to submit to Parliament some time later amendments to regimes on which it has already taken a decision under the Code of Conduct.

The footnote in the November 1999 Report setting out France's position pointing out the link between the various components of the tax package could be deleted.

Complimentary close.

Florence Parly

Madame Dawn Primarolo
Chairman of the Code of Conduct
Follow-up Group
H. M. Treasury
Parliament Street
LONDON SW1P 3 AG
Royaume-Uni

GERMANY

4 October 2001

Subject: Rollback: Answer of the German Delegation

Dear Mrs. Babiker,

Concerning the rollback of measure AAM019 (profit mark-up for the control and coordination centres of foreign group companies in the Federal Republic of Germany) I would like to point out that Germany has revoked the regulation with effect from 1 January 2001 (see Doc. 14430/00 FISC 219).

Yours sincerely,

Lars Poltorek
Germany Federal Ministry of Finance

GREECE

HELLENIC REPUBLIC
MINISTRY OF FINANCE
INTERNATIONAL ECONOMIC RELATIONS
TAX AFFAIRS SECTION

To

Secretariat D.G.G. Fiscalité

Date: October 12th, 2001

For the attention of: Mrs. Sue Babiker

Subject: Rollback: follow-up to Meeting of the Code of Conduct Group on 26/9/01
Ref.: Your document dated 2/10/2001

Concerning the above-mentioned subject, we would like to inform you that under Article 7 of a draft-law that recently has been submitted to the Greek Parliament for ratification, the abolition of the law 89/1967 (described as B.11 by the Group of Contact) is provided.

Specifically the provisions of the above-mentioned Article 7, are as following:

Par. 1: Exceptions on customs, and taxes and as well as any facilities provided by the law 89/1967 (O.J.132A) cease to apply, for the foreign industrial - commercial companies established in Greece, from 1st January 2002 and after.

Par. 2: Companies of the previous paragraph that already are covered by the law 89/1967 are going to be covered, as far as exception on customs and on taxes concerns, till 1st December of 2005.

By the Minister's order
The Director
C. Nihoritis

IRELAND

9 October, 2001

Ms. Sue Babiker,

Code of Conduct Group,

HM Treasury,

Parliament St.,

London FWIP 3AG.

Code of Conduct (Business Taxation)

(1) Rollback and New Entrants

(2) Removal of Footnotes to November 1999 Report

Dear Ms. Babiker,

As requested by the Chair, I enclose:

- A report on Ireland's implementation of the November 2000 Ecofin conclusions relating specifically to rollback and new entrants; and

- A note of our present position regarding the footnotes to the November 1999 Report — we agree to withdraw three of our four reservations in light of the Group's subsequent work.

Yours sincerely,

_____

Donal McNally
Second Secretary General

Implementation of commitment in November 2000 Ecofin conclusions regarding new entrants

At the November 2000 Ecofin, Ministers agreed (in paragraph 4 of the Code of Conduct conclusions):

> "to undertakings being barred from entering into harmful arrangements after 31 December 2001, except where such arrangements are the subject of an existing Commission decision providing for longer duration within the framework of State aids and, in any case, from deriving benefit from them after 31 December 2002".

The position as regards new entrants for the five Irish measures considered harmful by a majority of the Code of Conduct Group is as follows:

B001 International Financial Services Centre (Dublin)	The November 2000 Ecofin conclusion regarding new entrants has been implemented
C024 10% Manufacturing Rate	The November 2000 Ecofin conclusion regarding new entrants has been implemented
C025 Petroleum Taxation	This measure can no longer be regarded as harmful as the rate of taxation (25%), which is applied to both new entrants and existing companies, is now higher than the generally applicable rate (20%)
D017 Shannon Airport Zone	The November 2000 Ecofin conclusion regarding new entrants has been implemented
E007 Foreign Income	The November 2000 Ecofin conclusion regarding new entrants has been implemented

The present position as regards the Irish footnotes to the November 1999 Report is as follows:

Footnote 4	We can now agree to the removal of footnote 4.
Footnote 21	The reservation in footnote 21 is a fundamental one for Ireland which we would wish to retain in the Report. There is no basis in the Code for considering the level of taxation in any other country as part of the assessment of individual measures. □
Footnote 28	Measure E007 has now been rolled back but there are a limited number of transitional cases. In light of this, we wish to retain footnote 28 for the present.
Footnote 38	As measure C24 has been rolled back fully in line with the Ecofin conclusions of November 2000, we can now agree to withdraw footnote 38, except for the last sentence which is simply a factual statement about measure C25.

ITALY

Sir,

In your letter dated 12 February 2001 in connection with the Code of Conduct Group's proceedings you asked me what steps the Italian Government was planning to take in respect of the regime listed for Italy.

As you know, the Code of Conduct Group's report to the ECOFIN Council on 29 November 1999 listed only one harmful regime for Italy, namely that applying to the *Centro di servizi finanziari e assicurativi di Trieste* [Trieste Financial Services and Insurance Centre] (Article 3 of Law No 19 of 19 January 1991).

I confirm Italy's undertaking not to implement the Centre. The Commission (Directorate-General for Competition) was given formal notification of this commitment through the Permanent Representation in September 2000.

I take this opportunity to renew Italy's full backing for progress in the Code of Conduct Group's work and on the tax package as a whole.

LUXEMBOURG

Code of Conduct – Follow-up to the meeting on 26 September 2001

Rollback

Reply from the Luxembourg delegation

Introduction

The note from the Chair relating to the timetable and future work programme as resulting from the proceedings of the Code of Conduct Group on 28 June 2001 (10302/1/01 REV 1 FISC 122) states:

"7.

To enable the Group to take forward work on rollback of the 66 measures listed in Annex C in the Report from the Group to the ECOFIN Council of 29 November 1999, a report is to be prepared for ECOFIN:

- *on the measures which Member States are ready to implement in order to fulfil their commitment in the Conclusions of the ECOFIN of November 2000 regarding new entrants; and,*

- *on whether Member States who have footnotes to the November 1999 Report wish to maintain those reservations in light of the Group's subsequent work."*

In accordance with the said work programme, the Code of Conduct Group intends to tackle the problems connected with rollback at its meeting on 17 October 2001.

The Luxembourg delegation welcomes the resumption of the discussions on rollback which are indispensable for maintaining the balance of the tax package. However, it is obliged to note that these discussions are hampered not only by the footnotes appearing in the November 1999 report but also by a number of other factors such as:

- the fact that the list of harmful measures has still not been formally approved by the Ecofin Council;

- the Commission's recent initiative as regards State aid;
- some of the statements made in the context of the conclusions of the Ecofin Council on 26 and 27 November 2000;
- the confusion between the code criteria / the "features" of the final report/the "features" of the "guidelines";
- the uncertainty surrounding the follow-up to requests for extensions.

More particularly, the Commission's launching of infringement proceedings against certain Member States as regards certain regimes appearing on the list of 66 measures may jeopardise the rollback proceedings under the Code to the extent that legal procedures are involved which have their own rules. Some actions in the Code or under cover of the Code may cause problems or may even be incompatible with the aid proceedings launched.

Moreover, there remains some uncertainty about other measures. It should for example be noted that the Commission called for information in the framework of the State aid proceedings without having decided to date whether or not to start infringement proceedings. Such uncertainty has a number of consequences rendering discussions under the Code more difficult. By way of example, it should be noted that if a regime is rolled back there is no guarantee that rollback - where the regime is regarded as aid - complies with the requirements concerning aid and it should be noted that the rollback process may indeed exert a legal influence on the Commission's decision on State aid.

It should be remembered that one objective - if not the principal objective of paragraph J, which provides for the rigorous implementation of the rules relating to aid - was to prevent regimes similar to those considered harmful under the Code from being authorised or from continuing to be authorised as State aids.

Rollback/new entrants

In the context of the November 2000 conclusions relating to the tax package, the Member States committed themselves in principle to ensuring that companies could enter harmful regimes only until 31 December 2001 and that they could only benefit from them until 31 December 2002.

It is a fact that this commitment relates to "harmful regimes" and not to the "measures referred to in Annex C of the report from the Code of Conduct Group to the Ecofin Council of 29 November 1999" and therefore presupposes an agreement on the list of harmful measures by the end of the year. However, the timetable for the tax package as adopted by the Ecofin Council on 10 July 2001 does not provide for such an agreement in 2001.

The Luxembourg delegation is willing to ensure that together with the other Member States and their dependent or associated territories it honours its commitments in general and in particular for the new entrants within the required deadlines.

For two Luxembourg measures appearing on the list of Annex C of the November 1999 report, namely for coordination centres and financing companies, there are by definition no new entrants given that the two circulars in question have been abolished.

As regards the three other Luxembourg measures referred to in Annex C to the November 1999 report, Luxembourg considers that prior approval of the list of harmful measures constitutes an indispensable condition for launching the necessary legislative procedures at national level.

Without prejudice to these general remarks and with reference to the above comments on State aids, the Luxembourg delegation is willing to envisage the following measures to honour its commitment in relation to the new beneficiaries.

As regards the 1929 holding companies regime, Luxembourg is willing to amend the Law of 31 July 1929 on the fiscal arrangements for holding companies.

In the case of provisions for claims fluctuations in reinsurance it should be remembered that Luxembourg does not share the assessment made by the Group. It is nevertheless willing to amend the Grand-Ducal Regulation of 20 December 1991 taken in implementation of Articles 95, 96, 98 and 99 of the Law of 6 December 1991 on the insurance sector and concerning more particularly reinsurance.

As regards finance branches, Luxembourg is willing to start negotiations with Switzerland with a view to an additional tax convention between Switzerland and Luxembourg aimed at replacing the exemption mechanism with a tax credit mechanism if necessary so as to align branches on similar regimes in other Member States not referred to in the Code.

Footnotes in the November 1999 report.

The November 1999 report contains three footnotes by the Luxembourg delegation.

In the first footnote, the Luxembourg delegation recalls that the Code of Conduct covers business taxation and concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community and that it has serious difficulties in sharing the asymmetrical approach taken, under which positive evaluations have primarily been given to measures relating to intra-group services and financial services and offshore companies.

The second footnote from the Luxembourg delegation relates to the assessment of measure B7 "provisions for claims fluctuations". In this footnote Luxembourg reiterates its position (set out in FISC 211/98 ADD 1) on the assessment of criteria 1b and 2b and that on the non-application of point G, paragraph 1 of the Code (inter-State comparison).

The Luxembourg delegation intends to maintain these footnotes. It considers that the Group's subsequent specific discussions on the problems connected with the scope of the Code of Conduct, the interpretation of certain criteria and the non-application of an inter-State comparison did not reflect a more balanced approach than that underlying the November 1999 report. Moreover, the Luxembourg delegation 's concern has increased in the light of the Union's enlargement and in the absence of a review of the code.

In the third footnote, which relates to the assessment of the "participation exemptions" measures, Luxembourg wishes to enter a sort of scrutiny reservation owing to the ambiguity of the reference to the impact of the existence of legislation on controlled foreign companies on the positive or negative evaluation of participation exemption measures. Luxembourg is willing to withdraw this footnote.

THE NETHERLANDS

HM Treasury
Attn. Mrs. Dawn Primarolo
Parliament Street
SW1P 3AG LONDON

VERENIGD KONINKRIJK

Dear Mrs. Primarolo,

In response to your request for information regarding rollback and whether the Netherlands wish to maintain its reservations made to the November 1999 report I would like to inform you as follows.

As of April 1, 2001, the Netherlands have amended its approach for making advance agreements, thus replacing the ruling practice with an APA/ATR practice. The requirements for obtaining an advance pricing arrangement (APA) are fully in line with the guidance, published in 1999, given on this subject in the transfer pricing guidelines of the OECD. This means that the assessment will take place on a case by case basis whether the correct transfer pricing method and benchmarks will be applied. The use of fixed margins for any activity will no longer take place. A regular review of the margins against normal commercial criteria will take place. The decrees that establish the APA/ATR-practice are publicly available. Besides this, the policy underlying the conclusion or denial of APAs/ATRs will be published, unless the relevant policy has been published before. This means that full transparency is guaranteed. All the translated decrees concerning the APA/ATR practice are enclosed. These decrees are also to be found on the website of the Dutch Ministry of Finance.

Furthermore a draft bill is submitted to the Dutch Parliament to codify the arm's length principle. With this codification, the arm's length principle as stated in article 9 of the OECD Model Tax Convention is applicable in the Netherlands. The bill is to be implemented next year.

Due to the introduction of the APA practice, the following agreements are amended as from April 1, 2001, thus fully meeting the European criticism:

- the cost-plus ruling;
- the resale-minus ruling;
- the intra group finance ruling;
- the finance branch ruling;
- the royalties ruling;
- the non standard ruling;
- US foreign sales corporation ruling.

On the point of informal capital, it can be remarked that no specific measure is involved, but a general principle arising from the Dutch corperate income tax system. The effect of this principle is that taxation takes place on an arm's length basis. All aspects of agreements concerning informal capital will therefore be checked against the OECD transfer pricing guidelines as a part of the APA practice.

At the ECOFIN Council held on November 26 and 27, 2000 an agreement was reached between member states on the guidance on rollback and standstill for, among other things, the holding companies. In the view of the Netherlands, as it was stated at the ECOFIN Council of November 2000, the participation exemption is fully in line with the aforementioned guidance.

Although the Commission started a state aid procedure for the measure International Financing Activities, the Netherlands is willing to commit itself to continue the process engaged by the Code of Conduct Group. Nevertheless the Netherlands feels that the problem of the lack of a level playing field on the taxation of financing and other mobile activities in the EU should be discussed.

Within the code of conduct, the Netherlands has taken upon itself the obligation to promote the application of the principles of the code of conduct in the dependent or associated territories to the best of its abilities. The Netherlands strives to ensure that both Aruba and the Netherlands Antilles will comply with the principles of the code of conduct.

Consultations with these autonomous states are parts of the Kingdom of the Netherlands have already led to results. The government of the Netherlands Antilles and Aruba committed themselves to the OECD-process on harmful tax competition and they have concluded an agreement with the Netherlands in which they have promised to adjust/keep their tax legislation in accordance with the OECD and EU standards concerning international acceptability.

Finally, the Netherlands wish to maintain its reservations regarding the November 1999 Report.

With kind regards,

M. Brabers
Director General for Tax and Customs Policy and Legislation

Annex: Decrees APA practice

Advance certainty; good faith between treaty partners[1]

Directorate for Legal Affairs

Decree of 30 March 2001, No. BOB2001/698M

The State Secretary for Finance has decreed as follows.

The Decree of 21 July 1995 (No. AFZ94/4519M) on fiscal implementation policy, standpoint provisions and appeals policy (as amended by the Decree of 26 January 1997 (No. AFZ94/4609M) sets out the rules for the provision of advance certainty by the tax administration. This decree provides a further explanation of those situations in which advance certainty will not be provided.

1. Introduction

In his letter to parliament of 17 February 1995 (No. DB96/716M), the State Secretary for Finance made the following remarks about the conditions under which advance certainty may be issued: "No rulings can be issued in cases of abuse of law or where such an action could constitute a breach of good faith between treaty partners". Under the Decree Transfer prices, the application of the arm's length principle and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) of 30 March 2001 (No. IFZ2001/295M), the policy as published in the above mentioned letter was withdrawn. The present decree makes it clear that, in the future, the government will continue to pursue a policy based on the principle that no advance certainty will be granted if this is in breach of good faith between treaty partners and/or of general international interests.

1. This document contains an unofficial English translation by the Netherlands' Ministry of Finance of Decree No. BOB2001/698M, officially published in Dutch on 30 March 2001. Rights can only be derived from the original Dutch text of the decree.

2. Good faith

No advance certainty will be granted if this is in breach of good faith between treaty partners and/or of general international interests.
This means, for example, that the requested advance certainty will not be granted if the tax inspector suspects that doing so would be detrimental to the interests of a treaty partner or to another international interest.

A strong indication that providing advance certainty would be contrary to good faith between treaty partners arises if one or more aspects that are inherent in the proposed structures and/or to all of the various transactions related to the application for advance certainty would be contested if they occurred in the Netherlands (i.e. if the applicant is patently testing the limits of fiscal regulations). This strong indication that providing advance certainty would be contrary to good faith between treaty partners can be removed by imposing supplementary conditions on such advance certainty. In this respect the applicant may be asked to demonstrate that the treaty country or countries which are to be confronted with the aspects in question is or are aware of the overall structure and the series of connected transactions for which the advance certainty is requested in the Netherlands. An example of a situation in which it is possible to remove a suspicion that the provision of advance certainty would be contrary to good faith between treaty partners, is where a professional sportsman who is not resident in the Netherlands applies for advance certainty for the tax implications of a number of related transactions that have the effect of transferring the (legal and/or economic) interests of the sportsman's right to his name and image to an entity that is taxed at a rate which would not be considered as being reasonable by Dutch standards. There is a real risk in this situation that the tax base would be eroded either in the country in which the sportsman has built up his name and image or in the country in which the sportsman is a resident. For this reason, advance certainty will be provided in such cases only if the applicant is able to demonstrate that the tax administration in the country in which the sportsman has built up his name and image and/or in the country in which the sportsman is a resident is aware of the series of related transactions.

I have included other examples of situations which would be detrimental to the interests of a treaty partner inter alia in the Decree Entities providing intra-group financial services without a real economic presence in the Netherlands; no advance certainty, exchange of information and limited opportunities for crediting withholding tax (the Decree of 30 March 2001 (No. IFZ2001/294M), Paragraph 2).

An example of a situation that is contrary to general international interests is where goods are invoiced with the aim of concealing their origin and thereby evading an international boycott.

As a final point, no advance certainty is given, of course, if the tax inspector suspects that the information disclosed to the relevant foreign authorities is either inaccurate or inconsistent.

Procedure for dealing with requests for advance certainty in respect of transfer prices in cross-border transactions (advance pricing agreements) [1]

International Tax Policy and Legislation Directorate, Multilateral Affairs Division

Decree of 30 March 2001, No. IFZ2001/292M
The State Secretary for Finance has decreed as follows.

An advance pricing agreement (APA) provides advance approval on the determination of an arm's length price or a method for the determination of such a price for cross-border transactions (goods and services) between associated entities and between different parts of the same entity. The *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* published by the OECD in 1995 (hereinafter the OECD Guidelines) provide detailed guidance on the arm's length principle as included in Article 9 of the OECD Model Tax Convention.

The possibility of requesting an APA is being introduced into the national legislation of a growing number of countries. In October 1999, the Committee for Fiscal Affairs of the OECD published further procedural guidance (hereinafter the APA Guidelines) for the provision of such advance certainty. The APA Guidelines constitute a detailed explanation of Paragraphs 4.124 to 4.166 of the OECD Guidelines. The APA Guidelines are included as an Annexe to the OECD Guidelines[2]. The present decree provides detailed guidance on the application of the APA Guidelines in the Netherlands' tax practice.

1. This document contains an unoffical English translation by the Netherlands' Ministry of finance of Decree No. IFZ 2001/292M, officially published in Dutch on 30 March 2001. Rights can only be derived from the original Dutch text of the decree.
2. The Dutch translation of the OECD Guidelines is included in binder *Internationale Fiscale Zaken* (Binder A), number 750.00.00.

This decree is not aimed at violating the rights and obligations set out in the General Taxes Act. The provision by the Netherlands' tax authorities of certainty falls within the scope of the Decree on Fiscal implementation policy, standpoint provisions and appeals policy (the Decree of 21 July 1995 (No. AFZ 94/4519M), as amended by the Decree of 26 January 1998 (No. AFZ97/4609M) and as further expanded by the Decree on advance certainty and good faith between treaty partners of 30 March 2001 (No. BOB 2001/698M)).

Since an APA provides advance certainty on the determination of transfer prices in an international context, the consequences of this certainty will not be limited to the Netherlands' tax base. This is what distinguishes an APA from giving advance certainty in a national context.

1. Organisation

A request for an APA should be addressed to the competent tax inspector. The tax inspector will always submit the request to the APA/ATR team of the Tax Office (Large Enterprises) in Rotterdam for binding advice. The APA/ATR team of the Tax Office (Large Enterprises) in Rotterdam will consult with the Co-ordination Group on Transfer Pricing (CGTP) in respect of the possible policy related aspects associated with the request which have not been published yet as part of existing policy in order to ensure that policy is consistent in both principle and practice. One of the members of the APA/ATR team of the Tax Office (Large Enterprises) in Rotterdam will at the same time be a member of the Co-ordination Group on Transfer Pricing.

If a request for the conclusion of a bilateral APA is submitted, the APA/ATR team of the Tax Office (Large Enterprises) in Rotterdam will immediately send a copy of the request to the Co-ordination Group on Transfer Pricing and to the International Tax Policy and Legislation Directorate of the Ministry of Finance. The International Tax Policy and Legislation Directorate will, as the competent authority for the Netherlands, notify the competent authority of the other state concerned of the request in order to start the bilateral procedure.

In order to accelerate the procedure of bi- and multilateral APAs, associated entities that are involved in such APA requests are advised to submit a request simultaneously to the competent authority in all the other states concerned. This will allow the states to start the assessment of the request at the same time instead of successively.

2. Unilateral or bilateral

The proceedings of the Netherlands' tax administration will in principle be aimed at concluding a bilateral APA. The consultation with the competent authorities of treaty countries for the conclusion of bilateral APAs is based on Article 25 of the OECD Model Tax Convention. Although a bilateral APA provides advance certainty to both sides, the tax administration cannot prescribe its use by taxpayers. In addition, in order to be able to enter into a bilateral APA, the Netherlands must have entered into an agreement for the avoidance of double taxation with that state that contains a provision similar to Article 25 of the OECD Model Tax Convention. The other state must also be prepared to enter into such a preliminary consultation. These circumstances may prevent the conclusion of a bilateral agreement. In less complex cases, for example, when only limited functions are performed with which little risk is involved or in cases with sufficient comparable data available, an unilateral APA may be preferable.

In certain circumstances, a taxpayer may wish to seek advance certainty in more than two countries and requests a multilateral APA. The tax administration will, in principle, co-operate with such requests. Should one or more states have, however, any objections to such a procedure, the request will be regarded as a request for the conclusion of various separate bilateral APAs. The applicant will be informed by the Tax Office (Large Enterprises) in Rotterdam on the division of the request into various separate requests for bilateral APAs.

3. Scope of an APA

An APA may include all of the transfer pricing issues relating to a taxpayer. The taxpayer has, however, a certain amount of flexibility to limit the request to specified related entities or specific transactions. Reference is made to Paragraph 4.137 of the OECD Guidelines. This does not mean that an APA request will be assessed in isolation. In its assessment of the request, the tax administration takes into account all of the relevant facts and circumstances that relate to the transaction(s) for which advance certainty is requested, such as, for example, the organisational structure that is chosen.

4. Duration

An APA is valid for the period specified in the agreement. On the one hand, it is desirable to provide approval for as long as possible a period in order to assess the tax implications of a business decision in advance as accurately as possible. On the other hand, a long period makes the predictions as to the future conditions on which the request is based less accurate thereby potentially casting doubt on the reliability of the methodology used in the request. The applicant is required to indicate for what period the advance certainty is desired and to provide reasons to support the acceptability of the use of this period. The acceptability of the period will, in particular, depend on the character of the activities and the period for which the facts and circumstances that affect the determination of the transfer prices can be regarded as retaining their relevance. In principle, the duration of the arrangement will be limited to four or five years. Exceptions may be made relating to, for example, long-term contracts.

At the expiry of the agreed period, on the request by the taxpayer, the tax authorities will assess whether or not a new APA can be concluded under the same conditions.

5. Retroactive effect

Although an APA normally applies to future transactions, the transaction or transactions to which a request relates may already have taken place in whole or in part before agreement is reached on the APA request. Then an APA may in certain cases apply to the transactions already concluded, provided that the taxpayer has requested this retroactive effect.

In principle, a requirement for retroactive effect is that the relevant facts and circumstances in the relevant period in the past are comparable to the facts and circumstances that are the basis for the APA request. Should there be recognisable differences in the relevant facts and circumstances, such a request can be considered if the applicant can demonstrate that for these differences accurate adjustments can be made to eliminate the material differences. When a request is made for an unilateral APA, the tax administration will take a request for retroactive effect only into consideration when it has been established that the retroactive effect does not lead to a reduction of the taxable profits in the outstanding years, which could effectively lead to part of the profits not being taxed at all.

6. The APA request

Depending on the facts and circumstances of each case, the taxpayer will have to submit the following information to the tax administration:

(a) information on the transactions, products, business or arrangements that will be covered by the request (including, if applicable, a brief explanation of why not all of the transactions, products, business or arrangements of the taxpayer(s) involved in the request have been included);
(b) information about the enterprises and permanent establishments involved in these transactions or arrangements;
(c) the names of the other state or states to which the request relates;
(d) information regarding the worldwide organisational structure (including information on the beneficial owners of the applicant's capital), history, financial data, products and functions, including the assets (tangible and intangible) and risks of any of the associated enterprises involved;
(e) a description of the proposed transfer pricing methodology, including a comparability analysis which includes comparable data from unrelated market parties and possible adjustments;
(f) the assumptions underpinning the request and a discussion of the effect of changes in those assumptions or other events, such as unexpected results, which might affect the continuing validity of the request;
(g) the financial years to be covered; and
(h) a general description of market conditions, for example, industry trends and the competitive environment.

Ad e. Transfer pricing methodology

The tax administration will start the assessment of a request in accordance with Paragraph 4.9 of the OECD Guidelines from the perspective of the method as proposed by the applicant. It follows that the taxpayer is free, in principle, in his choice of a transfer pricing method, provided that the chosen method leads to an arm's length remuneration for the specific transaction for which advance certainty is requested. The taxpayer has to substantiate the choice for a specific method.

Ad f. Critical assumptions

An APA relates to remuneration for transactions that have not yet taken place. It is, therefore, necessary to include in the determination agreement the critical assumptions, for example, operational and economic circumstances that may affect remuneration for the transactions when they take place. The taxpayer should include a description of these critical assumptions in his request. The purpose of the critical assumptions is to protect both the taxpayer and the tax administration against the risk that the agreement leads to results that are not in accordance with the arm's length principle. The assumptions should be phrased in such a way that the certainty remains applicable when the elements that are covered by the critical assumptions stay within certain margins. This prevents the situation arising that, for every variation from the starting situation, the APA has to be revised or reconsidered. With this, flexibility is guaranteed. When the market share of a certain product influences the determination of the arm's length price, a range for the market share could be considered. Within such a range, a change in the market share is supposed not to influence the price. When an assumption is no longer valid, a review of (a part of) the agreement is, in principle, required.

An overview of possible critical assumptions is set out below. This overview is not exhaustive and serves only as an example, and includes:

(a) assumptions that show the consequences for the APA of the relevant changes in legislation, published policy or case law;

(b) assumptions regarding tariffs, duties, import restrictions and government regulations;

(c) assumptions regarding economic conditions, the market share, market conditions, the end selling price and sales volume;

(d) a description of the functions provided in the request, taking into account the assets used and the risks assumed by the enterprises that are involved in the transactions; and

(e) assumptions regarding exchange rates, interest rates, credit ratings and capital structure.

7. Assessment of the request

The facts as presented in the request will, in principle and where possible, be reviewed by the tax administration. The extent of this review will depend on the specific facts and circumstances of each case. Where necessary, further explanations and information will be requested from a taxpayer.

8. Exchange of information

As part of the determination agreement, the applicant is required to declare that the information as included in the APA is not subject to one of the exemption clauses set out in Article 13, Paragraph 3, of the International Assistance with Levying Taxes Act (*Wet op de internationale bijstandsverlening bij de heffing van belastingen*,WIB) regarding commercial, industrial or professional secrets. In this way possible conflicts between the tax administration and the applicant are avoided.

9. Determination agreements

In the case of a bilateral APA, the final consensus between the states involved will be recorded in an agreement between the states. In order to implement this bilateral agreement in the Netherlands, the tax administration will conclude a determination agreement with the same contents with the associated entities involved which are resident in the Netherlands. In the case of a unilateral APA, only the last form of determination agreement is concluded. The tax administration will take into account the framework for determination agreements, as described in the Decree of 1 December 1997 (No. AFZ97/2412).

This decree includes a procedure on recording negative decisions on a request for a determination agreement. In this respect, the following should be noted. The orientational phase should not be regarded as constituting a form of consultation as defined in the above decree.

There will only be a form of consultation for which a written record needs to be drawn up once the request in question is more or less fully consistent with the framework for APAs that is issued under the government's current policy. A decision by the tax inspector in this specific case not to conclude a determination agreement will be communicated to the taxpayer in writing. In this case, a record is drafted as described in the Decree of 1 December 1997 (No. AFZ97/2412).

The determination agreement will at least contain the following elements:

a. the names and addresses of the enterprises that are covered by the agreement;
b. the transactions, agreements or arrangements and financial years covered by the agreement;
c. a description of the agreed methodology and other related matters such as agreed comparable data or a range of expected results;
d. a definition of relevant terms that form the basis for applying and calculating the methodology, for example, sales, cost of sales, gross profit, etc.;
e. the critical assumptions upon which the methodology is based;
f. any agreed procedures to deal with changes in the factual circumstances that could occur during the term of the determination agreement, such that the effects that arise from relatively minor changes of facts and circumstances are set out in the determination agreement (the establishment of this adjusting mechanism prevents every change in facts and circumstances resulting in the termination of the validity of the determination agreement);
g. if applicable, the agreed tax treatment of related issues;
h. the terms and conditions that must be fulfilled by a taxpayer in order for the mutual agreement to remain valid, together with the procedures to ensure that the taxpayer fulfils these terms and conditions;

i. the provision that the determination agreement will be rendered invalid immediately upon a change in the relevant legislation (should a transitional arrangement have been made under which the determination agreement may remain in force for either the whole or part of its remaining period, the determination agreement will cease to be valid either at the end of the period specified in the transitional arrangement or, as the case may be, at the end of the remaining period of the determination agreement);
j. the declaration by the taxpayer that the information as included in the determination agreement is not subject to one of the exemption clauses specified in Article 13, Paragraph 3, of the WIB; and
k. the provision that the determination agreement will cease to be valid if the agreed transfer price or methodology is not actually set out in the contracts between the applicant and the associated enterprise or is not actually paid and/or received, unless otherwise agreed.

10. Tax audits

During periodic audits, which can be initiated by the competent tax inspector in respect of all taxpayers and, therefore, also with taxpayers with whom an APA has been concluded, it will be verified whether or not the transfer prices are set as agreed in the determination agreement. This will include a check on whether or not the critical assumptions in the determination agreement are still satisfied, and if not, whether or not the determination agreement requires adjustment or has ceased to be valid.

11. Exclusions

The Decree of 21 July 1995 (No. AFZ94/4519M), as most recently amended by the Decree of 26 January 1998 (No. AFZ97/4609M) and as further expanded by the Decree of 30 March 2001 (No. BOB2001/698M regarding good faith), sets out a general framework within which the tax administration is entitled to refuse to give advance certainty. In addition, the Decree on entities providing intra-group financial services without a real economic presence in the Netherlands; no advance certainty, exchange of information and limited opportunities for crediting withholding tax of 30 March 2001 (No. IFZ2001/294M) describes a number of specific situations in which no advance certainty is given. The Decrees in question apply equally to the conclusion of APAs.

12. Publication of APAs

With regard to the Decree of 21 July 1995 (No. AFZ94/4519M), as most recently amended by the Decree of 26 January 1998 (No. AFZ97/4609M), the policy underlying the decision to issue or, depending on the circumstances, to refrain from issuing, APAs will be published unless the relevant policy has been published before. The relevant APAs will be published either on an anonymous basis or -- if it is not possible to conceal the applicant's identity even if the name is not revealed and where the revelation of the applicant's identity may constitute a breach of the duty of confidentiality laid down in Article 67 of the General Tax Act -- in the form of a summary. In the latter case, the summary should contain all of the elements that have determined the policy pursued.

13. Entry into force

This Decree enters into force on 1 April 2001.

14. Cancellation of previous decrees

This Decree replaces the Decree of 19 October 1994 (No. IFZ94/855).

Procedure for dealing with requests for advance certainty in the form of an advance tax ruling (ATR)[1]

International Tax Policy and Legislation Directorate, Multilateral Affairs Division
Decree of 30 March 2001, No. IFZ2001/293M
The State Secretary for Finance has decreed as follows.

1. Introduction

This decree describes the procedures that have to be followed when issuing an advance tax ruling (ATR). An ATR provides advance certainty in respect of the tax consequences of a contemplated transaction or combination of related transactions. The term "ATR" is reserved exclusively for the provision of advance certainty in respect of the situations described in paragraph 3 of this decree.

2. Organisation

The request for the issue of an ATR should be addressed to the competent tax inspector. To ensure the co-ordination of the practice, the tax inspector will always submit the request to the APA/ATR team of the Tax Office (Large Enterprises) in Rotterdam for binding advice. The APA/ATR team of the Tax Office (Large Enterprises) in Rotterdam will, if necessary, consult with the relevant knowledge groups to secure a uniform policy both in principle and in practice.
Because the APA/ATR team of the Tax Office (Large Enterprises) in Rotterdam is represented in all of the relevant knowledge groups, this form of consultation can take place during the assessment process, thereby helping to ensure that the request is dealt with both swiftly and efficiently.

1. This document contains an unofficial English translation by the Netherlands' Ministry of Finance of Decree No. IFZ 2001/293M, officially published in Dutch on 30 March 2001. Rights can only be derived from the original Dutch text of the decree.

3. Binding advice

The local tax administration should submit the following requests for advance certainty for binding advice:

i. requests for advance certainty on the application of the participation exemption to conduit companies in international structures and to top holding companies where none of the subsidiaries of the top holding company conducts any business activities in the Netherlands;

ii. requests for advance certainty in respect of international structures involving forms of hybrid finance and/or hybrid legal entities. The Decree of 30 March 2001 (No. RTB2001/1379M[2] should be taken into consideration in assessing these requests; and

iii. requests for advance certainty on whether or not an entity that is registered abroad may be regarded as having a permanent establishment in the Netherlands.

4. Requests

Depending on the facts and circumstances of the specific case, a (potential) taxpayer will need to provide the tax authorities with at least the following information:

a. a detailed description of the facts and the contemplated legal acts covered by the request;

b. the names of the companies and permanent establishments involved;

c. the other state or states to which the request relates;

d. information on the group's worldwide legal structure and history (including full information on the beneficial owners of the applicant's capital); and

e. the financial years to which the request will apply.

2. This decree describes the situations in which advance assurance may or may not be given on the tax consequences of the use of hybrid forms of finance and hybrid legal entities (Revision of the Decree of 26 April 2000 (No. DB99/3582M)).

5. Duration

The applicant is initially required to specify the period for which it is reasonable to grant advance certainty. In principle, a period of four years is regarded as reasonable.

On the expiry of the agreed period, at the request of the taxpayer, the tax authorities will assess whether or not a new ATR can be issued under the same conditions.

6. Appraisal of the request

In appraising the request, the tax administration will take account of all of the relevant facts and circumstances relating to the transaction(s) for which advance certainty is requested.

7. Exchange of information

As part of the determination agreement, the applicant is required to declare that the information included in the ATR is not subject to one of the exemption clauses set out in Article 13, Paragraph 3, of the International Assistance with Levying Taxes Act (*Wet op de internationale bijstandsverlening bij de heffing van belastingen*, WIB) regarding commercial, industrial or professional secrets. In this way, possible conflicts between the tax administration and the applicant are avoided.

8. Determination agreements

In order to establish the consequences of an ATR, the tax administration will enter into a determination agreement with the entity requesting the ATR to make a formal written record of the ATR. The tax administration will take into account the framework for determination agreements, as described in the Decree of 1 December 1997 (No. AFZ97/2412). This decree includes a procedure for recording negative decisions on a request for a determination agreement. In respect of this, the following should be noted. The orientational phase should not be regarded as constituting a form of consultation, as defined in the above decree. There will only be a form of consultation for which a written record is required to be drawn up once the request in question is more or less fully consistent with the framework for ATRs, as issued under the government's current policy. The decision by the tax inspector in this specific case not to conclude a determination agreement will be communicated to the taxpayer in writing. In these cases, a record is drafted as described in the Decree of 1 December 1997 (No. AFZ97/2412).

The determination agreement will at least include the following elements:

1. the names and addresses of the entities that are to be covered by the agreement;
2. the facts, legal acts and financial years to which the agreement applies;
3. a description of the tax consequences;
4. a record of the relevant conditions that constitute the basis for the application of the relevant tax consequences;
5. the agreed procedures to respond to possible changes in the prevailing circumstances;
6. where relevant, a description of the arrangements that have been made for dealing with related tax issues;
7. a description of the conditions that the entity must meet in order for the agreement to remain valid, together with a description of the procedures that the entity must follow in order to comply with these conditions;

8. a provision to the effect that the determination agreement will be rendered invalid immediately by a change in the relevant legislation (where a transitional arrangement has been made under which the determination agreement can remain valid for either the whole or part of its remaining term, the determination agreement will lose its validity either at the end of the period specified in the transitional arrangement or, as the case may be, at the end of the remaining term of the determination agreement);
9. a declaration by the taxpayer that the information, as included in the determination agreement, is not subject to one of the exemption clauses specified in Article 13, Paragraph 3, of the WIB; and
10. where the request relates to the application of the participation exemption, a provision to the effect that the applicant will finance the cost price of the participations for which the ATR is being requested with at least 15 per cent equity capital.

9. Exclusions

The Decree of 21 July 1995 (No. AFZ94/4519M), as most recently amended by the Decree of 26 January 1998 (No. AFZ97/4609M) and as further expanded by the Decree of 30 March 2001 (No. BOB2001/698M regarding good faith), sets out a general framework within which the tax administration is entitled to refuse to give advance certainty. In addition, the Decree regarding entities providing intra-group financial services without a real economic presence in the Netherlands; no advance certainty, the exchange of information and limited opportunities for crediting withholding tax of 30 March 2001 (No. IFZ2001/294M) describes a number of specific situations in which no advance certainty can be given. These decrees apply equally to the conclusions of ATRs.

10. Publication of ATRs

With regard to the Decree of 21 July 1995 (No. AFZ94/4519M), as most recently amended by the Decree of 26 January 1998 (No. AFZ97/4609M), the policy underlying the decision to issue or, depending on the circumstances, to refrain from issuing ATRs, will be published unless the relevant policy has previously been published. The relevant ATRs will be published either on an anonymous basis or - if it is not possible to conceal the applicant's identity even if his name is not revealed and where the revelation of the applicant's identity may constitute a breach of the duty of confidentiality laid down in Article 67 of the General Taxes Act - in the form of a summary. In the latter case, the summary should contain all of the elements that have determined the policy adopted.

11. Competency

For information on the competency with regard to taxpayers applying for an ATR, reference should be made to the Decree of 30 March 2001 (No. RTB2001/1195M) on Advance Pricing Agreements (APAs), Advance Tax Rulings (ATRs), financial services, conduit companies, the International Investors Desk and Rulings, and Organisation and Jurisdiction Rules (no English translation available).

12. Entry into force

This decree enters into force on 1 April 2001.

Entities providing intra-group financial services without a real economic presence in the Netherlands; no advance certainty, exchange of information and limited opportunities for crediting withholdingtax[1]

International Tax Policy and Legislation Directorate, Multilateral Affairs Division
Decree of 30 March 2001, No. IFZ2001/294M
The State Secretary for Finance has decreed as follows.

1. Entities providing intra-group financial services

For the purpose of this decree, the term "entities providing intra-group financial services" (hereinafter referred to as service entities) is used to refer to entities the activities of which consist primarily of, either in law or in fact, directly or indirectly, and based on related transactions amongst entities that form part of the same group, the receipt and the (on)payment of interest and/or royalties under whatever name and of whatever nature. Activities related to the ownership of participations are not taken into account in assessing whether or not an entity's activities consist primarily of the activities described in the preceding sentence.
The term "group" is used with respect to the taxpayer together with related entities, as defined in Article 10a, Paragraph 4, of the Corporation Tax Act 1969, and related natural persons, as defined in Article 10a, Paragraph 5, of the Corporation Tax Act 1969. Transactions are regarded as related if they are arranged as a complex transaction, the results are mutually dependent or if in any other way a connection exists between the transactions.

2. No advance certainty

No advance certainty will be granted to a service entity on the tax consequences of all of the contemplated related transactions as defined in paragraph 1 above, if:

1. This document contains an unoffical English translation by the Netherlands' Ministry of Finance of Decree No. IFZ 2001/294M, officially published in Dutch on 30 March 2001. Rights can only be derived from the original Dutch text of the decree.

a. the service entity does *not* meet one or more of the requirements listed in the Annexe in respect of the existence of a real presence (substance) in the Netherlands.

No advance certainty will be granted to a service entity on the tax consequences of related transactions as defined in paragraph 1 above, if:

b. the functions performed by the service entity in relation to these specific related transactions do not entail on balance any real risk (see paragraph 6 below).

This means that, if a service entity does not meet the requirements referred to in point a. with respect to a real presence in the Netherlands, no advance certainty will be granted for all of the contemplated transactions qualifying under the description in paragraph 1 above, regardless of whether or not the transactions in question entail any real risk as described in point b., and regardless of whether or not the taxpayer gives his consent to the spontaneous exchange of information to the country of source.

When a service entity does meet the requirements referred to in point a. in relation to a real presence in the Netherlands but fails the requirement referred to in point b., the service entity will not be granted advance certainty with regard to the specific related transactions that do not meet the requirement referred to in point b.. Contrary to the provisions of point b., advance certainty may nevertheless be granted in such situations if the taxpayer gives his consent, in a determination agreement with the tax administration, to the spontaneous exchange of information to the country of source.

For the purpose of the application of point b., risks that have been transferred to third parties (i.e. unrelated entities) shall be treated as the risks of the service entity. In general, this will lead to the result that groups that concentrate their treasury activities in one or more departments will be deemed to be running a real risk with regard to all of the financial transactions conducted by these treasury departments, given that one of the these departments' basic tasks is transferring to third parties the net risk run by the group regarding all of the financial transactions for which the department in question is responsible. The responsibility of the centralised treasury department will generally consist of independently managing the risks related to all of the financial transactions conducted by (an independent part of) the group. Where a service entity's responsibility does not extend to independently managing the risks as described above, this is an indication that the entity does not perform an active treasury function. In these situations, further action will be required to determine whether or not real risk is being incurred with respect to the related transactions as defined in paragraph 1.

3. Exchange of information

Point b. of paragraph 2 states that no advance certainty will be given on any related transactions as described there, unless the applicant gives his consent, as part of the determination agreement, to the spontaneous exchange of information to the country of source. This consent also includes a confirmation by the applicant that the information described in the advance pricing agreement or advance tax ruling that will be exchanged is not subject to one of the exemption clauses specified in Article 13, Paragraph 3, of the International Assistance with Levying Taxes Act (*Wet op de internationale bijstandsverlening bij de heffing van belastingen*, WIB). Once an applicant has committed himself to this position in the determination agreement, the grounds for an objection or appeal on the basis of this article, against the notification in which the exchange of information is announces, will cease to exist.

The fact that no advance certainty is granted in the situations described in paragraph 2, points a. or b. does not restrict taxpayers from conducting the financial transactions described under these points without any advance certainty about their tax consequences. Here too, the spontaneous exchange of information will take place to the country or countries in question. In situations where the requirements for a real presence in the Netherlands (see paragraph 2, point a.) are not met, information on a taxpayer's actual circumstances with regard to the requirements set out in the Annexe will be disclosed to other countries for which this may be relevant. In situations where structures are implemented as described in paragraph 2, point b., the information that is to be disclosed will relate to transactions performed or to be performed and the character of the entity.

The exchange of information will take place following a request for a certificate of residence or when, during the handling of a taxpayer's tax assessment, the suspicion arises that a country may have an interest in the information, but in any event no later than the date on which the corporation tax assessment is formally assessed. Thereto, the tax inspector will forward the relevant information, with a statement of the name of the country or countries concerned, to the Fiscal Information and Investigation Services (FIOD) in Haarlem. FIOD Haarlem International will determine whether or not the exchange of the information is in accordance with the relevant statutory regulations and treaty provisions, for example, whether or not it would constitute a breach of Article 13, Paragraphs 1 and 2, of the WIB.

4. Credit for foreign withholding tax

For the transactions described in paragraph 2, point b., no credit for foreign withholding tax will be provided, as the financial service entity in fact operates as an intermediary, which means that the received cash flows do not form part of that entity's Dutch tax base.

In the light of improving the international transparency of the treatment of such entities in the Netherlands, the government is considering codification of this matter.

5. Good faith between treaty partners

No advance certainty is given in the cases described in paragraph 2, points a. and b., as the elements referred to in these points form an indication that the provision of advance certainty would constitute a breach of good faith between treaty partners. In addition to the elements described specifically in points a. and b., any requests for advance certainty should be assessed in more general terms by reference to the Decree of 21 July 1995 (No. AFZ94/4519M) on fiscal implementation policy, standpoint provisions and appeals policy (as amended by the Decree of 26 January 1997 (No. AFZ94/4609M) and as further expanded in the Decree of 30 March 2001 (No. BOB2001/698M) on advance certainty and good faith between treaty partners).

6. No real risk exposure

When the functions performed by the service entity that are related to the related transactions described in paragraph 1 do not entail any real risk on balance, advance certainty may be given only if, as part of the determination agreement in which the advance certainty is set out, the taxpayer gives his consent to the spontaneous exchange of information to the treaty partner. It is, therefore, important to determine to what extent the service entity bears a risk in relation to these related transactions.

The risks that can relate to the transactions described in paragraph 1 consist, in particular, of credit risk (debtor and foreign exchange risk), market risk and operational risk. If the only risks born by the service entity are operational risks, this will generally not lead to the presence of real risk as defined in this decree. The extent to which the service entity bears a risk will translate itself primarily into the possibility that the equity held by the service entity to secure its assets could be affected. The decisive factor in assessing whether or not and to what extent a service entity is bearing real risk is therefore the question of whether or not and to what extent the service entity is bearing one or more of the above risks and whether or not the service entity maintains sufficient equity to be able to carry those risks.

A service entity, the activities of which consist of lending money, is regarded as bearing real risk if the amount of the equity that is required for it to be able to carry the risks is at least equal either to 1% of the nominal value of the loan or to an amount of EUR 2 million (NLG 4,407,420). If, therefore, the equity a service entity should maintain to adequately secure the money-lending activity concerned is at least equal either to 1% of the nominal value of the loan or to an amount of EUR 2 million, whichever is lower, the service entity in question is deemed to be bearing a real risk, provided that the applicant is able to show that there is a real possibility of it having to utilise this equity if the risks related to the related transactions materialise in practice.

Example 1

The sole activity of a service entity (SE) consists of the lending of EUR 100 million to X, a related entity. The equity of SE amounts to EUR 1.5 million. In addition, SE borrows, for the purpose of financing the issue of this loan, an amount of EUR 98.5 million from a related entity, Y. SE's parent company (PC) has given Y a guarantee that it will repay the entire loan if SE defaults on its repayment obligations. The first event that occurs if SE's credit risk (i.e. the debtor risk) materialises (i.e. X is unable to meet its repayment obligations) is that SE will be forced to utilise its own equity. The guarantee given by PC will take effect only if SE's equity is not sufficient to cover the repayment obligations. As SE maintains equity against the loan that is higher than 1 per cent of the nominal value of the loan and there is a real possibility that this equity could be affected when the risks born by SE (i.e. the debtor risk in this case) materialise in practice, SE may be regarded as bearing a real risk.

Example 2

The sole activity of a service entity (SE) is lending EUR 400 million to X, a related entity. The equity of SE amounts to EUR 3 million. In addition, SE borrows an amount of EUR 397 million from Y, another related entity, for the purposes of financing the issue of the loan. SE's parent company (PC) has given a guarantee that it will repay to SE the entire outstanding loan to X if X defaults on its repayment obligations. If SE's credit risk (i.e. the debtor risk) materialises (i.e. X is unable to meet its repayment obligations), SE will be able to invoke PC's guarantee and obtain repayment of the loan. Although SE has equity in excess of EUR 2 million, there is no realistic possibility that this equity will be affected if X defaults on its repayment obligations. For this reason, SE may not be regarded as running a real risk.

For the determination of an arm's length remuneration for entities providing intra-group financial services, see the Transfer Pricing Decree of 30 March 2001 (No. IFZ2001/295M).

7. Competence

For information on the competence with respect to service entities as referred to in this Decree, see the Decree of 30 March 2001 (No. RTB2001/1195M) on Advance Pricing Agreements (APAs), Advance Tax Rulings (ATRs), financial services, conduit companies, the International Investors Desk and Rulings. Organisation and Jurisdiction Rules (no English translation available).

8. Entry into force

This decree enters into force on 1 April 2001.

ANNEXE

List of minimum requirements

- At least half of the total number of the statutory directors and the directors competent to make decisions reside in the Netherlands (individuals) or have the place of effective management situated in the Netherlands (non-individuals).

- The directors resident in the Netherlands (individuals) or with the place of effective management situated in the Netherlands (non-individuals), have the professional knowledge required to properly perform their duties. The tasks of the (joint) directors include, at the very least, the decision making -- based on the legal entity's own responsibility and within the framework of normal intra-group involvement -- on transactions to be concluded by the legal entity as well as ensuring a proper execution of all of the concluded transactions. The legal entity has qualified staff at its disposal (either its own staff or obtained from third parties) who can adequately perform and record the transactions to be conducted by the legal entity.

- (Key) managerial decisions should be taken in the Netherlands.

- The legal entity's (main) bank accounts should be maintained in the Netherlands.

- The legal entity's accounts should be kept in the Netherlands.

- The legal entity should have complied with all of the relevant requirements relating to the submission of tax returns, at least until the date on which its application is assessed. This applies equally to all forms of tax, including corporation tax, wage withholding tax, VAT, etc.

- The legal entity's registered office must be located in the Netherlands. The legal entity is, to the best knowledge of the entity, not (also) regarded as tax resident in another country.

- The legal entity's equity should be adequate in relation to the functions performed (taking into account the assets used and the risks assumed).

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Transfer prices, the application of the arm's length principle and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines)[1]

1. This document contains an unofficial English translation by the Netherlands' Ministry of Finance of Decree No. IFZ 2001/295M, officially published in Dutch on 30 March 2001. Rights can only be derived from the original Dutch text of the decree.

4. **Secondary adjustments (*Paragraphs 4.67-4.77*)**

5. **Arm's length price when valuation at the time of the transaction is highly uncertain (*Paragraphs 6.28-6.35*)**

6. **Intra-group services (*Chapter VII*)**

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8. **Arm’s length fee for financial services**

9. **Subsidies, tax incentives and costs subject to deduction restrictions**

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11. **Entry into force**

12. **Application to current policy**

Transfer prices, the application of the arm's length principle and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines)

International Tax Policy and Legislation Directorate, Multilateral Affairs Division
Decree of 30 March 2001, No. IFZ2001/295M
The State Secretary for Finance has decreed as follows.

With regard to cross-border transactions, there is agreement amongst the OECD member countries regarding the "arm's length principle", as is included in Article 9 of the OECD Model Tax Convention. The OECD's commentary on Article 9 of the OECD Model Tax Convention and the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (henceforth the OECD Guidelines)[2] provide further guidance on the arm's length principle. The policy of the Netherlands on the arm's length principle in the field of international tax law is that this principle forms an integral part of the Netherlands' system of tax law as a result of its incorporation in the broad definition of income recorded in Section 3.8 of the Income Tax Act 2001. In principle, this means that the OECD Guidelines apply directly to the Netherlands under Section 3.8 of the Income Tax Act 2001. There are a number of areas in which the OECD Guidelines provide scope for individual interpretation by the member countries. In a number of other areas, practical experience has shown that the OECD Guidelines are in need of clarification. This decree explains the Netherlands' position in relation to these particular points and seeks, where possible, to remove any confusion. The OECD Guidelines have not yet fully crystallised and are regularly expanded and adjusted. If necessary, this decree will also be adjusted to take account of new developments.

For the sake of clarity, the paragraphs in the OECD Guidelines corresponding to the text of the decree are referred to in brackets.

2. The Dutch translation of the OECD Guidelines is included in the binder *Internationale Fiscale Zaken* (binder A), number 750.00.00.

It is important to remember when assessing transfer prices that -- as the OECD Guidelines also stress -- transfer pricing is not an exact science. Accordingly, the OECD urges tax administrations to adopt a flexible approach and not to expect taxpayers to set transfer prices with a degree of accuracy that is unrealistic in the light of all of the various facts and circumstances. The Netherlands' tax administration will also bear this point in mind when assessing transfer prices.

For the sake of clarity, I have decided to integrate the text of a number of existing decrees into the text of the present decree. This means that the decrees referred to in section 12 are hereby revoked.

1. The arm's length principle (*Chapter I*)

Generally speaking, the arm's length principle is applied by comparing the conditions of a transaction conducted between associated enterprises with the conditions of a transaction conducted by independent or unrelated enterprises. Taxpayers are expected to be able to demonstrate that their transfer prices are consistent with the arm's length principle. The basic principle is that each of the enterprises involved should receive a remuneration that is a reflection of the functions performed, taking into account the assets used and the risks assumed (Paragraph 1.20).

Where the term "function(s)" appears elsewhere in this decree, it is intended to have the meaning of "function(s), taking into account the assets used and the risks assumed".

1.1. Aggregation of transactions (*Paragraphs 1.42-1.44*)

In principle, the OECD Guidelines require arm's length prices to be based on individual transactions. This requirement can, however, create a number of practical problems. When it is either very difficult or impossible to assess each individual transaction, for example, in case of a large number of similar transactions, the transactions may be aggregated for the purpose of deciding whether or not they were conducted at arm's length. In such a situation, taxpayers are expected to be able to demonstrate that the transfer price applying to the aggregated transactions is in accordance with the arm's length principle.

1.2. The use of a range (*Paragraphs 1.45-1.48*)

In some cases it will be possible to apply the arm's length principle and arrive at one single figure that is the most reliable to determine the arm's length character of the transfer prices. Because, however, transfer pricing is not an exact science, a particular transfer pricing method will often generate a range of figures all of which are equally reliable. The range is determined by the largest and the smallest value found. Where an arm's length range is used, after determining such range, the question arises as to which figure within the range a comparison can be made and to what point within the range an adjustment can be made. The OECD Guidelines leave this open.

It is important to make a distinction, when determining a range, between situations in which the comparables consist of readily comparable values and a situation in which use is made of less accurate comparative material. If the comparables consist of readily comparable values, these are all part of the range. If, however, use is made of less accurate comparative material, it may be necessary to use statistical methods to enhance the reliability of the material. One example would be the use of an interquartile range. The effect of this type of statistical method is to reduce the extent of the range, leaving a relevant range consisting of more reliable reference material.

Once the range is defined, the next step is to decide whether or not the remuneration for the transaction in question falls within the range. If it does fall within the range, no adjustment is made. An adjustment is made only if the remuneration does not fall within the range and the taxpayer cannot provide a substantiated explanation for the deviation. According to the OECD Guidelines, an adjustment should be made in such an event to the point within the range that best reflects the facts and circumstances of the relevant intra-group transaction. If there are grounds for assuming that one specific point within the range comes closest to replicating the conditions under which the intra-group transaction took place, this point should be taken as the basis for the adjustment. If it is not possible to identify one specific point, the Netherlands' position is that the median (i.e. the middle point of the range) should be taken as the basis for adjustment. As the OECD has yet to formulate a clear policy on this point, it may occur that the state in which the associated enterprise is located does not permit the transfer prices to be adjusted to the median. In such situations, the competent authority in the Netherlands, acting on the taxpayer's request, will consult the other state with a view to reaching agreement on a point within the range that is acceptable to both states.

In some cases, the transfer price originally adopted is adjusted either upwards or downwards by the taxpayer, leading to a shift within the range. In such situations, the taxpayer has to be able to substantiate the change in conditions in such a way as to justify the adjustment of the transfer price. If the taxpayer is unable to demonstrate that conditions have indeed changed in such a way as to justify an adjustment in the transfer price, it will generally be assumed that the reasons for adjusting the transfer price are predominantly tax driven. In such situations, the tax administration will not accept the change in the transfer price. An additional condition for accepting this type of shift within the range is that the modified price must be stipulated in the contracts concluded by the parties to the transaction and should actually be charged.

1.3. The use of multiple year data (*Paragraphs 1.49-1.51*)

It may be useful to evaluate data relating to a number of years when assessing a transaction. Making use of data covering a succession of years is one way of preventing adjustments from being made in a particular year, even though the average remuneration received by the taxpayer concerned over a number of years is in fact consistent with the arm's length principle. At the same time, the use of multiple year data may result in certain situations in the past being assessed with the benefit of hindsight. The OECD Guidelines stipulate that tax administrations cannot use hindsight. This means that, when multiple year data are used, the only figures that can be used are those relating to the year in question and previous years. One of the results of this is the system of moving averages. This leads to the following method:

- The first step is to assess whether or not the remuneration for the transaction in question falls within the arm's length range that has been created for the year in question. No adjustment is made if the remuneration falls within the range;
- If the remuneration does not fall within the range, it is then compared with the (moving) averages for a number of years. The length of the period on which this comparison is based depends partly on the length of the product's life cycle. If the average remuneration for the transaction in question falls within the multiple year range, no adjustment is made; and
- If the remuneration does not fall within the arm's length range for the year and not within the multiple year arm's length range, an adjustment is made in accordance with the procedure set out in section 1.2.

1.4. The effect of government policies (Paragraphs 1.55-1.59)

Certain government interventions may be regarded as being market conditions in the country in question and should for this reason be reflected in the transfer price.
Paragraph 1.59 of the OECD Guidelines describes two possible approaches to a situation in which a country, for example, either prevents or blocks a particular payment. Under Netherlands' tax law, the remuneration relating to a particular performance must be reflected in the result. It can, however, be in accordance with sound business practice to depreciate (partly) the value of accounts receivable relating to the particular performance. The costs associated with the transaction can be taken into account. Obviously, an assessment must be made when the account receivable arises as to whether or not the conditions of the transaction justify the conclusion that the transaction should materially be regarded as a contribution of equity rather than remuneration for an activity performed (Supreme Court, 27 January 1988, BNB1988/217). In addition, it goes without saying that the taxpayer is under an obligation to substantiate the reduction in value of the account receivable.

1.5. Request to lower transfer pricing adjustments (*Paragraphs 1.60-1.64*)

When the tax administration audits a taxpayer's books, the taxpayer is entitled to apply for a reduction in the proposed adjustment of a transfer price if the taxpayer is of the opinion that the adjustment proposed by the tax administration does not take sufficient account of compensating transactions. Under the OECD Guidelines, tax administrations have discretionary powers either to grant or deny such requests. The distinction made in the OECD Guidelines between a situation in which a taxpayer demonstrates the presence of an intentional set-off at the time when a tax return is filed and a situation in which an intentional set-off is stated by the taxpayer (and the acceptability is demonstrated) at the point when the tax administration recommends certain adjustments on the basis of a tax audit, is not relevant to the Netherlands' situation. In both cases, the taxpayer retains his statutory right to lodge an objection or appeal.

2. Transfer pricing methods (*Chapters II and III*)

Chapter II of the OECD Guidelines discusses the three traditional transaction methods introduced in Paragraphs 1.68 to 1.70 (i.e. the comparable uncontrolled price method, the resale price method and the cost-plus method), whilst Chapter III examines the methods known as the transactional profit methods (i.e. the profit-split method and the transactional net margin method or TNMM). Depending on the circumstances, a choice of one of these five accepted methods has to be made. The methods can supplement each other. The OECD Guidelines are based on a certain hierarchy of the methods where a preference exists for the traditional transaction methods. On the one hand, transactional profit methods are considered more or less as methods of last resort. On the other hand, the OECD Guidelines state that the tax authorities need to start a transfer pricing audit from the perspective of the method chosen by the taxpayer (see Paragraph 4.9 of the OECD Guidelines).

In accordance with Paragraph 4.9 of the OECD Guidelines, whenever the Netherlands' tax administration undertakes a transfer pricing audit, it should start from the perspective of the method adopted by the taxpayer at the time of the transaction. This complies with Paragraph 1.68 of the OECD Guidelines. The implication is that taxpayers are in principle free to choose a transfer pricing method, provided that the method adopted leads to an arm's length outcome for the transaction in question. In certain situations, however, some methods will generate better results than others. Although taxpayers may be expected to base their choice of a transfer pricing method on the reliability of the method for the particular situation, taxpayers are definitely not expected to weigh up the advantages and disadvantages of all of the various methods and then explain why the method that was ultimately adopted generates the best results in the prevailing conditions (i.e. the best method rule). Certain situations are also suited for a combination of methods. At the same time, taxpayers are not obliged to use more than one method. The only obligation resting on the taxpayer is to explain why the decision was taken to adopt the particular method that was adopted.

A number of examples of the various transfer pricing methods are given in the following paragraphs to illustrate how they work. It is explicitly not the object to discuss all issues that may arise in practical situations in relation to each method.

2.1. Comparable uncontrolled price method (*Paragraphs 2.6-2.13*)

With this method, the price calculated for goods that are transferred and services that are performed in a transaction with an associated party is compared with the price that is calculated for similar goods that are transferred and services that are performed in a free market transaction under comparable circumstances. If a comparable price is available, the comparable uncontrolled price method (commonly known as the CUP method) will, in general, be the most direct and the most reliable method in determining the transfer price, so that this method is to be preferred over other methods. A point to note is, however, that the reliability of the CUP method depends on the degree of accuracy with which adjustments can be made for purposes of comparison.

Example

A producer in country X sells wine to an associated Dutch wholesaler. The same producer in country X sells the same wine to an independent Dutch wholesaler for EUR 5 per bottle. In the agreement with the independent wholesaler, the external transportation costs are for the account of the producer. Under the arrangement made with the associated wholesaler, the external transportation charges of EUR 1.50 per bottle are not borne by the producer, but by the wholesaler. The other circumstances are the same for the associated wholesaler and the independent wholesaler. The wine is sold at EUR 12.50 per bottle.

Based on the difference in contractual terms, an adjustment needs to be made to the third party price in accordance with Paragraphs 2.8 and 2.9 of the OECD Guidelines. The CUP method can be used as follows to calculate the comparable third party price (i.e. the CUP).

Purchase price paid by independent wholesaler	5.00
Adjustment to account for difference in external transportation expenses between associated wholesaler and independent wholesaler	1.50
CUP for associated wholesaler	3.50

2.2. Resale price method (*Paragraphs 2.14-2.31*)

The second traditional transaction method is the resale price method. This method has as its starting point the market price that is agreed to with respect to the sale of a product to third parties. This product has been purchased from an associated enterprise. In order to calculate the arm's length remuneration for the functions performed by the associated enterprise that sells the product to the third party, the product's market price is reduced by a gross profit margin. The gross profit margin consists of the selling expenses and other costs arising from the functions performed by the seller and an appropriate profit margin. What is left after the adjustment for other costs associated with the sale of the product, such as customs duties, is an arm's length price.

Example

This example is based on the same situation used in the example illustrating the CUP method. The resale price method is based on the gross profit margin earned by the independent wholesaler, which may be calculated as follows:

Retail price	12.50	100%
Purchase price paid by independent wholesaler	5.00	40%
Gross profit margin of the independent wholesaler	7.50	60%

The functions performed by the independent wholesaler are the same as those performed by the associated wholesaler. The only difference is that the associated wholesaler is responsible for the external transportation charges whereas the independent wholesaler is not. The associated wholesaler will have to receive as remuneration for the functions performed an amount equal to the remuneration received by the independent wholesaler, plus a mark-up to cover the external transportation charges. The external transportation charges are 12 per cent of the retail price (i.e. EUR 1.50 per bottle selling at EUR 12.50). This means that a commercial gross profit margin for the associated wholesaler can be set at 72 per cent (i.e. 60 per cent plus 12 per cent). Using this figure as a basis, the resale price method can be used to calculate the following transfer price for the associated wholesaler:

Retail price	12.50	100%
Required gross profit margin	9.00	72%
Arm's length transfer price	3.50	28%

The example shows that the associated wholesaler and the independent wholesaler pay the same purchase price, including external transportation charges (i.e. EUR 3.50 plus EUR 1.50 equals EUR 5).

2.3. Cost-plus method (*Paragraphs 2.32-2.48*)

The cost-plus method is the third traditional transaction method. In applying this method, the costs incurred by the enterprise are divided into the direct and indirect costs that can be allocated to individual transactions with (associated) enterprises (hereinafter: the direct and indirect costs) and the enterprise's other costs which cannot be allocated to individual transactions in such way (hereinafter: overhead costs). An appropriate mark-up that is required to realise profit in accordance with the functions performed is applied to the direct and indirect costs (the cost base) that can be allocated to an individual transaction with an associated enterprise. The mark-up also has to cover the overhead costs. The method is, therefore, based on a gross profit margin. This is the difference between the cost-plus method and the transactional net margin method, in which the operating profit is calculated either as a percentage of total cost, i.e. including overhead costs, or as a percentage of turnover.

Budgeting versus actual cost

In general, prices will be determined in advance based on budgeted cost. If the actual costs that are related to the transaction are higher than the budgeted costs, it depends on the nature of the difference whether or not this will lead to an adjustment of the price. In general, one can assume that the higher costs that are the result of inefficiency will be for the account of the party which performs the functions and services. This is after all the party that can influence the costs. In such a situation, an independent customer would not accept a price adjustment.

A requirement for a correct determination of the transfer prices based on budgeting is that these budgets are determined in an economically correct manner.

Overcapacity losses

A special situation presents itself with a "contract manufacturer". The characteristic of a contract manufacturer is that it performs certain production activities regarding the products of the principal in return for a previously agreed to fee. Because the goods in question remain the principal's property, the contract manufacturer assumes only a limited degree of risk with regard to the goods. Associated enterprises often subcontract production activities to a contract manufacturer working exclusively for the enterprise in question. The transfer prices are then often calculated on the basis of either the cost-plus method or the TNMM. Here too, the calculated mark-up should reflect the functions performed. An important factor for the calculation of the mark-up for the contract manufacturer is the question of who is responsible for any overcapacity losses. If these are the responsibility of the principal, a low(er) mark-up may be sufficient.

Disbursements

Costs that have the character of disbursements may be excluded from the cost base. These includes costs that are initially paid by the performing party but which are generally passed on separately to the client, for example, legal dues, court registry charges and costs charged for third party services. Although these external charges are related to the functions performed by the performing party, they do not warrant any additional remuneration, as there is no question of any added value generated by the performing party.

Financing costs

As is indicated earlier, overhead costs are excluded from the cost base, but should be covered by the mark-up. Generally, the costs of the capital, both the equity and the loan capital that is used for financing the enterprise's activities are regarded as forming part of the overhead costs. If, however, the financing costs are included in the direct costs in comparable situations, they should be included in the cost base.

Situations in which the cost-plus method can be used

The OECD Guidelines give examples of situations where the cost-plus method can be applied. This method is probably very useful where semi-finished goods are sold between related parties, where related parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services (see Paragraph 2.32). Paragraphs 2.46 to 2.48 of the OECD Guidelines provide examples of possible applications of the cost-plus method. From these examples it appears that the cost-plus method gives the most reliable outcomes in situations where the functions performed are relatively straightforward and the contribution made by the associated party concerned is also of little added value or relatively straightforward.

Start-up period

Given that the cost-plus method will generally be used in relatively risk-free and straightforward settings, a party acting on an arm's length basis will not accept that during the start-up period no mark-up is charged. At the same time, the taxpayer may incur a loss because he is less efficient and, therefore, incurs relatively more expenses than the unrelated third party that has been used as a benchmark for the purpose of calculating the mark-up (see the section above on budgeting).

Example

A Dutch company (A) assembles computers for the European market on behalf of an independent computer manufacturer in country X. The assembly work is based on standard instructions compiled by the computer manufacturer in country X. Both the components and the finished products are and remain the property of the computer manufacturer in country X. The remuneration that A agrees with the computer manufacturer is fixed as follows:

Budgeted attributable costs (i.e. direct and indirect assembly costs)	100
Budgeted mark-up to cover overhead costs, plus profit mark-up (60%)	60
Price set	160

A computer manufacturer from country Y decides to set up a subsidiary in the Netherlands (B) to assemble computers for the European market. Whilst the computers assembled by A and B are not entirely identical, the assembly work performed by the two enterprises is comparable. In addition, the two companies assume similar risks (i.e. the computer manufacturer from country Y also holds and retains the title to both the components and the finished products). This means that A and B perform comparable functions. The direct and indirect costs resulting from B's assembly activities are EUR 110.

The cost-plus method can be used as follows to determine the arm's length price.

Budgeted attributable costs (i.e. direct and indirect assembly costs)	110
Budgeted mark-up to cover overhead costs, plus profit mark-up (60%)	66
Arm's length transfer price set	176

2.4. Profit-split method (*Paragraphs 3.5-3.25*)

The profit-split method is a transactional profit method. If transactions are strongly interconnected, they can often not be evaluated separately. With the profit-split method, first the combined profit accruing to the associated enterprises from a controlled transaction is identified. Subsequently, this profit is split between the associated enterprises in a manner that approximates to the division of profits that would have occurred in an agreement made at arm's length.

2.5. Transactional net margin method (TNMM) (*Paragraphs 3.26-3.48*)

The TNMM is also a transactional profit method. The net operating profit (i.e. earnings before tax, interest and extraordinary income and expenditure) relating to an appropriate base (such as costs, turnover or assets) that the taxpayer realises from a controlled transaction is compared with the net profit that a third party operating in comparable circumstances and performing comparable functions realises from comparable transactions. Further details on this method are given in Paragraphs 3.26 to 3.48 of the OECD Guidelines.

In the following paragraphs, the difference between the TNMM and the resale price method on the one hand and the TNMM and the cost-plus method on the other is illustrated by two examples.

2.5.1. TNMM versus the resale price method

The details of this example are the same as those in the example used to illustrate the resale price method, with the exception of the additional information given below on the composition of the aggregated costs.

A producer in country X sells wine to an associated Dutch wholesaler. The same producer in country X sells the same wine to an independent Dutch wholesaler for EUR 5 per bottle. Under the contract agreed with the independent wholesaler, the external transportation costs are for the account of the producer. Under the arrangement made with the associated wholesaler, the external transportation charges of EUR 1.50 per bottle are not borne by the producer but by the wholesaler. The other circumstances are the same for the associated wholesaler and the independent wholesaler. The wine sells at EUR 12.50 per bottle.

Additional information: the other costs incurred by the independent wholesaler in addition to the purchase price of the wine are estimated at EUR 6.25 per bottle.

The net profit margin earned by the independent wholesaler may be calculated as follows:

Retail price	12.50	100%
Purchase price paid by independent wholesaler	5.00	40%
Gross profit margin earned by independent wholesaler	7.50	60%
Other costs	6.25	50%
Net profit margin earned by independent wholesaler	**1.25**	**10%**

The associated wholesaler performs the same functions as the independent wholesaler. There are certain costs, however (i.e. the external transportation charges of EUR 1.50 per bottle), that the associated wholesaler bears that are not borne by the independent wholesaler. Provided that there is no difference in the type of functions performed, this type of difference in the division of costs between the producer and the wholesaler will not result in any difference in the net profit margin agreed between the two parties. In other words, the associated wholesaler will need to earn the same net profit margin as the independent wholesaler. The purchase price paid by the associated wholesaler may be calculated as follows:

	Independent wholesaler	**Associated wholesaler**
Retail price	12.50	12.50
Purchase price	5.00	?
External transportation charges	0.00	1.50
Other costs	6.25	6.25
Profit	1.25	1.25

The profit margin earned by the associated wholesaler must be the same as that earned by an independent third party. This means that the purchase price has to be set at EUR 3.50.

The retail price charged by the associated wholesaler may be broken down as follows:

Purchase price paid by associated wholesaler	3.50	28%
Other costs	7.75	62%
Net profit margin earned by associated wholesaler	1.25	10%
Retail price	12.50	100%

2.5.2. TNMM versus the cost-plus method

The details of this example are the same as those in the example used to illustrate the cost-plus method, with the exception of the additional information given below on the composition of the aggregated costs.

A Dutch company (A) assembles computers for the European market on behalf of an independent computer manufacturer in country X. The assembly work is based on standard instructions compiled by the computer manufacturer in country X. Both the components and the finished products are and remain the property of the computer manufacturer in country X.

Additional information: the remuneration that A agrees with the computer manufacturer is fixed as follows:

Indirect and direct assembly costs + overhead costs	145	(100%)
Net profit mark-up	15	(10.3%)
Price set	160	(110.3%)

A computer manufacturer from country Y decides to set up a subsidiary in the Netherlands (B) to assemble computers for the European market. Whilst the computers assembled by A and B are not entirely identical, the assembly work performed by the two enterprises is comparable. In addition, the two companies run similar risks (i.e. the computer manufacturer from country Y also holds and retains the title to both the components used and the finished products). This means that A and B perform comparable functions. B's aggregate costs are estimated at EUR 160.

Using the TNMM method, the transfer price may be calculated as follows:

Indirect and direct assembly costs + overhead costs	160	(100%)
Net profit mark-up	16	(10.3%)
Price set	176	(110.3%)

3. Administrative approaches for avoiding and resolving disputes on transfer pricing (*Chapter IV*)

3.1. Mutual agreement procedures (Paragraph 4.61)

3.1.1. General

The number of mutual agreement and arbitration procedures with treaty countries is growing as a result of the rapid globalisation of the economy coupled with the increasing interest of tax administrations in transfer pricing issues. Accordingly, it is becoming increasingly important for the business community to be aware of the policies and procedures followed by the Netherlands' government in relation to such mutual agreement and arbitration procedures. The Netherlands aims at resolving issues of double taxation caused by transfer pricing adjustments as quickly as possible, and wishes to minimise the (administrative) burden placed on the private sector as a result of such adjustments.

All of the treaties for the avoidance of double taxation that the Netherlands has entered into contain a clause that is comparable to Article 25 of the OECD Model Tax Convention. In addition, for Member States of the European Union, the Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (henceforth the Arbitration Convention (90/436/EEC)) applies since 1 January 1995. Unlike the mutual agreement procedures, the Arbitration Convention actually obliges the signatories to eliminate double taxation.

Taxpayers are entitled to lodge an objection or appeal if they are of the opinion that a profit adjustment is not justified. In addition, if the profit adjustment leads to international double taxation, taxpayers can also submit an application for a mutual agreement or arbitration procedure to the competent authority in either one of the Member States or both of the Member States involved.

3.1.2. Address for submitting the request

A request for the application of the mutual agreement article of a treaty or an Arbitration Convention procedure should be addressed to the competent authority, i.e.:

The Ministry of Finance
Director of International Tax Policy and Legislation
P.O. Box 20201
2500 EE The Hague
The Netherlands

Requests for a reduction in previous tax assessments resulting from transfer pricing adjustments either already made or likely to be made in the future by foreign tax administrations (i.e. requests for corresponding adjustments) should be addressed to the Ministry of Finance for the attention of the Director of the International Tax Policy and Legislation Directorate.
The competent authority will send a copy of all applications to the Co-ordination Group on Transfer Pricing (*Coördinatiegroep verrekenprijzen*, CGVP) for their advice. The CGVP was set up in March 1998 (see the Decree of 30 March 2001, No. RTB/1365M). In all cases, consultation will take place between the CGVP and the International Tax Policy and Legislation Directorate on the final position.

Where requests for corresponding adjustments in relation to either past or future tax assessments are received by the competent tax inspector, the latter should pass on such applications to the CGVP. The CGVP is responsible for soliciting the views of the International Tax Policy and Legislation Directorate on the matter and will give the inspector a binding advice on how the application should be dealt with.

3.1.3. Deadline for submitting the request

Article 25 of the OECD Model Tax Convention states that requests for competent authority assistance must be presented within three years from the first notification of the action resulting in international double taxation. Article 6 of the Arbitration Convention contains a similar clause.

Neither the commentary on Article 25 of the OECD Model Tax Convention and the Arbitration Convention, nor the text of the articles themselves, make it clear what exactly is meant by the term "first notice". The position taken by the Netherlands' government is that the taxpayer's request is regarded as having been submitted in time if it is received within three years either of the date of the assessment incorporating the adjustment or of the date on which justification was given for the adjustment, should this be later. As the mutual agreement and arbitration procedures involve more than one state, the taxpayer should ascertain the position adopted by the other state with regard to the starting date of the three-year period. If the other state has a different position, this could result in the three-year period commencing on a date prior to that on which the three-year period starts in accordance with the Netherlands' position.

Where the period quoted in the mutual agreement clause in a specific tax treaty differs from the period of three years referred to above, the taxpayer should take regard of the text of the mutual agreement clause and the commentary on this clause in the treaty. As long as there is no conflict either with the tax treaty in question or with the commentary on the treaty, the principle outlined in the preceding paragraph will be followed by analogy.

3.1.4. Concurrence of the objection and appeal procedure and the mutual agreement procedure

In principle, the competent authority in the Netherlands will not consult the competent authority in the other state involved as long as the taxpayer has the possibility under Netherlands' law (i.e. in the form of an objection, an appeal or an appeal in cassation) to contest a tax assessment resulting either from an adjustment or from the rejection of an application for a corresponding adjustment. The competent authority in the other state will, however, be informed that an application for a mutual agreement or arbitration procedure has been received. The reason for not starting consultation is the fact that, until the domestic procedure has been completed, it is not clear whether or not any international double taxation will indeed arise and, if so, what amount will actually be involved.

In certain situations, however, it may be highly inefficient for the competent authority to wait for the completion of all domestic procedures before starting a consultation with a foreign competent authority. For this reason, taxpayers are offered the possibility to request the competent authority to enter into consultation with the competent authority of the foreign state in question, in spite of the fact that the domestic procedures are still pending. A request to this effect will be granted only if the following conditions are met:

- the request for an early commencement of consultation must be made to the competent authority within six weeks of the date of the decision taken on the applicant's letter of objection. The request should be accompanied by a copy of the appeal (either substantive or pro forma) lodged with the Court of Appeal;

- the competent authority will only start the consultation after the Court of Appeal has approved the suspension of legal proceedings for the duration of the mutual agreement or arbitration procedure. To this end, the taxpayer is required to produce a written statement indicating his willingness to lend his full co-operation for a period of two years in obtaining the Court of Appeal's approval for the suspension of legal proceedings or, as the case may be, for the extension of the suspension of legal proceedings. Upon the expiry of this two-year period, the taxpayer is free to request the Court of Appeal to recommence legal proceedings;
- the tax administration and the taxpayer should sign a determination agreement in which the taxpayer undertakes immediately to cease legal proceedings if the mutual agreement or arbitration procedure leads to the elimination of the international double taxation in accordance with the mutual agreement or arbitration clause in the relevant treaty; and
- the competent authority is entitled to deny a request for an early commencement of consultation if the inspector submits detailed evidence showing that the taxpayer has failed to comply with his administrative obligations, as a result of which the burden of proof with respect to the adjustment to which the adjustment relates has been transferred to the taxpayer.

The competent authority in the other state may well not be prepared to assist in the early commencement of the mutual agreement or arbitration procedure, for example, because it feels that there is not sufficient certainty as to the existence of the international double taxation in question. If this situation occurs, the Netherlands' competent authority should notify both the taxpayer and the competent tax inspector immediately. Once they have received this notification, both the taxpayer and the tax inspector are entitled to request the Court of Appeal to recommence legal proceedings.

3.1.5. Start of the two-year period referred to in Article 7 of the Arbitration Convention

The Decree of 13 October 1997 (No. IFZ97/1113M) and the letters of 19 December 1997 (No. IFZ97/1515) and 15 April 1998 (No. IFZ98/266U) from the State Secretary for Finance to the Permanent Finance Committee of the Lower House of the Netherlands' Parliament set out the government's position on the Arbitration Convention. The Decree of 13 October 1997 (No. IFZ97/1113M) sets out the government's position on the start of the two-year period referred to in Article 7 of the Arbitration Convention. According to the wording of the latter decree, the Netherlands assumes that the two-year period does not start until the competent authority in the other state has rejected the adjustments made by the first state and the tax assessment incorporating the adjustments has been irrevocably determined. Developments in neighbouring countries have caused the Netherlands' government to revise its position on the two-year period. The period is now assumed to start on the later of the following two dates:

- the date on which the tax assessment incorporating the adjustments is irrevocably determined; and
- the date on which the competent authority receives the request.

In principle, it is up to the taxpayer to decide whether or not to invoke the Arbitration Convention straightaway or to avail himself first of the various legal remedies available under Netherlands' law. For the remainder, the decrees referred to above retain their validity.

Even in situations in which the competent authority has started the "early" consultation with the other state involved, as described in section 3.1.4., the wording of Article 7, Paragraph 1, second sentence, of the Arbitration Convention means that the two-year period does not start until the tax assessment incorporating the adjustments has been irrevocably determined. In terms of Article 7, Paragraph 4, of the Arbitration Convention, however, this requirement may be ignored, provided that this is done with the agreement of both the competent authorities and the associated enterprises in question. In terms of this article, the Netherlands' competent authority, acting on the request of the associated enterprises, will suggest to the competent authority in the other state that the two-year period should be limited to no more than twelve months after the date on which the tax assessment incorporating the adjustments has been irrevocably determined.

A request to this effect from the associated enterprises in question must be received by the Netherlands' competent authority within six weeks of the date on which the tax assessment incorporating the adjustments has been irrevocably determined. A copy of the proposal to reduce the term will be submitted to the taxpayer at the same time the proposal is submitted to the other competent authority. As soon as the competent authority receives a reply to the request, the taxpayer will be notified.

3.1.6. Oral explanation by the taxpayer

To a greater extent than in other situations, the underlying facts and circumstances play a key role in making and substantiating transfer pricing adjustments. In most cases, the underlying facts and circumstances are both complex in nature and numerous in quantity. Experience shows that taxpayers involved in mutual agreement and arbitration procedures relating to transfer pricing adjustments would like an opportunity to explain their position orally to the competent authority. In the light of this apparent need, taxpayers will upon request be given an opportunity to give such an oral explanation. Taxpayers may indicate, when submitting a request for a mutual agreement or arbitration procedure to be put into motion, that they wish to avail themselves of this opportunity.

3.1.7. Deadline for making a corresponding adjustment by means of a reduction ex officio in the tax assessment

It is frequently the case that, when a foreign state makes a transfer pricing adjustment, the corresponding tax assessments in the Netherlands have already been irrevocably determined. In such an event, a corresponding adjustment will, if necessary, be made in the form of a reduction ex officio in the tax assessments. The Decree on reductions ex officio in irrevocable tax assessments (the Decree of 25 March 1991 (DB89/735)) has given the tax administration a period of five years (plus any extension that has been granted to the taxpayer) in which to grant a request for a reduction ex officio. This period may be extended by a further five years if a reasonably recognisable error has been made. In certain situations in which a mutual agreement procedure has been conducted as a result of transfer pricing adjustments, the five-year period has been found to be too short, despite the fact that the time limits set for the submission of requests in the relevant tax treaty or in the Arbitration Convention have been met.

I agree to an extension of the five-year period in such cases, on condition of course that sufficient data are available to substantiate the existence of international double taxation.

3.1.8. Transfer pricing adjustments and interest charges (*Paragraphs 4.64 - 4.66*)

In addition to the actual transfer pricing adjustment that forms the subject of the mutual agreement or arbitration procedure, differences between the arrangements made by the respective states with regard to the collection and assessment of interest charges related to the adjustments may also cause international double taxation. In some cases, the amount of interest due may actually be larger than the tax charge. For this reason, Section 30k of the General Tax Act (*Algemene Wet inzake Rijksbelastingen*) and Section 31a of the Tax Collection Act 1990 (*Invorderingswet* 1990) create the possibility of including interest payments in any compromise reached in a mutual agreement procedure. When conducting mutual agreement and arbitration procedures, the Netherlands' government will seek to ensure that the assessment and collection of interest charged by one state and paid by the other state match each other.

Where the Netherlands is the state making the adjustment, the Netherlands' tax administration will upon request grant a deferral of payment on that part of the tax charge that is related to the adjustment. In principle, deferral will be granted until the date on which both the domestic and the international procedures for resolving the dispute have been completed. The policy in this respect will be based on the policy applying to objections lodged against tax assessments (see Article 25, Paragraph 2, of the Tax Collection Guidelines 1990 (*Leidraad Invordering* 1990)). The Tax Collection Guidelines 1990 will be amended on this point. This means that the entities involved will, apart from the obligatory collection and assessment interest, not have any other form of loss of interest. The above will resolve the interest and financing problems that can be caused by mutual agreement and arbitration procedures.

4. Secondary adjustments (*Paragraphs 4.67 - 4.77*)

Paragraphs 4.67 to 4.77 of the OECD Guidelines deal with the consequences of secondary transactions. Most countries do not limit transfer pricing adjustments to adjustments of taxable income, but also require that a secondary transaction is made so that the taxpayer's accounts reflect the way in which the adjustment made to the taxpayer's profit and loss account and balance sheet has been processed. A secondary transaction may take the form of an adjustment to a current account, a distribution of income or an informal capital payment. The Netherlands' authorities always require a transfer pricing adjustment to be processed by means of a secondary transaction. A secondary transaction may lead to a secondary adjustment, such as the attribution of interest to the current account, the levying of dividend withholding tax on a distribution of income, or the levying of capital duty on an informal capital payment. Systems differ from one country to another, and this means that the foreign tax authority in question may not be prepared, for example, to credit the dividend withholding tax against its own tax because it does not recognise the payment of a deemed dividend. The secondary adjustment is not performed if the taxpayer is able to demonstrate that, in the light of the difference between the tax systems used by the two states, the dividend withholding tax paid cannot be credited and there is no situation of abuse aimed at the avoidance of dividend withholding tax.

5. Arm's length pricing when valuation at the time of the transaction is highly uncertain (*Paragraphs 6.28 - 6.35*)

Where intangible assets such as patents are transferred, it may be difficult to establish the value at the time of the transfer because not enough information is available about the future benefits and risks. Paragraph 6.34 states in this respect that, if independent enterprises under similar conditions would have demanded a price adjustment clause, a tax administration must be permitted to calculate the price using this type of clause. This refers to an arrangement whereby the fee is commensurate with the benefits that the intangible asset will generate in the future.

Agreeing to a benefit dependent fee contributes to taxation that is more in accordance with the actual results obtained. In certain circumstances, the Netherlands' tax administration also takes the position that it is not at arm's length to agree on a fixed price if there is very little certainty about the asset's value at the time of the transaction, as unrelated third parties would not agree on a fixed price in a similar situation.

In such cases, a price adjustment clause should be incorporated into the contract between the associated enterprises stating that the price charged depends partly on the level of future income. An example would be the situation in which a new intangible asset has been developed that is sold to an associated enterprise at a time when there are very few guarantees as to its future success, for instance because it has yet to generate any revenue and any estimates of future revenue are surrounded by major uncertainties. In these circumstances, it is very difficult value the asset at the time of the transaction and it would be sensible for the parties to use an arm's length price adjustment clause (see, for example, the Supreme Court decision of 17 August 1998 (No. 32.997, BNB1998/385)).

6. Intra-group services (*Chapter VII*)

According to the arm's length principle, an intra-group service is an activity performed for a group entity that adds economic or commercial value and for which the group entity concerned would normally have been willing to pay. This does not apply to activities performed as a shareholder. The taxpayer can choose one of the methods described above for calculating the transfer price. In principle, remuneration is regarded as arm's length only if it includes an appropriate profit mark-up. The only exception to this requirement is the situation described in Paragraph 7.33 of the OECD Guidelines.
As far as charging for intra-group services is concerned, the OECD Guidelines express a clear preference for a direct method (Paragraph 7.20). Experience shows, however, that indirect methods are also frequently used, because of the major practical problems that the direct method can cause.

Where such practical problems occur, the Netherlands' tax authorities will accept the indirect method chosen by the taxpayer. Obviously, the method must produce a reliable result that is in accordance with the arm's length principle. For the purposes of an allocation key, the relationship between turnover, the number of personnel, or the human resource expenses could be relevant. An allocation key in which the price charged depends on the level of profit is not regarded as generating a result that is in accordance with the arm's length principle.

7. Contributions to a Cost Contribution Arrangement (CCA) with a profit mark-up (*Chapter VIII*)

Paragraph 8.15 of the OECD Guidelines leaves member countries the option of using both market prices (with a profit mark-up) and cost (without a profit mark-up) for the calculation of contributions to a CCA.
Some countries give a precise definition of the transactions between related parties which can be regarded as a CCA (without a profit mark-up) and transactions which can be regarded as services (with a profit mark-up). A CCA is defined here as an agreement between related parties in which each of the participants makes a relatively similar contribution and receives relatively similar benefits, and these contributions and benefits are permanently in balance. The Netherlands does not offer a specific definition of what can be classified as a CCA. In principle, a profit mark-up need not be added in a situation where each of the parties makes a similar contribution and receives relatively similar benefits, so that the mutual relationship is fairly in balance. Whether or not such a balance has actually been achieved in practice is a matter that has to be assessed on a case-by-case basis. When embarking on a CCA, one problem is how to make a correct assessment of the likely contributions and benefits for the various participants. The Netherlands takes the position that in principle a profit mark-up is always required on intercompany transactions. If interested parties nevertheless choose not to add a profit mark-up, that choice will have to be properly substantiated. In this respect , see the recommendations on the form of documentation to be supplied in Paragraph 8.40 of the OECD Guidelines.

Certain countries may not allow a mark-up to be charged. In such cases, they may well permit a fee to be charged for the capital tied up in the activities in question. Both methods may lead to the same result. The Netherlands' tax administration may give its consent to a particular modus operandi in the light of the acceptability of charges in certain countries, provided that the result is in accordance with the OECD Guidelines.

8. Arm's length fee for financial services

Financial services exist in a vast variety of forms. Here too, an arm's length price should be calculated on a case-by-case basis, based on the functions performed and on a comparison with transactions between third parties. If the functions of a financial service company consist primarily in supplying loans, the functions performed by the company in question are basically comparable with the functions performed by independent financial institutions operating under the supervision of the Netherlands' Central Bank (*De Nederlandse Bank*). The application of the arm's length principle implies that the arm's length price for the functions performed should be based on the fees charged by these institutions for comparable services.

Basically, there are four aspects that financial institutions, the functions of which consist of supplying loans, take into account when deciding whether or not to make a loan and, if so, on what conditions this should be made and what level of fee they should charge.

- *Financial risk*. In order to determine the financial risk assumed by the lender, the borrower's financial position is assessed on the basis of its balance sheet and profit and loss account.

- *Debtor risk*. Three specific aspects are scrutinised in order to measure the debtor risk, i.e. the presence of collateral, the purpose of the loan and the term of the loan.

- *Business risk/classification of the quality of the loan*. The assessment of this type of risk is based on the lender's views on the sector in which the borrower is active.

- *Structural risk*. The calculation of this type of risk is based on the classification (ratings) assessed by independent credit rating agencies.

In principle, these elements should be taken into account in determining the arm's length fee which an associated lender should charge.

Independent financial service providers calculate the charges for their loans by adding a number of mark-ups or surcharges to the basic cost of funding, i.e. a surcharge to take account of solvency requirements, a surcharge to take account of the credit risk, a handling fee and a mark-up for any foreign exchange risk that may be involved. The credit risk should be calculated on the basis of the contractual terms of the loan and the results of the risk analysis described above. The contractual terms of the loan also affect the degree of foreign exchange risk. Independent financial service providers always link the size of the fee charged to either the amount of money borrowed or the market value of assets held under management.

A surcharge to take account of solvency requirements may be based on the lender's own solvency or on the solvency of an associated enterprise that is acting as a guarantor, as in the latter case it is the guarantor's capital that is at risk. In the former case, the surcharge will consist of an arm’s length fee for the equity that the lender needs to retain for the purpose of the transaction. In the latter case, the enterprise acting as a guarantor will in principle charge a fee in return for placing its capital at risk. The solvency surcharge charged by the lender should at least consist of the cost of the guarantee.

If either the incoming or the outgoing interest payments are liable to withholding tax, the price charged in a transaction involving two unrelated enterprises will generally take account of which of the two ultimately pays the tax.

9. Subsidies, tax incentives and costs subject to deduction restrictions

It is clear from practical experience that, particularly in situations in which the cost-plus method is used for determining an arm's length price, the question arises as to whether or not subsidies and tax benefits should be deducted from the cost base. The basic rule in the Netherlands is that subsidies may be deducted from the cost base if there is a direct relationship between the subsidy and the product or service supplied, and the subsidy is granted in the form of a discount or a cost allowance.

This would be the case, for example, with a subsidy granted for the use of relatively expensive but environmentally friendly materials, a grant awarded on the purchase of an energy-efficient piece of machinery, or a grant made under the government's investment grant scheme (*investeringspremieregeling* (IPR)). Conversely, additional taxes, for example, in connection with the use of materials that are detrimental to the environment, will lead to an increase in the level of the cost base. Reduction remittances referred to in Section 3 of the Wages and Salaries Tax Act (*Wet vermindering afdracht loonbelasting en premie voor de volksverzekeringen*) reduce wage costs and result in a lower cost base for the application of the cost-plus method.

Subsidies and tax benefits granted specifically to the entity in question without any causal link with the cost-plus activity do not lead to a lowering of the cost base. Insofar as these form part of the pre-tax profit, they are credited individually to the profit and loss account.

If the tax benefits in question are granted in the form of tax credits or allowances that may be deducted from the enterprise's taxable income, allowances for work-related training and investment allowances may not be deducted from the cost base. The rule is that the profit should first be calculated using the cost-plus method, after which the allowance is deducted separately from the taxable income.

Under Netherlands' tax law, certain types of cost are not fully deductible. This applies, for example, to costs incurred under Section 3.14 of the Income Tax Act 2001. At the same time, these costs do form part of the cost base to which the cost-plus mark-up is applied. The restriction on the deduction of these costs is implemented by adding the non-deductible part of the cost to the profit when determining the taxable profit.

10. Allocation of profit to headquarters and permanent establishments

The arm's length principle applies by analogy to the permanent establishments of foreign taxpayers.

This is in accordance with the existing practice of allocating profits to a foreign taxpayer's permanent establishment under Article 7 of the OECD Model Tax Convention. The country in which the permanent establishment is located is entitled to tax any profits that can be allocated to the permanent establishment in question. Revenue and expenditure are divided between the headquarters and the permanent establishment in accordance with the functions performed by each of them, as if they were unrelated enterprises. This means that an arm's length price should be used for internal supplies of goods and services, except where the commentary on Article 7 of the OECD Model Tax Convention, the Double Taxation Avoidance Decree 2001 (*Besluit voorkoming dubbele belasting* 2001) and/or Netherlands' case law impose certain restrictions on such practices

Any assets transferred to a Netherlands' permanent establishment by the foreign headquarter (i.e. including intangible assets) are valued at fair market value. This applies equally to goodwill. For the purpose of calculating the profit made by the Netherlands' permanent establishment, depreciation of the fair market value of the goodwill and other fixed assets is taken into account.
In order to prevent either all or part of the capitalised value from being disregarded by the relevant foreign tax authorities, the treaty partner will be informed of the capitalised value of the assets in question.

Under the provisions of Article 9 of the Double Taxation Avoidance Decree 2001, the above also applies to the mirror image situation in which the taxpayer needs to calculate the amount of profit that is attributable to a foreign permanent establishment (see also the Decree of 22 January 1996 (No. DGO96/06916)).

Article 7, Paragraph 3, of the OECD Model Tax Convention lays down certain rules for the deduction of costs from the profit allocated to the permanent establishment. Managerial fees and general administration charges are regarded as qualifying costs irrespective of the country in which these are incurred. In connection with this, Paragraph 3 of Article 7 should be seen as a clarification of, and not as a restriction on, Paragraph 2 of Article 7.

11. Entry into force

This Decree enters into force on 1 April 2001

12. Application to current policy

The publications listed below under points 1 to 11 apply exclusively to rulings (including "quasi" rulings) which, under the transitional arrangement set out in the Decree of 21 December 2000 (No. RTB2000/3227M), are due to expire after 31 March 2001. I should like to point out for the sake of clarity that any rulings currently in force that are consistent with the policy as at 31 March 2001 and which are due to expire before 31 December 2005 will be extended to 31 December 2005, unless the taxpayer wishes to adhere to the earlier date specified in the ruling. It goes without saying that the applicability of the ruling may not be extended beyond 31 December 2005.

The published, tailor-made rulings listed under point 12 below continue to remain valid in accordance with the provisions of the first paragraph with regard to rulings and "quasi" rulings. These publications also remain valid, provided that the policy set out therein is unconnected with the policy that is to be revoked as described in points 1 to 11 below, and on condition that there is no conflict with the provisions of the present decree. The policy on the participation exemption and the provision of advance assurance on the participation exemption remain unchanged.

1. Decree of 25 April 1985 (No. 084-2737); Tax treatment of certain intra-group activities (BNB1985/196).

2. Announcement of 7 May 1985 (No. 285-6549) by the State Secretary for Finance on the treatment of foreign sales corporations, as published in *Infobulletin* 1985/253. This publication contains the letter of 3 December 1985 (No. 284-17129) from the State Secretary for Finance and the letter of 25 March 1985 (Ref. 285-4056) from the State Secretary for Finance.

3. Letter of 15 October 1985 from the State Secretary to the Permanent Finance Committee of the Lower House of the Netherlands' Parliament, and of 24 December 1986 to the Secretary General of the Lower House of the Netherlands' Parliament (Proceedings II, 19700, Chapter IXB). Nos. 25 and 36 respectively.

4. Decree of 6 June 1989 issued by the State Secretary for Finance, Policy on the extension and termination of tax rulings, Government Gazette (*Staatscourant*) 107.

5. Announcement of 8 August 1989 (No. DB89/3695) by the State Secretary for Finance, Profit ruling on perpetual loans, as published in *Infobulletin* 1989/504.

6. Decree of 26 April 1990 (No. CA90.3) issued by the State Secretary for Finance, Explanatory notes on the concentration of the treatment of rulings, and the reprint of 15 September 1997.

7. Announcement of 4 February 1993 (No. DB93/228) by the State Secretary for Finance, Spreads for finance rulings/arm's length remuneration in respect of finance companies, published in V-N1993/496, point 19, and the revised edition published in V-N1993/606, point 20.

8. Decree of 5 March 1993 (No. DB93/881) issued by the State Secretary for Finance, Ruling, mixed expenses under "Oort" regulations and cost-plus rulings, second reprint of 15 September 1997.

9. Model book rulings, Tax Ruling Team at Local Office for Business Taxpayers/Large Companies in Rotterdam, September 1993.

10. Announcement by Local Office for Business Taxpayers/Large Companies in Rotterdam, unnumbered and undated, guidelines on ruling companies, V-N1994/173, point 28.

11. Brochure outlining the ruling policy, *Financiënreeks* 95-3, 17 February 1995, DB95/761M.

12. Published non-standard, tailor-made rulings:

- Letter of 15 March 1990 from the State Secretary for Finance (No. DB 90/1475);
- Letter of 20 February 1992 from the State Secretary for Finance (No. DB92/831);
- Letter of 7 January 1993 from the State Secretary for Finance (No. DB92/6363);
- Decree of 16 September 1994 (No. V-N1994, p. 3018) issued by the State Secretary for Finance;
- Letter of 11 October 1994 from the State Secretary for Finance;
- Letter of 14 December 1994 from the State Secretary for Finance (No. DB94/4108M);
- Decision of 18 June 1999 (No. WJB99/534) taken by the State Secretary for Finance, V-N1999/31.27;

- List of non-standard rulings for the period from 1995 to 1998, as published in *Fiscaal up to Date* of 7 December 1999, No. 1999-1854, p. 5 ff; and
- List of non-standard rulings for the period from 1999 to mid-September 2000, as included in Annexe 4 to the letter of 20 November 2000 (No. G2000-00454) from the State Secretary for Finance to the Lower House of the Netherlands' Parliament.

The Decree of 18 December 2000 (No. IFZ2000/1327M, transfer of goodwill to a permanent establishment in the Netherlands) is repealed as of 1 April 2001, given that its contents are incorporated into the present decree.

PORTUGAL

REPORT PRESENTED BY THE PORTUGUESE REPUBLIC

Taking into consideration the working programme of the Code of Conduct (Business Taxation) Group, in particular the presentation of a report until 10-10-2001, and:

Whereas the sole unique Portuguese measure "classified" as harmful in the "Primarolo Report" was the measure B6, concerning the financial activities of Madeira's Free Trade Zone (ZFM);

Whereas it is a special measure with peculiar features and, as such, it must be duly assessed by the Code of Conduct Group and that such measure must be included within the scope of state aids regime of fiscal nature, as it constitutes a component of a unitary and consistent development policy of a small and furthermost island with strong constraints and structural deficiencies not only at economic but also at social level;

Whereas the Commission has successively approved this regime under the state aids regime, with effects up to 31-12-2011, being the term of the last authorisation up to 31-12-2000;

Whereas under such scope, the above referred measure should have been carefully assessed by the Code of Conduct Group, particularly the submitted reports on its proportionality to the desired economic goals, under the terms of paragraph G of the Code;

Whereas as opposed to the methodology adopted relatively to all the other member-States delegations, the second report submitted by Portugal according to paragraph G of the Code of Conduct, has never been discussed within the Group;

Whereas Portugal doesn't agree with the sustained assessment of measure B6 and has clearly underlined this position on footnote nº 8 of the "Primarolo Report";

Whereas under the scope of State aids of regional nature, the Commission took investigation proceedings against the regime in respect to the year 2000, taking into account the new guidelines regarding State aids of that nature;

Whereas relevant changes were brought about on the fiscal regime applicable to financial activities of Free Trade Zone, to be in force from the 1st of January 2001 to the 31st of December 2006, in particular the introduction of progressive increase of the corporate income tax rates, such changes being in a stage of negotiation with the Commission in the context of State aids of regional nature;

The Government of the Portuguese Republic states the following:

1. The objections that were stated by Portugal in the past, in respect to the procedure adopted in the assessment of measure B6 concerning financial activities of the Free Trade, are still valid.

In fact, the measure has never been duly assessed from the perspective of its respective proportionality to the desired economic goals, as opposed to what is foreseen in paragraph G of the Conduct Code. Portugal maintains all the objections expressed on footnote nº 8 added to the Primarolo Report, restating its total disagreement with the "classification" of the measure as harmful and with the procedure adopted for such purpose.

2. Concerning the licensing of new entities under the regime, in as much as the Commission has taken investigation proceedings in respect to the year 2000 and considering that some amendments to the fiscal regime are under negotiation. These amendments will apply as from o1-01-2001 and, as such, no new entities have been licensed since 01-01-2000.

3. Regarding the measure rollback we consider that the rollback of a measure can not take place, if this measure has never been duly assessed harmful.

On the other hand, we would like to point out that the ECOFIN council has never formally approved the Primarolo Report.

Nevertheless, according to what we have already mentioned, Portugal has introduced relevant amendments to the regime in the context of State aids of a regional nature to be in force from 01-01-2000 to 31.12.2006. Among those amendment we would like to underline the progressive increase in corporate income tax rates. The above mentioned amendments are being negotiated with the Commission, in the context of the respective notification as State aids of regional nature.

SPAIN

ROLLBACK – INFORMATION ON THE SPANISH MEASURES

As was agreed at the meeting of the Code of Conduct Group on 28 June 2001, the Spanish delegation hereby reports on the administrative and legislative processes carried out and still to be executed in order to roll back the Spanish measures assessed positively within the Code of Conduct Group, particularly with regard to the new entries.

- **A4: Control, coordination and financial centres in the Basque Country**

  As has already been notified to the European Commission on past occasions, at meeting No 1/2000 of the Spanish State-Basque Country Joint Committee on Tax Rates on 18 January 2000 an undertaking was given by the Provinces of Álava, Guipúzcoa and Vizcaya to abolish the coordination centres provided for in their respective legislation.

  Only Vizcaya's measure has still to be abolished. We hope that by 31 December 2001 it will be abolished or else that the undertaking will be given not to make further authorisations.

- **A5 Control, coordination and financial centres in Navarra**

  Under the first agreement reached by the Spanish State-Community of Navarra Cooperation Committee, meeting on 16 January 2001, Regional Law 8/2000 of 10 November 2000 abolished the coordination centres provided for in its legislation.

- **C25: Investigation and exploitation of hydrocarbons**

  With regard to the tax scheme for hydrocarbon prospection and exploitation, under Chapter X of Law No 43/1995 of 27 December 1995 on corporation tax, the Government wishes to meet the time limits set, taking the opportunity afforded by a general overhaul of corporation tax, currently under consideration.

The scheme is not implemented through administrative authorisations, but applies automatically. For this reason, before abolishing the scheme, it is not possible to carry out any legal measure preventing the entry of new beneficiaries.

Nevertheless, despite the fact that entry into the tax scheme does not require an authorisation, it would be necessary to deal with the administrative process for obtaining a permit, authorisation or administration concession in order to commence hydrocarbon exploration, prospection and exploitation activities. For this reason, new entries in the tax scheme are unlikely.

Finally, Spain is willing to study, within the Code of Conduct Group, the possibility of withdrawing the reservations contained in the footnotes to the Group's November 1999 report, insofar as the other Member States take a similar view.

UNITED KINGDOM

ROLLBACK OF HARMFUL MEASURES

NOTE FROM THE UNITED KINGDOM

In the November 1999 Report to ECOFIN from the Code of Conduct Group (SN 4901/99), three measures in Gibraltar were identified as having harmful features and sixteen in four UK dependent territories.

In the Code Group and at ECOFIN, the UK has accepted that it should seek the rollback of the measures found harmful in the Group's Report, as part of a balanced programme of rollback.

Under Section M of the Code the UK is committed to ensuring that the Code's principles are applied in its dependent territories "within the framework of their constitutional arrangements". The UK report to the Code Group of November 1998 (13193/98, FISC 179) explained those arrangements. Tax laws are enacted by the directly elected legislative assemblies of the Crown Dependencies and Overseas Territories. In the light of its commitment to the Code of Conduct the UK is actively pursuing the process of rollback. The UK has been engaged in extensive discussion with the governments of Gibraltar and the other dependent territories concerned and has repeatedly made its position clear.

The UK believes that its commitment under Section M of the Code (including on new entrants and the process of rollback) which it reiterates, will most effectively be advanced by a clear demonstration that all Member States are equally determined to apply the findings of the Group as rigorously to themselves as to dependent and associated territories.

Gibraltar

As a European Territory for whose external relations the UK is responsible, Gibraltar is within the European Union as part of UK membership by virtue of Article 299.4 of the Treaty of Rome.

The Group's November 1999 report found that the following measures had harmful features:

A017 Gibraltar 1992 Companies

B012 Exempt (offshore) Companies and Captive Insurance

B013 Qualifying (offshore) Companies and Captive Insurance

Overseas Territories and Crown Dependencies

The Group's November 1999 report found that the following measures had harmful features:

British Virgin Islands	F056:	International Business Companies
Guernsey (incl Alderney)	F037:	Exempt Companies
Guernsey (incl Alderney)	F038:	International Loan Business
Guernsey (incl Alderney)	F040:	International Bodies
Guernsey (incl Alderney)	F042:	Offshore Insurance Companies
Guernsey (incl Alderney)	F043:	Insurance Companies
Isle of Man	F061:	International Business Companies
Isle of Man	F062:	Exemption for Non Resident Companies
Isle of Man	F063:	Exempt Insurance Companies
Isle of Man	F065:	International Loan Business
Isle of Man	F066:	Offshore Banking Business
Isle of Man	F067:	Fund Management
Jersey	F045:	Tax Exempt Companies
Jersey	F046:	International Treasury Operations
Jersey	F047:	International Business Companies
Jersey	F078:	Captive Insurance Companies

ANNEX 2

The UK's intensive discussions with its Dependent Territories

2001

29 October ***Official-level discussions arranged with Guernsey***

23-26 October ***Ministerial bilateral and multilateral discussion arranged with all Caribbean dependent territories***

17 October ***Official-level discussions arranged with Jersey***

12 October **Official-level discussions with Isle of Man**

9 October **Ministers from Treasury and Lord Chancellor's Department (LCD) meet Guernsey government and officials**

Sept/Oct **Foreign Office Minister in regular discussions with Chief Minister of Gibraltar**

25 September **Annual Overseas Territories Consultative Council. Treasury and Foreign Office Ministers discuss all aspects of international tax initiatives. Cayman, British Virgin Islands, Turks and Caicos Islands, Montserrat and Bermuda in attendance.**

12 September **Ministers from Treasury and Lord Chancellor's Department meet Jersey government and officials**

29 August **Official-level discussions with Isle of Man**

3 August **Six monthly review of international matters as they affect the Crown Dependencies, held by Lord Chancellor's Department– all aspects discussed with both officials and politicians.**

31 July **Chief Minister of Gibraltar discusses Code of Conduct with officials**

24 July **LCD Minister visits Jersey.**

4 July **Treasury Minister visits Isle of Man**

26 June **UK officials visit Isle of Man**

28 April –2 May **UK officials visit Caribbean OTs.**

11 April **UK visit to Jersey for official level meeting.**

6 April **Jersey official level meeting with Chancellor's Special Advisers in London.**

16 February **Home Office Minister visits Jersey**

February **Ministerial letters regarding the Code of Conduct sent to Crown Dependencies, held at HMT – all aspects discussed at official level.**

12 January **Six monthly review of international matters as they affect the Crown Dependencies, held at HMT – all aspects discussed at official level.**

2000

23 November **Treasury Minister's Bilateral with Jersey**

23 November **Treasury Minister's Bilateral with Guernsey**

22 November **Treasury Minister's Bilateral with Isle of Man**

10 November **Home Office Minister's visits Isle of Man. Council of Ministers discuss Savings Directive.**

3-5 October **Annual Overseas Territories Consultative Council followed by a Tax Seminar covering all aspects of international tax initiatives. Cayman, British Virgin Islands, Turks and Caicos islands, Monserrat and Bermuda in attendance.**

19-21 Sept **Commonwealth Finance Ministers Meeting in Malta – discussions of harmful tax competition/OECD initiatives.**

26 June **Six monthly briefing meeting for Crown Dependency representatives on "Europe and international developments" held at Home Office. All aspects of Tax Package discussed.**

1999

17 December **Six monthly briefing meeting for Crown Dependency representatives on "Europe and international developments", held at the Home Office. All aspects of Tax Package discussed.**

19-20 October **Consultative Council with Overseas Territories. Broad discussion of international initiatives.**