Tax Avoidance

An in-depth audit of tax avoidance in relation to the tax rules and treaty network

Executive summary

The text of the report *Tax Avoidance; An in-depth audit of tax avoidance in relation to the tax rules and treaty network* was adopted on 5 November 2014.
The report was submitted to the House of Representatives on 6 November 2014.
This is the executive summary of the report.

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Executive summary

At the request of the House of Representatives, the Netherlands Court of Audit has carried out an in-depth audit of tax avoidance in relation to the tax rules and the Dutch tax treaty network.

Tax avoidance

Controversial but not illegal

Different countries have different tax regimes. The differences are due not only to a country's tax laws but also to the tax treaties it concludes with other countries. Multinational enterprises generally seek to organise their activities in a way that lowers their tax burden, while remaining within the bounds of the law. This is known as tax planning or tax avoidance. Both tax planning and tax avoidance are legal. A strict distinction must be made between tax avoidance and tax evasion. Tax evasion is illegal. Multinationals do not locate their activities in particular countries solely for tax purposes. Other factors include the presence of an educated workforce, socioeconomic stability and investment protection schemes.

If multinationals are able to continually reduce the tax they pay on their profits, there is a corresponding impact on the tax burden borne by other persons and organisations in all the countries concerned. Small and medium-sized enterprises that operate nationally may be at a competitive disadvantage compared to multinationals. Tax treaties enable multinationals, unlike companies that operate only nationally, to exploit differences in national corporation tax rates, tax bases and withholding tax rates.
The United Nations Conference on Trade and Development (UNCTAD) has observed a growing need for an international strategy on taxation. 'Unsustainable levels of public deficits and sovereign debt have made governments far more sensitive to tax avoidance, manipulative transfer pricing, tax havens and similar options available to multinational firms to unduly reduce their tax obligations in host and home countries.' The OECD's Base Erosion and Profit Shifting Project also seeks to combat tax avoidance, in part by obliging multinationals to be open about the taxes

they pay in a particular country so that other countries can see where profits and losses are recognised. They are not obliged to do so at present.

Audit structure

The House of Representatives asked us to carry out an in-depth audit of the practice of tax avoidance in relation to the tax treaty network, paying particular attention to Special Financial Institutions (SFIs) registered in the Netherlands. SFIs transfer dividends, interest and royalties from a company in a foreign country to a company in another foreign country. The House also asked us to determine how multinationals allocate their assets and liabilities (profit shifting).

Dutch legislation

Het fiscaal klimaat in Nederland is voor internationaal opererende ondernemingen gunstig maar de wet- en regelgeving is als zodanig niet heel afwijkend van de ons omringende landen The Netherlands has a favourable tax climate for multinationals, but the legislation as such is not significantly different from that in neighbouring countries.

For multinationals, individual tax schemes in the Dutch tax system do not differ substantially from those in comparable European countries such as the United Kingdom, Switzerland and Luxembourg. However, schemes directed principally at the avoidance of double taxation do offer some advantages to multinationals, for example:

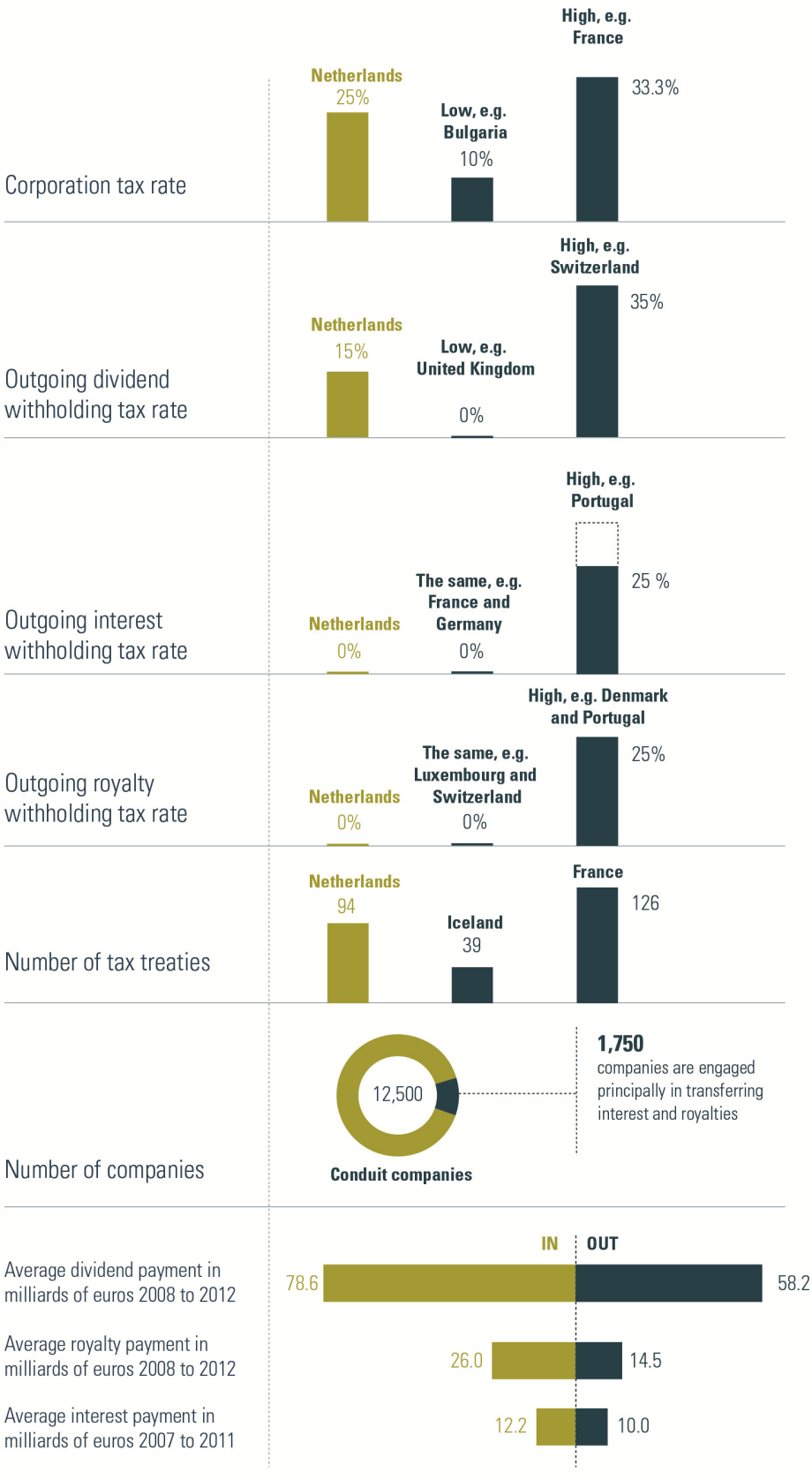
- income earned by foreign holdings is not taxed twice;
- tax is not withheld from interest and royalty payments;
- lower withholding tax rates on incoming dividends, interest and royalties.

Multinational groups take advantage of these treaties by establishing companies in the Netherlands that receive dividends, interest and royalties and then transfer them to other group companies established elsewhere.

Furthermore, multinationals can agree advance tax rulings with the Dutch Tax and Customs Administration to give them assurance on the taxes they pay. The rulings must always comply with Dutch law.

Figure 1 provides facts and figures on tax rates and tax treaties..

Figuur 1 **Facts and figures 2014**



Dutch tax treaty policy

We found that the Netherlands negotiated tax treaties are in accordance with the principles laid down in the Tax Treaty Policy Memorandum 2011, which is in turn based on the model convention of the Organisation for Economic Co-operation and Development (OECD).

The principles of the tax treaties concluded by the Netherlands are laid down in the Tax Treaty Policy Memorandum 2011, which is in turn based on the OECD model convention. We would note that some of the OECD principles are controversial, such as those on the arm's length pricing of intangible assets.

On the basis of six recent negotiation dossiers, we investigated whether the State Secretary for Finance had applied the principles of the tax treaty policy, in so far as they were relevant to the dossiers. That proved to be the case.

We found from information submitted by entrepreneurs to the Dutch central bank (DNB) that substantial dividend, interest and royalty payments passed through the Netherlands, but we have no benchmark to draw further conclusions. We also found that the dividend, interest and royalty payments had increased sharply in the past 10 years.

Tax planning in practice

No fixed patterns but some examples

Tax planning is tailored to take advantage of differences in tax rates and the tax treatment of entities and transactions. As there is no fixed pattern we cannot say how prevalent a particular arrangement is. An arrangement's attractiveness depends on a combination of many factors such as corporation tax rates and tax base, withholding tax rates, options to set off tax withheld in another country, anti-abuse provisions in national legislation or tax treaties, and the presence of an investment protection treaty. By itself, a tax treaty is not an essential condition for an international tax avoidance arrangement; differences in international tax rates can provide sufficient incentive to set up such an arrangement. In many cases, however, a tax treaty offers the taxpayer additional tax savings or additional certainty on the country of taxation.

Examples of structures found in practice include:

- goods flows are organised in such a way that manufacturing, sourcing, distribution and sales are located in different countries. Tax considerations may influence the choices made in the logistics chain;

- the exploitation of tax treaties to minimise tax on profits from holdings;
- the organisation of royalty payments, for example by means of the Double Irish Dutch Sandwich, to locate activities in several countries, e.g. Ireland, the Netherlands, the United States and Bermuda, in order to minimise or defer withholding and profit tax on royalties.

Review of transfer prices

We concluded from the files we reviewed that the Tax and Customs Administration's supervision of the (internal) transfer prices set by multinationals was sound and thorough.

The Tax and Customs Administration's supervision of the (internal) transfer prices set by multinationals is sound and thorough. We drew this conclusion from our reviews of the Administration's reports, reviews of files of requests by multinationals for advance pricing agreements and the Administration's audit files on the arm's length prices set where advance pricing agreements had not been made.

Review of advance rulings and substance requirements

The Tax and Customs Administration reviews and clears advance rulings conscientiously and consistently and in line with procedures.

In the 13 files we reviewed, the Tax and Customs Administration assessed and cleared requests by multinationals for advance rulings in accordance with applicable legislation, policy and case law. The conditions governing advance rulings are clearly laid down in tax legislation and administrative rules. The Administration requests and assesses relevant information and has more than one expert check the ruling before approving it.

Checks of substance requirements stepped up in 2014

Before 1 January 2014, the Tax and Customs Administration checked substance requirements chiefly when deciding whether to issue an in advance ruling. Since 2014, supervision of compliance with substance requirements has been stepped up and more attention has been paid to ex post checks at companies that already have an advance ruling. The Administration has also paid more attention to companies that do not request advance rulings. The Administration made preparations to step up its supervision and carried out its first checks during our audit. It is currently too early to report on the initial results of the increased supervision. We concluded that supervision of substance requirements still needs to be further implemented.

In practice, substance requirements can usually be satisfied simply through the use of a trust office. There need not be a visible presence

with its own personnel in the Netherlands; all the required activities can be performed by a trust office.

Provision of information to the House of Representatives

Information provided to the House of Representatives is correct but has limitations.

The State Secretary for Finance gives parliament information chiefly during the negotiation of a tax treaty or when the House asks questions about current events. The information is consistent with that presented in our report. We would note, however, that the State Secretary is not free to provide unlimited information. Information that can be traced back to an individual company may not be made public. We would also note that the House does not have a complete picture of Dutch policy to improve the tax climate for international businesses and its relationship with international tax planning. Although policy information is provided in the Tax Treaty Policy Memorandum 2011 and when treaties are concluded or renewed, little clear-cut information is available on the results of the policy and related capital flows. Systematic, periodic reports are not issued.

Recommendations

Tax avoidance is an international phenomenon. Dutch measures alone cannot prevent companies following tax routes that lead to the lowest possible tax burden. Countries actually compete with each other to offer the most advantageous tax arrangements. Because international tax avoidance can undermine the sustainability of public finances and a fair distribution of the tax burden, we recommend that the Netherlands support or initiate international measures to prevent unintended effects and enhance transparency. Initiatives by international organisations such as the OECD, G20, European Union and United Nations that actively combat arrangements that are contrary to the spirit of the rules, and are set up to minimise tax, therefore deserve the sustained and active support of the Netherlands.

We recommend that the responsible members of the government:

1. when submitting new or revised treaties, inform parliament of the measures taken to prevent their misuse or unintended use;
2. step up cooperation with treaty partners, giving greater priority to the conclusion and application of tax treaties that:
   a. improve the exchange of information;
   b. prevent legal uncertainty for companies wishing to use a treaty (e.g. by explaining how provisions to prevent misuse will be applied);

c. actively assist the Tax and Customs Administration and the tax authority of the treaty partner where necessary;

3. improve the information provided to the House by issuing a periodic monitoring report on the tax climate for international companies and the use made of it, the amount of money involved, and the impact of measures to combat improper use of tax rules and tax treaties.[1]

If the House of Representatives wishes to receive reliable cumulative information on the size of dividend, interest and royalty payments, the State Secretary for Finance could be asked to collect this information and present it in a monitoring report.

Response of the State Secretary for Finance

The State Secretary was pleased with our conclusion that the Dutch tax climate was attractive to international businesses without being out of step with that in other European countries. He noted that retaining an attractive business climate, in which taxation was just one factor, had the government's constant attention. In pursuing this aim the government's focus was on rules that were consistent with international guidelines and on combating tax avoidance. He also agreed with our other conclusions. The State Secretary referred to the concerns we expressed in our report about the consequences of international tax avoidance for the sustainability of public finances and for an even distribution of the tax burden, and the associated recommendation to support international initiatives and measures to manage the situation. He thought our conclusion significantly supported the government's policy.

The State Secretary made several comments on our recommendation to improve the information provided to the House by issuing a periodic monitoring report on the tax climate for international companies and the use made of that climate, the amount of money involved, and the impact of measures to combat improper use of tax rules and tax treaties.

In our report Combating Money Laundering: State in 2013 (Netherlands Court of Audit, 2014), we referred to the importance of collecting and analysing quantitative and qualitative information on financial flows through the Netherlands, the sharing of information between the parties engaged in combating money laundering, and providing adequate information on these matters to the House of Representatives

[1] We previously highlighted the importance of collecting and analysing quantitative and qualitative information on the payments channelled through the Netherlands, sharing information with the parties combating money laundering and providing adequate information to the House of Representatives in our report Combating Money Laundering: State in 2013.

The State Secretary wrote that wherever possible he already informed the House as fully as possible about the quantitative impact of proposed and existing measures and treaties. He could not deny, though, that it was often impossible to make reliable quantitative analyses. In his opinion, so many factors influenced the tax climate for international businesses and the potential for misuse that it would rarely be possible to measure the impact of an individual measure. Certain aspects of our recommendation were therefore a matter of concern. Periodic reports giving an overview of the tax climate could be issued but the impact of anti-misuse measures was, he thought, difficult to measure. It could not be determined, for example, how taxpayers would have behaved if the measures had not been introduced. Another problem was that even if a measure's impact could be quantified it would take some time before it fed through into the tax figures.

The State Secretary observed that the size of incoming and outgoing dividend, interest and royalty payments to and from the Netherlands was already known from data published by De Nederlandsche Bank (the Dutch central bank) and Statistics Netherlands. The data could be stripped of the influence of Special Financial Institutions to give an indication of the attractiveness of the Dutch investment climate. He suggested conducting a pilot project over the next five years to improve the provision of information to the House, involving a short annual review of developments in the tax climate.

Court of Audit's afterword

We note that the State Secretary's response indicated approval for our recommendations. He considered our concern about the consequences of international tax competition and the associated recommendation to support international initiatives and measures significantly supported the government's policy. We therefore assume that the State Secretary will address this concern in consultation with parliament, partly on the basis of our recommendations. Since one of the recommendations relates to the provision of comprehensive information on this complex matter to the House of Representatives and the State Secretary has proposed that an annual reporting system be established to do so, we suggest that the House consult the State Secretary to discuss how he can best meet its information requirement.

Questions from the House of Representatives and summary answers

The audit questions and related findings are summarised in the table below.

Question from the House of Representatives	**Answer Netherlands Court of Audit**
1a) Can the Court of Audit carry out an in-depth audit of the tax avoidance arrangements found in practice and their relationship with the tax treaty network?	**Yes**. We provide examples of the tax avoidance arrangements found in practice at various places in this report and, where relevant, explain the relationship with treaties. It cannot be said how often a particular arrangement occurs in practice because tax planning is tailored to specific circumstances and the arrangement can differ from one company to another. In general, tax treaties are one of the instruments used in tax planning but are not essential for tax avoidance. The substance and scope of the Dutch treaty network are not exceptional in comparison with neighbouring countries.
1b) Can the Court of Audit carry out an in-depth audit of the legislation that enables tax avoidance?	**Yes.** Tax planning is enabled by international differences in tax legislation and the existence of tax treaties. This report considers such aspects as differences in corporation tax rates and bases, the levying of withholding taxes and different setoff methods in relation to Dutch treaty policy.
1c) Can the Court of Audit carry out an in-depth audit of ruling practice in the Netherlands?	**Yes.** Further to our audit of the legislation (see question 1b) we obtained information from the Tax and Customs Administration on its assessment process (ex ante) and supervision (ex post) of compliance with the relevant requirements, including substance requirements. We held interviews and studied files. We concluded that supervision is organised effectively. About 30% of the qualifying companies opted to conclude advance pricing agreements (APAs) or advance tax rulings (ATRs) with the Tax and Customs Administration. Until 1 January 2014, the Administration checked substance requirements when deciding whether to issue an advance ruling. This ex ante supervision was conscientious and consistent. Since 2014, supervision of compliance with the substantive requirements has been stepped up and the Administration has paid more attention to companies that do not conclude advance rulings. Random checks are carried out based on a risk analysis. We were unable to determine the effect of the stricter supervision owing to its recent introduction.
1d) Can the Court of Audit investigate how account is rendered on the above (questions 1a-1c) to the government and parliament?	**Yes.** Rendering account to the government is principally an internal matter for the State Secretary, policy departments and the Tax and Customs Administration. Our audit found no reason to question the information provided by the Administration to the State Secretary for Finance. The members of the government responsible for Finance and Ministers of Finance, Foreign Affairs, and Foreign Trade and Development Cooperation provide information to parliament on many occasions, when negotiating tax treaties and in response to questions in the House following press publications and the publication of reports. Nevertheless, because of the 'tailor-made' approach which is inherent in both tax planning and treaty

	negotiotions and due to the absence of data on payments at aggregate level, the government does not have a complete picture of the Dutch tax climate for international companies and its relationship with international tax planning. Systematic, comprehensive, periodic reports are not published. Account is rendered to parliament principally in response to questions in the House or on the submission of new treaties or legislation.
1a-d) Can the Court of Audit consider as many arrangements as possible, not only special financial institutions (SFIs), or letterbox companies, but also, for example, how multinationals allocate their assets and liabilities (transfer pricing and profit shifting)?	**To a limited extent.** Arrangements are tailored to specific circumstances. We restricted ourselves to the commonest categories, i.e. arrangements centring on transfer pricing and dividend, interest and royalty payments. We also considered hybrid legal forms. Our report uses the term SFIs only where information is available from the Dutch central bank (DNB). Otherwise we use the same term as the Tax and Customs Administration, conduit companies.
2a) Can the Court of Audit investigate the extent to which SFIs satisfy the substance requirements, how supervision is organised and how substance requirements are enforced?	**Not completely.** DNB knew of about 12,000 active SFIs in 2012. The Tax and Customs Administration, which supervises compliance with the substance requirements, uses the term conduit companies instead of SFI, and knew of about 12,500. The 12,500 conduit companies together constitute about 10,000 taxpayers. About 1,750 of them are financial service entities. Financial service entities are taxpayers whose activities consist principally of receiving and paying interest and royalties. They have long had to comply with the substance requirements. The other conduit companies, which act chiefly as holding companies, have had to comply with the substance requirements since 1 January 2014, but only if they wish to conclude an APA/ATR with the Administration. Before the adoption of a new inspection plan in 2014, the Administration checked a financial service entity's request for an APA/ATR chiefly in advance. A plan for ex post supervision was introduced in 2014. As the plan was only recently introduced, very few results are known and we cannot state the extent to which substance requirements are satisfied in practice.
2b) Can the Court of Audit make a better estimate of the revenue raised from dividend tax?	**No.** We cannot make a better estimate than what the House already has. We can determine from the Minister of Finance's central government annual financial report only the total revenue raised from dividend tax in the Netherlands. The figure was €2.2 billion in 2013. The impact of tax treaties and non-resident groups on the size of this revenue cannot be determined. The Administration does not keep overarching information on dividends paid by multinationals and their relationship with dividend tax or exemption from dividend tax. It can provide information, however, from the APA/ATR team of the Large Companies Local Tax Office in Rotterdam, which is responsible chiefly for conduit companies. Furthermore, many multinationals registered in the Netherlands carry out a wide range of activities here and, apart from concluding advance rulings, do not fall under the competence of the APA/ATR team. The information from the APA/ATR team indicates that multinationals, in so far as they do fall under the team's competence, apply

	the treaties and European legislation to minimise their dividend tax payments (to less than 1% instead of 15%).
3a) Can the Court of Audit outline the size of dividend tax exemption, and interest and royalty payments?	**Partially.** The Tax and Customs Administration does not generate comprehensive information on dividend, interest and royalty payments declared in multinationals' corporation tax returns. Nor does the Administration have information on dividend tax or dividend tax exemption based on tax treaties. We received information from DNB on incoming and outgoing dividend, interest and royalty payments, in so far as they could not be traced to individual companies. We found that the volume of dividend and royalty payments in particular had increased sharply in the past 10 years.
3b) Can the Court of Audit provide an insight into the rules on dividend tax exemption, and interest and royalty payments?	**Yes.** Anti-misuse provisions in treaties and international agreements are also relevant in this context. They regulate access to treaty benefits and are directly related to the substance requirements.
3c) Can the Court of Audit provide an insight into the supervision of the rules on dividend tax exemption, and interest and royalty payments?	**Yes.** We provide an insight into how supervision is regulated and express an opinion on how the Tax and Customs Administration performs this task. Supervision covers transfer pricing, compliance with APA/ATR conditions and ex post supervision of the companies that fall under the competence of the APA/ATR team. In the cases we reviewed, the supervision was satisfactory.