

## **PROPOSAL TO DISALLOW UNILATERAL DOWNWARD TRANSFER PRICING ADJUSTMENTS**

**Yesterday, the Dutch Ministry of Finance kicked-off an internet consultation on a draft proposal (the “Draft Bill”) to amend the Dutch codification of the arm’s length principle. The Draft Bill intends to disallow, as of 1 January 2022, downward transfer pricing adjustments to the taxable profit of Dutch group companies, to the extent that the corresponding upward adjustment is not included in the taxable base of the foreign counterparty to the transaction. Group companies operating in the Netherlands are recommended to review their existing advance pricing agreements and / or tax rulings as well as their transfer pricing policies to assess the impact of this proposed amendment of the arm’s length principle.**

### **BACKGROUND**

Over the last years, the Dutch government has focused intensively on combatting tax planning schemes. This, for instance, resulted in the introduction of a conditional withholding tax on certain interest and royalty payments, and the Dutch implementation of the EU Anti-Tax Avoidance Directive II (“ATAD II”). ATAD II, amongst others, denies the deduction of payments made on hybrid instruments and to hybrid entities. However, ATAD II did not affect ‘transfer pricing mismatches’, such as unilateral downward transfer pricing adjustments.

### **CURRENT TRANSFER PRICING RULES**

Based on Dutch transfer pricing rules, a taxpayer has to deal with related entities on arm’s-length terms. This means that where conditions (transfer prices) of the transactions between related entities differ from market conditions, the entity’s profit will be determined as if “arm’s-length” conditions applied.

This may result in a unilateral downward adjustment of the (commercial) profit of a Dutch group company, i.e. not mirrored by a corresponding adjustment at the counterparty. This concept of a unilateral downward adjustment was confirmed by the Dutch Supreme Court in a situation where an arm’s length interest was deducted on an interest free intercompany loan granted to a Dutch company.

The downward transfer pricing adjustment is currently not dependent on the recognition of the corresponding upward adjustment in the other jurisdiction. As an example, this means that it is entirely possible that certain costs are tax-deducted in the Netherlands based on the arm’s length principle (a so-called ‘deemed deduction’), but that there is no pick-up of the revenues elsewhere.

### **PROPOSAL**

The Draft Bill proposes to only allow downward adjustments to the extent that a corresponding adjustment is included in the taxable basis in the other jurisdiction. This implies that e.g. deemed deductions that are not picked up elsewhere, would no longer be allowed.

The Draft Bill also impacts situations where the country of the other group company does not levy corporate income tax at all. However, the Draft Bill should not have an impact if the corresponding adjustment is effectively untaxed due to offset against losses available for carry forward or is taxed at a rate of 0%.

In addition, under the Draft Bill the purchase price of an asset can no longer be adjusted upwards to the fair market value (a ‘step-up in basis’) to the extent that the fair market value of the asset is not taken into account in the country of the seller. This would have the effect that taxpayers can no longer claim a tax-deductible depreciation of such fair market value. The proposed measures also limit the tax depreciation of such assets acquired in the five years prior to FY2022.

The Draft Bill does not provide for grandfathering rules. Therefore, if enacted, it is expected that existing rulings and / or advance pricing agreements in which a unilateral downward transfer pricing adjustment is endorsed will expire as of 1 January 2022, as such rulings and advance pricing agreements generally include a termination clause in case of a change of the relevant laws and regulations.

### **STATUS**

This Draft Bill is currently subject to public consultation and input can be provided until 2 April

2021. We note that that parliamentary elections will be held in the Netherlands on 17 March 2021. Although there is a possibility that a new government will not introduce this Draft Bill, this is currently not expected.

#### **AUTHORS' NOTE**

The Netherlands has always been proud to be among the few countries in the world to apply a truly consistent interpretation of the arm's length principle: non-arm's length conditions are to be adjusted, regardless of whether the counterpart country also applies the holy principle of transfer pricing as it was intended. Arguably, the conceptually superior way to solve transfer pricing mismatches is that other countries start following our example. In practice however, it seems inevitable that the Netherlands gives in to the overwhelming international pressure to take the easy road in the battle against effective tax structuring.

#### **TAKE AWAY**

Groups with companies in the Netherlands applying contractual terms and conditions that deviate from the arm's length principle, should closely follow the legislative process of this Draft Bill. In anticipation of its implementation, it is well-advised to review the transfer pricing policies and to assess whether existing rulings and / or advance pricing agreements would be terminated as of 1 January 2022.

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