10th Annual International Tax Developments Seminar

Summary

9 April 2024

During the 10th Annual International Tax Developments Seminar, several Loyens & Loeff tax experts updated the participants on their insights on the latest international tax developments. OECD and above all numerous EU developments, amongst others, in the field of minimum taxation and transfer pricing remain amongst multinational enterprises' challenges.

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Latest news on transfer pricing - OECD Pillar One Amount B

Natalie Reypens & Jan-Willem Kunen

Goals and key points

Pillar One consists of Amount A and Amount B, where we focus on Amount B. The final report on Amount B was published on 19 February 2024. The main objective of Amount B is to simplify and streamline the pricing of baseline marketing and distribution activities. However, it remains doubtful whether this simplification will actually be achieved.

Amount B has no revenue threshold and therefore a very broad application. The application of Amount B is optional for jurisdictions for financial years as of 1 January 2025. This means that jurisdictions may choose to apply it as a safe harbor or make it mandatory for all marketing and distribution activities within its scope. A safe harbor would be more in line with existing regulations for low value-added services. Alternatively, if it would become mandatory in certain jurisdictions, it becomes more important to analyse whether you are in scope or not.

The Amount B report will be an annex to Chapter IV of the OECD Transfer Pricing Guidelines (Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes).

Qualifying transactions

The first step is to determine which transactions would qualify for Amount B. There are two types of transactions that would qualify for Amount B:

- Buy-sell marketing and distribution arrangements where the distributor purchases goods from one or more associated enterprises for wholesale distribution to unrelated parties except end consumers; and
- Sales agency and commissionaire arrangements where the sales agent or commissionaire contributes to one or more associated enterprises' wholesale distribution of goods to unrelated parties except end consumers.

Scope

If there is a qualifying transaction, the second step is to evaluate whether the transaction is in scope. There are several requirements for being in scope:

- A transaction should be able to be priced using a one-sided transfer pricing method;
- The tested party in the qualifying transaction must not incur annual operating expenses lower than 3% and greater than 20% to 30% of its annual net sales;
- Amount B only applies to goods and not to non-tangible goods, services or the marketing, trading or distribution of commodities; and
- The tested party should not have any non-distribution activities, unless the distribution activities can still be adequately assessed separately.

Pricing methodology

The third step in the application of Amount B is the pricing method. The Transactional Net Margin Method Return on Sales ("TNMM RoS") is selected as the most appropriate method. The OECD uses a global distribution database to create a periodically updated matrix with a range of 0.5% for each activity. The position in the table is determined based on industry grouping and factor intensity, which is the ratio of operating asset to sales (operating asset intensity) and the ratio of operating expense to sales (operating expense intensity).

As this table is based on a global dataset, there are jurisdictions where the table may need to be modified. For qualifying countries that are not accurately reflected in this global dataset, an adjustment would be made based on their sovereign credit rating. As the table is composed of data from more developed countries, this adjustment would generally be relevant for developing countries.

Finally, there is an operating expense cross-check to verify that the operating expenses to sales returns are in line with what the OECD expects as the cost profile for these types of entities. The operating expense cross-check may result in an adjustment of the Return on Sales to ensure an equivalent return on operating expenses within the set values.

Based on the above, a percentage can be selected from the table. The steps described above, i.e., qualifying the transactions, determining the scope and identifying the characteristics of the transaction, are not a simplification of the current transfer pricing ("TP") methodology. However, the table presented as Amount B, which provides the percentages and replaces the requirement for a benchmark, is such simplification with respect to the current TP methodology.

Documentation and tax certainty

The documentation requirements for the determination of Amount B will be similar to the local file documentation. Therefore, there would be no (or perhaps a limited) additional documentation burden for entities currently already within the scope of the master file/local file documentation. Since there is no revenue threshold for the application of Amount B, companies that do not have a local file obligation could also apply Amount B. However, the application would result in an additional burden for these companies as they would then be required to prepare local file style documentation. It is required to confirm application of Amount B for a minimum of 3 years in the documentation upon applying it for the first time.

If a dispute arises regarding the application of Amount B, the regular mutual agreement procedure applies to resolve these disputes. The forthcoming update of the Commentary to Article 25 of the OECD Model Tax Convention introduces new dispute resolution rules for discussions on the application of Amount B in a situation where jurisdictions would apply Amount B in different ways.

Furthermore, if you currently have a bilateral or multilateral Advance Pricing Agreement ("APA") or a Mutual Agreement Procedure ("MAP") in place, these will continue to apply and would not be affected by the introduction of Amount B.

Key takeaways

- Depending on a jurisdiction's implementation, Amount B will be a safe harbour or may be mandatory for interpreting how the arm's length principle applies to baseline buy-sell marketing and distribution activities.
- Amount B only applies to wholesale distribution of tangible goods.
- Amount B uses a pricing matrix based on industry grouping, assets, and expenses. This simplifies pricing, but the functional analysis and potential qualification discussions will remain.
- Geographical adjustments should be made depending on the type of jurisdiction based on its sovereign credit rating.
- The documentation requirements would be in line with local file guidance.
- The application of Amount B requires consent to apply the approach for a minimum of 3 years.
- The regular Mutual Agreement Procedure ("MAP") is in place to resolve disputes, with additional Amount B provisions to be introduced.

Latest news on transfer pricing - Pillar Two

Natalie Reypens & Jan-Willem Kunen

Covered transactions

This section will only cover the Transfer Pricing ("TP") aspects of Pillar Two. Pillar Two has an arm's length provision included in the GloBE rules. However, this is not linked to the OECD TP Guidelines.

Covered transactions for Pillar Two are intragroup transactions between (foreign) entities (or permanent establishments). Domestic transactions would generally not be covered by Pillar Two unless they generate a loss for GloBE purposes.

Pillar Two requires that the covered transactions are consistent with the arm's length principle. Pillar Two is therefore predominantly aimed at consistent pricing, rather than arm's length pricing in line with the OECD TP Guidelines. For example, timing differences pursuant to TP provisions are not covered unless they have an impact on deferred tax accounting (the mechanism in GloBE to cover timing differences).

It is noteworthy that the subject-to-tax-rule is based solely on payment and makes no reference to arm's length pricing.

Key takeaways

- The Pillar Two rules explicitly cover intragroup transactions, also with permanent establishments. These transactions need to be consistently priced for GloBE purposes (and not necessarily at arm's length priced). For consistent pricing, it is necessary to have sufficient alignment between the financial accounts used for GloBE and the tax accounts in order to avoid mismatches. Specific local TP rules, such as the Dutch TP mismatch rules and rules in respect of non-businesslike loans, may make such alignment difficult as these would generally not be accounted for in the financial accounts. This could result in discrepancies between the financial accounts used for GloBE and the tax accounts.
- It is strongly recommended to avoid year-end adjustments and adjustments in later years. Year-end adjustments may result in differences between the financial accounts used for GloBE and the tax accounts. This could result in undertaxed jurisdictions due to an effective tax rate ("ETR") below 15%.
- Not all adjustments have been defined for GloBE purposes, especially in the case of unilateral local adjustments.
- Through bilateral APAs, taxpayers can increase tax certainty as these are also binding for GloBE purposes.
- There is a possible incentive to settle audits or Mutual Agreement Procedures ("MAPs") in certain years to increase/decrease covered taxes. Therefore, not only regular considerations in terms of timing a settlement such as tax interest should be considered, but also the potential Pillar Two impact.
- There is an outstanding question whether the current MAP mechanism is adequate to settle TP discussions under Pillar Two, as there might not always be a direct link to a transaction.
- There is a new role for Country-by-Country Reporting ("CbCR"). In previous years, the CbCR was less detailed, while for Pillar Two, the CbCR must be qualifying to serve as a transitional safe harbor. In addition, the CbCR must account for EU public CbCR as of 2025, and for some countries already as of 2024. Therefore, the CbCR needs to be more accurate and the high-level approach of previous years would no longer be sufficient.

Documentation as a tool of risk mitigation

State of play

In recent case law, the importance of documentation in a discussion with the Tax Dutch Authorities has been emphasised. There are many recent cases where we see that discussions are complicated by the lack of good documentation. Although taxpayers often believe that once a master file and a local file have been prepared, the job is done, there is much more to be done to be better prepared for a potential discussion.

What we see in practice

We see more discussions with the Tax Authorities and more of those discussions ending up in court. The Tax Authorities place higher demands on the content and quality of Transfer Pricing ("TP") documentation. The Tax Authorities indicated that while they see an upward trend in the quality of documentation, they are often still dissatisfied with the content. As an example, the Tax Authorities would like more information in a local file on the supply chain and the people through organisational charts, salary scales, etc.

Additionally, the Tax Authorities are more likely to refer to other documentation and sources than just the master file and local file when a discussion arises. For example, by consulting public sources, websites, LinkedIn pages and internal presentations.

According to taxpayers, TP documentation is often just a mandatory formality that should not cost too much money and time. When documentation is requested by the Tax Authorities, taxpayers are often confronted with the fact that the people within the group who were responsible for certain decisions or who had access to information are no longer working in the group. We also see that taxpayers have no documentation at all or inconsistent documentation.

As a result, the taxpayer is often in a less favourable position at the start of an audit and/or when ending up in court.

Case law

There have been five recent Dutch (TP) cases where documentation played a key role.

- **Court of Amsterdam, 26-05-2020 – Arm's length character of (interest on) loan**:
  The taxpayer received a loan of EUR 650 million and prepared TP documentation to justify that this loan was not a non-businesslike loan for Dutch tax purposes. The taxpayer argued that the loan was divided into 8 tranches of approximately EUR 100 million, with each of the tranches having its own terms and conditions, and a different risk profile. Therefore, according to the taxpayer the arm's length character of the tranches should be assessed separately. The court did not agree and referred to the wording of the loan documentation, where there was a clear reference to "the available amount". The court stated that the civil law qualification is to treat it as one loan as "the available amount" refers to the total amount of the loan.

- **Court of Den Haag, 14-07-2023 – Interest and commitment fees**:
  The taxpayer had attracted various loans and paid, besides interest, also commitment fees on the loans. The Tax Authorities challenged the arm's length character of the interest rates and the commitment fees. The taxpayer argued that the interest and the commitment fees should be considered as an "all-in rate" from an economic perspective, and that the TP analysis needed to be prepared for this all-in rate. According to the court, there is an explicit difference between interest and commitment fee in the agreement. This civil law qualification is to be followed and, therefore, the TP analysis could not be followed as it should have accounted for both elements.

- **Court of Noord-Holland, 26-04-2022 – Interest on shareholder loan**:
  In this case, the Tax Authorities place a higher burden on the substantiation of financial transactions. The taxpayer received a shareholder loan with an interest rate of 8%. The Tax Authorities challenged the interest rate and performed an alternative TP study resulting in a much lower rate of approximately 2%. The court first rejected the benchmarks performed by the taxpayer and the benchmark performed by the Tax Authorities on the basis of quality. The court set the arm's length rate at 4.5% without any further insight into the underlying analysis.

- **Court of 's Hertogenbosch, 13-04-2022 – Price charged on the sale of goods**:
  The price for a particular transaction differed significantly from the prices set out in the TP documentation. According to the court, this was inconsistent with the TP policy and no justification was provided for these inconsistencies. The court relied on the master file documentation, which had been available for many years, was updated annually, and contained detailed information. It was used as the basis for setting intercompany prices. The fact that the policy was not followed for this particular transaction led the court to conclude that the price was not at arm's length.

- **Court of Noord-Holland, 15 December 2023 – Termination of activities**:
  This case covers different intercompany transactions, one of them being a business restructuring. According to the taxpayer, the activities had been terminated in the Netherlands, whereas the Tax Authorities argued that there had been a transfer of activities outside the Netherlands and that this triggered an exit tax. The court followed the position of the Tax Authorities and based its decision on all available information, including internal presentations of the taxpayer in addition to the underlying agreements. Because there were inconsistencies in the TP documentation and internal communication of the taxpayer concerning the business restructuring, the court ruled that the burden of proof is on the taxpayer if the taxpayer claims that the information is not accurate, whereas it is very difficult to argue against one's own documentation.

Key takeaways

- It is important to review the local files, master files and other TP documentation in order to identify the risks in that documentation. It should be noted that careful drafting and specific information on risk allocation is important.
- Other documentation that is presented to the Tax Authorities beyond the local file and master file, should be consistent with the TP policies.
- In the case of a business restructuring, there must be sound documentation of the decision making, the reasons for the change and the realistically available options. Other documentation, such as internal presentations and minutes of board meetings, must also be carefully drafted to ensure alignment.
- For financial transactions, there is much debate on how to properly benchmark financial transactions, and these are often challenged. Therefore, it should be considered to use multiple TP methods or data, i.e., benchmark, market studies and/or modeling.

New Pillar Two insights

Charlotte Kiès, Steffie Klein and Fabian Sutter

The Global Anti-Base Erosion ("GloBE") Rules have entered into effect in multiple jurisdictions, both within and outside the European Union.

What to consider when reviewing the application of safe harbours, as well as the scope of application of the GloBE rules and when preparing for compliance obligations?

The Transitional CbCR Safe Harbour

In the guidance of December 2022, the Transitional CbCR Safe Harbour was introduced. It was introduced as a measure for the first three years in which the GloBE Rules can be applicable to an in scope group. If one of the three Transitional CbCR Safe Harbour tests is met for a tested jurisdiction, there is no need for a complicated GloBE calculation. However, you still have the obligation to file a GloBE Information Return. No complicated GloBE calculation is considered a relief for in scope groups as they transition into the GloBE Rules. The question is: what is the starting point for your Country-by-Country report? Can you only use the consolidated financial statements applied by the Ultimate Parent Entity ("UPE")?

As early as the introduction of the Transitional CbCR Safe Harbour, it became clear that this is not the case. You need to have qualified financial statements and a qualified CbCR. However, local financial statements could also qualify as qualified financial statements. In the guidance of December 2023, it became clear that for each tested jurisdiction, you can choose what is the best accounting standard to use for each tested jurisdiction. This means you can either use the UPE accounting standards or the local financial accounting standards. Therefore, consider what is the best accounting standard for a jurisdiction when you prepare the CBC report. What the best accounting standard is might not be something to be determined at head quarter level only. You might need local involvement of your subsidiaries for this.

An unanswered question is whether you can switch to other accounting standards in a next year.

The QDMTT Safe Harbour

Jurisdictions are in the position to allow local financial accounting standards for the calculation of the Qualified Domestic Minimum Top-Up Tax ("QDMTT"). If allowed, a choice must be made by the QDMTT jurisdiction itself whether or not to allow such local financial accounting standard, in order for the QDMTT to qualify for the QDMTT Safe Harbour. Either the UPE accounting standards or the local standard can be used for the calculation of the domestic Top-up Tax. The choice made applies to all Constituent Entities in that jurisdiction. It is important to look at the difference between these accounting standards as differences between accounting rules of these standards may impact the calculation of the effective tax rate ("ETR"). For instance, the amortisation of assets may be treated differently under IFRS and certain local accounting standards which may impact either the relevant income for Pillar Two purposes or the calculation of deferred taxes.

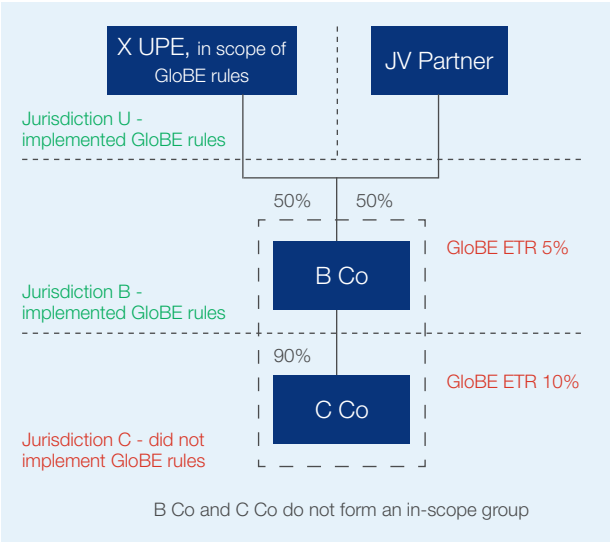
Implementation differences between jurisdictions regarding the calculation of the QDMTT are also important. For example, whether withholding taxes are considered as an Adjusted Covered Tax or not. If an entity distributes a dividend subject to a residual withholding tax and such tax is not taken into account for the calculation of the QDMTT, this could potentially lead to a higher Top-up Tax depending on what the blended tax rate is. This example applies to Switzerland and was probably not intentional.

GloBE and non-consolidated Entities

GloBE rules apply to Constituent Entities of your group, which are entities that are included in your consolidation on a line-by-line basis. However, also entities that are not included on a line-by-line basis can be affected by the GloBE rules.

Joint Ventures

The GloBE rules can for instance also affect joint venture structures.

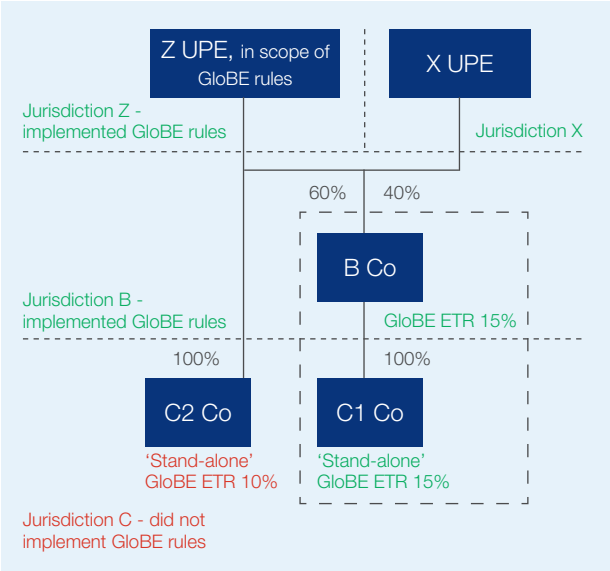


In the example above, B Co and C Co can be affected by the GloBE Rules if they are considered a Joint Venture respectively a JV Subsidiary within the meaning of the GloBE Rules. When reviewing a group, it is of the utmost importance to review the equity investments accounted for under the equity method and to check whether they fall under the definition of a Joint Venture under the GloBE Rules. Be aware that the definition of a Joint Venture under the GloBE Rules is not necessarily the same as the definition under accounting rules.

JV Group entities, such as B Co and C Co, are subject to a partial jurisdictional blending. For the determination of the ETR in a jurisdiction you only look at the JV Group entities in that jurisdiction. There is no jurisdictional blending with other "regular" Constituent Entities of the Joint Venture partners, such as the X UPE group or the JV Partner group. JV Group entities cannot collect Top-up Tax under the Income Inclusion Rule ("IIR") or Undertaxed Payments Rule ("UTPR"). If a JV Group entity is low-taxed, Top-up Tax will be levied at the level of the in scope group of the joint venture partners, such as X UPE and the JV Partner. They will be taxed pro rata to their shareholding in the JV Group Entity. However, a Top-up Tax can be levied at the level of a JV Group Entity itself, such as B Co, if the jurisdiction has implemented the QDMTT. As a result, a joint venture partner that is not in scope of the GloBE Rules can be economically affected by the fact that the other joint venture partner is in scope.

Minority shareholders: risk of POPE structure

In other split-ownership structures the effect of the GloBE rules may even go further. For instance, in the case of so-called Partially Owned Parent Entities ("POPE") structures.



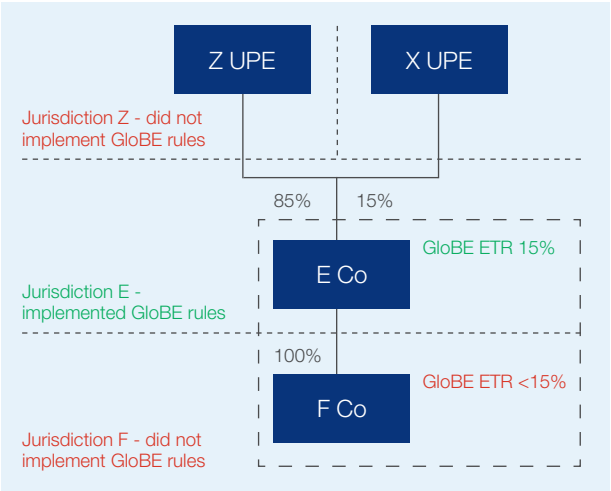
Any Top-up Tax collected under the IIR is in principle levied at UPE level. However, the rule regarding the POPE has priority over this. A POPE is an entity that is for at least 20% held by non-group entities. In the example above, the necessity to levy Top-up Tax under the IIR switches from Z UPE to B Co, being a POPE. This can economically affect the minority shareholder, such as X UPE, if the jurisdictional ETR of the group of Z UPE in one of the jurisdictions is less than 15%, pursuant to the jurisdictional blending which is required for POPE structures even in case the invested entities individually have an ETR of at least 15%. As jurisdiction C did not adopt the GloBE Rules and as a result did not implement the QDMTT, the Top-up Tax will not be collected by that jurisdiction. B Co, being the POPE, is required to collect the Top-up Tax under the IIR. It does not matter whether X UPE is in scope of the GloBE rules or not.

This is an unexpected and perhaps unwanted outcome given the fact that the minority shareholder of the POPE does not enjoy the benefit of the reduced ETR since, in the example above, the minority shareholder only holds a minority stake in a group of which the ETR in general is 15%. Therefore, you should be careful in less than 100% ownership structures (POPE structures), even if you do not hold control and the entity held is not a Joint Venture.

Timely action should be taken to mitigate the impact of Top-up Tax payable resulting from a too low ETR in the structure of the majority shareholder. It is recommended to review the possibility of restructuring and to cater for the impact in shareholders' agreements.

Less than 20% minority shareholder

Also, a minority shareholder holding less than 20% runs the risk to be economically affected by Top-up Tax without benefitting from a reduced ETR.



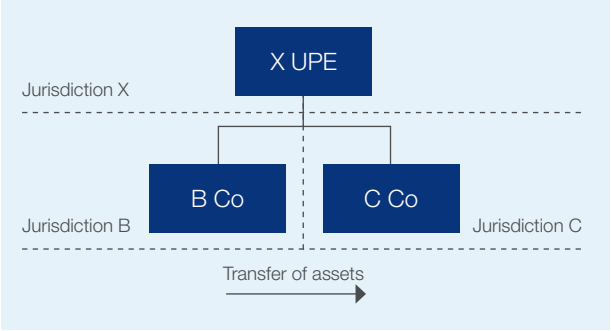
This risk occurs if the majority shareholder has not (yet) implemented the GloBE Rules. This namely results in the same consequence: the Top-up Tax obligation switches from the UPE to the intermediate parent entity (IPE).

As a minority shareholder in this IPE, you may also be affected in case of a less than 15% ETR. Unlike the POPE structure, in the example above, the minority shareholder will in this scenario benefit from the lower tax jurisdiction at the lower level of F Co. However, jurisdictional blending with another entity in the Z UPE structure in jurisdiction F could, just as in the POPE structure, negatively affect this outcome.

It is recommended to check whether the jurisdiction of the majority shareholder implemented the GloBE Rules. Delayed introduction of GloBE Rules at UPE level or the level of (in)direct minority owned shareholder might economically impact you. Even if you are not in scope of the GloBE Rules (yet) and the entity in the low-taxed jurisdiction is not part of your group. It is recommended to cater for the impact in shareholders' agreements.

Asset transfers in scope of or preceding the GloBE Rules

Pillar Two has specific rules for asset transfers between Constituent Entities. This notably applies to the value of a transferred asset as well as to the timing.



Whether or not transfers of assets at fair market value between group companies should create an issue, is relevant from a GloBE perspective as well as for the transition phase into the GloBE Rules. What rules apply to the companies involved upon the asset transfer? What accounting method is used and for which entities? How is the transfer of assets itself looked at under these methods? Which accounts are used and for what purpose? Did you book or disclose all your Deferred Tax Assets ("DTAs") related to the asset transfer? What does the transfer of assets mean for the Transitional CbCR Safe Harbour or the GloBE ETR?

Asset transfers can be divided into three periods:

- Asset transfers prior to 1 December 2021;
- Asset transfers as of 1 December 2021 and before Transition Year ("Transition Period"); and
- Asset transfers which are under the GloBE Rules ("Post Transition Period").

Prior to 1 December 2021

Asset transfers prior to 1 December 2021 are pre-GloBE and pre-Transition Period. Therefore, they are out of scope of the GloBE Rules. Whether or not a step-up is available for the application of the GloBE rules, depends on the financial statements. Sometimes, such financial statements will provide for a step-up, but often these intragroup asset transfers are included in financial statements transferred at their carrying value. In such cases, it is important whether a DTA can be recognised for the difference between the accounting carrying value and tax fair market value for purposes of the GloBE Rules. An important question is whether a related DTA has been accounted for in the financial statements. Such DTA can be relevant and can affect the future position under the GloBE Rules.

Transition Period

Asset transfers as of 1 December 2021 and before the so-called Transition Year have taken place during the Transition Period. Throughout this period, we look at the transferring entity and not at the acquiring entity. This period is also extended with the application of the Transitional CbCR Safe Harbour Rule in the jurisdiction of the transferor. The transition rules are particularly relevant for the acquiring entity. A step-up to the fair market value or a recognition of a DTA under these transition rules, may be limited and this can affect your GloBE position in future years. You do have some possibilities to claim this step-up or recognise a DTA. In order to do so, there needs to be an exit tax in the transferring jurisdiction or the utilisation of DTAs in relation to the assets transferred by the transferor.

Besides the transition rules, it is also important to analyse what it means for the Transitional CbCR Safe Harbour. The acquiring entity may also be in scope of the Transitional CbCR Safe Harbour. Always consider whether an asset transfer may have an effect on your position under the Transitional CbCR Safe Harbour. What for instance can happen is that the asset transfer affects your Simplified ETR, because your Simplified ETR is also based on your income tax expense in your financial statements. Is the income tax expense of the acquiring entity affected by this? For instance, not only a DTA recognised because you acquire an asset at carrying value, but also the acquisition of assets which generate income may lead to accounting recognition of a DTA in relation to prior year losses. All these changes will decrease your income tax expense and that will have an adverse effect on your Simplified ETR for the Transitional CbCR Safe Harbour. As a consequence, the Transitional CbCR Safe Harbour may not be available for such jurisdiction.

However, this does not necessarily result in a Top-up Tax in that jurisdiction. In this respect it is noted that it has been explicitly confirmed that a DTA recognised by the acquiring entity in relation to the asset transfer within the scope of the transition rules can be disregarded by the acquiring entity when calculating your Adjusted Covered Taxes in the year of acquisition. Also a later accounting recognition of prior year losses as a consequence of acquiring an

income-generating asset is disregarded. So, it may not affect your Top-up Tax, but it can lead to additional compliance obligations where you were expecting to rely upon the Transitional CbCR Safe Harbour.

Bear in mind that if you are out of the Transitional CbCR Safe Harbour in the transfer year or the year that you need to recognise the DTAs, you will also be out of the Transitional CbCR Safe Harbour for any subsequent years.

Post Transition Period

Asset transfers in the Post Transition Period (i.e., as from the application of the Transition Year in the jurisdiction of the transferring entity) fall under the GloBE Rules. Quite a lot of jurisdictions are expected to be under the Transitional CbCR Safe Harbour for the first three years. They may be kicked out by these transactions, but there are also jurisdictions where you are already under these GloBE Rules as from the start. In case of an asset transfer, the transferring entity will need to recognise income based on the fair value of the asset transferred for GloBE purposes. This means that if there is no corporate income tax and/or no utilisation of DTA, it may affect your position and could lead to Top-up Tax. If the transferring entity is in a jurisdiction where a Transitional CbCR Safe Harbour is no longer applicable or if the transferring and the acquiring entities already fall under the Globe Rules, the acquiring entity may still fall within the Transitional CbCR Safe Harbour. Therefore, the attention points for applying the Transitional CbCR Safe Harbour in the Transition Period also apply in case of a transfer that is subject to the GloBE Rules in the Post Transition Period.

It is important to check what a transfer of assets means in the year of transfer and in future years.

There is one specific difference compared to the transition rules. Under the transition rules, it is specifically confirmed that a DTA recognised as part of the transfer of an asset can be disregarded when you calculate your Adjusted Covered Taxes. If you have a transfer under the GloBE Rules, there is no such confirmation. Until recently, it was unclear how to treat the acquisition of the asset at the level of the acquiring entity in case of a transfer under the GloBE rules. A very welcome clarification was included in the OECD administrative guidance issued on 17 June 2024, including that a transfer of assets subject to a GloBE arm's length adjustment will also be recognised against such GloBE carrying value at the level of the acquiring Constituent Entity.

Tax controversy: lessons learned from recent case law

Tjebbe Gerverdinck

Trends – Change in tax litigation landscape

The tax litigation landscape is changing over the years as discussions with tax authorities intensify. We see the following important trends:

(i) Increase in the number of audits carried out post covid;
(ii) Increase in the number of penalties; and
(iii) The significant role for the reversal and increase of the burden of proof towards the taxpayer in court cases.

Burden of proof

Importance

The burden of proof is a very important item in tax litigation. If a taxpayer has the burden of proof and a court does not follow the taxpayer, it means the taxpayer loses. The burden of proof refers to factual questions. For legal questions, the burden of proof is not a factor because the court decides on these legal questions. For example, discussions concerning transfer pricing are primarily factual, making the burden of proof crucial.

Framework

There is no fixed legal framework on who bears the burden of proof. However, the following "rules of thumb" apply:

(i) Usually, the tax authorities need to prove items that increase income and the taxpayer needs to prove items that decrease income;
(ii) At times, the party that is most logical to provide evidence has the burden of proof; and
(iii) In case of an unusual stance, such as a taxpayer acting against its transfer pricing documentation, the taxpayer must provide evidence in support of his claim.

Evidence can be presented in various forms, as there is a "free theory of evidence".

Threshold of evidence

There are varying thresholds of evidence required in legal proceedings.

The standard threshold is typically relatively low, where a taxpayer must make a plausible case (*aannemelijk maken*). This means that it is more likely than not that you are correct (>50%). However, the burden of proof can be raised to a higher threshold, where you must prove beyond a reasonable doubt (…), leaving no room for error.

In cases where the burden of proof is reversed and increased to prove beyond a reasonable doubt, it becomes significantly more challenging for taxpayers to succeed. Therefore, the increase and reversal of the burden of proof plays an important role in the litigation strategy of the Dutch tax authorities.

Reversal and increase of the burden of proof

The reversal and increase of the burden of proof entails two implications:

(i) The burden of proof shifts from the tax authorities to the taxpayer, which can only occur if the original burden lies with the tax authorities. Conversely, if the burden of proof is initially on the taxpayer, it cannot be reversed; and
(ii) It is crucial in cases involving penalties that the burden of proof remains with the tax authorities and cannot be reversed.

How can the burden of proof be reversed and increased?

Information decision

Failure by the taxpayer to provide the required information may lead to a reversal of the burden of proof. Similarly, if the obligation to maintain accurate records and methods is not fulfilled, the burden of proof may also be reversed.

Tax authorities possess wide-ranging information gathering powers, allowing them to request any information that may be pertinent to taxation, even if its relevance is uncertain at the time of the request. These powers are not confined to information within the Netherlands; tax inspectors can also

seek information from the records of foreign group entities, although they must make formal requests to these foreign entities first.

To reverse the burden of proof, the tax authorities are required to issue an information decision. This information decision essentially consists of:

(i) A letter detailing the relevant information requested by the tax authorities;
(ii) The obligation for the taxpayer to provide it by a specified deadline; and
(iii) A warning that failure to comply will result in the burden of proof being reversed.

The information decision must be final and binding before it can increase and reverse the burden of proof. The decision can be challenged up to the Supreme Court. The information decision can be rendered obsolete if the taxpayer opts to voluntarily provide the requested information before the specified deadline.

The scope of information powers is extensive but not without limitations. These powers are restricted by two key factors:

(i) There must be a legitimate rationale for requesting the information to prevent unwarranted inquiries; and
(ii) Legal privileges such as formal legal privilege of lawyers and notaries and protection for information provided to tax advisors can exempt certain information from being disclosed to tax authorities, particularly in the context of criminal investigations.

Extensive information requests can present challenges, particularly when it comes to emails as standard practice. Email accounts often contain a mix of personal and professional communications, including messages from tax advisors, lawyers, and notaries. Managing this can be complex. We note that the tax authorities are usually receptive to a pragmatic approach, utilising e-discovery software to navigate through vast amounts of data effectively. This approach has proven to be successful in practice. Additionally, advancements in technology have led to requests extending beyond emails to include other forms of communication like WhatsApp messages. It is important to stay informed about and prepared for such developments.

Failure to file a correct tax return

Another situation wherein the burden of proof shifts to the taxpayer is when the tax return is inaccurately filed or not filed at all.

Character burden of proof

Reversing the burden of proof is not an actual penalty, but rather a concept to acknowledge that the process typically begins with the tax authorities. When the tax authorities can reasonably demonstrate a certain amount of unpaid tax, both in relative and absolute terms, the threshold is relatively low, typically ranging from 7-14% of the amount of tax due, the burden of proof can be reversed. This threshold does not require a significant mistake and can easily surprise unsuspecting taxpayers.

Meeting these normative criteria is relatively easy, but the consequences can be severe. In case of transfer pricing disputes, the burden of proof is reversed across the board, leading to harsh consequences. It is crucial to consider the potential risks and take a conservative approach in your tax return, even if you firmly believe you are in the right. Prioritising safety over potential disputes with the tax authorities is advisable in such situations.

Timeline

During the phase when an objection is filed with the tax authorities, they still have the wide power to request information. During the appeal phase, the power to request information shifts from tax authorities to the court.

Penalties

A penalty is a criminal charge that carries consequences for the case, such as a public hearing.

Interaction penalties and burden of proof

In penalty disputes, the burden of proof lies with the tax authorities. An important Supreme Court case ruled that the tax authorities must prove beyond a reasonable doubt that the taxpayer knowingly submitted an incorrect tax return. The tax authorities use increasingly strong language and tactics, refusing to admit and striving to meet this higher evidentiary standard for penalties. In addition, taking a stance discussed with the tax authorities in advance of filing the tax return but rejected by them, may no longer guarantee immunity from penalties, as previously believed. A recent judgment by a district court suggests that merely being transparent may not be sufficient. It is therefore advisable that taxpayers consider their position to be taken in their tax returns carefully.

Navigating EU policy changes: strategies for businesses in Europe

Vlad Olteanu & Peter Adriaansen

Background

In today's ever-evolving regulatory landscape, businesses operating within Europe are confronted with the challenge of remaining well-informed of the shifting policies of the European Union ("EU") to uphold competitiveness and adherence to regulatory requirements. Real-world events serve as incentives for policymakers to formulate rules and directives. By initiating engagement at the emerging stages of policy development, businesses can actively anticipate regulatory outcomes and adapt their strategies accordingly. This proactive stance not only facilitates risk mitigation but also enables businesses to seize emerging opportunities, thereby maintaining a competitive edge within the EU market.

Understanding the broader context

For businesses it is important to comprehend the broader context surrounding EU policies, extending beyond only tax implications. The broader context includes policies regarding environmental, social, and governance ("ESG") factors, emphasising their growing relevance in EU decision-making processes. The significance of sector-specific insights in predicting regulatory changes and identifying business opportunities is a central theme. This includes drawing upon past experiences such as the financial crisis and Brexit, and understanding how these events have shaped EU policies and outcomes. For businesses there are opportunities when they are aware of sector-specific trends, market dynamics and regulatory developments, to proactively anticipate changes and recalibrate their strategies accordingly. This enables businesses to stay ahead of the curve, to take advantage of emerging trends and to mitigate risks within their respective industries.

Evolution of EU decision-making

The evolving dynamics of EU decision-making processes include a shift towards more centralised decision-making frameworks and potential changes in EU decision-making procedures. Particularly noteworthy is the possible transition from unanimity to qualified majority voting in tax matters, signifying a crucial development with implications for businesses operating within Europe. Reflecting on the past couple of years, the implementation of policies like Pillar One and Pillar Two was significantly delayed due to the requirement of unanimous voting among all EU Member States. Transitioning from unanimity to qualified majority voting could potentially accelerate the introduction of new policies. Consequently, a thorough understanding of EU decision-making mechanisms enables businesses to adeptly navigate regulatory changes.

Future outlook and policy implications

For a future outlook on the finances of the EU, it is crucial to comprehend the key priorities for EU budget spending. The key priorities for EU budget spending (current or forecasted) are:

- Assistance to Ukraine (be it to handle the current war situation or the reconstruction effort post conflict);
- Investments in critical technologies & re-industrialisation;
- Green and digital transitions;
- Migration;
- Defence; and
- Agriculture.

To finance these spendings the European Commission plans to borrow EUR 807 billion until 2026 through loans and grants. Therefore, new sources of revenue for the EU must be established. Examples of potential new revenue sources include:

- Corporate taxation (BEFIT);
- “Fair Border Tax”;
- Financial Transaction Tax; and
- Digital Levies.

Other anticipated policies such as the proposal for a Transfer Pricing Directive and measures aimed at preventing the misuse of shell entities (ATAD 3 or ”Unshell”), if unanimously voted for by all EU Member States, could have significant impact on businesses operating within Europe. The central part for businesses is to anticipate these policies and take advantage of these possible emerging trends while better mitigating possible business risks areas.

Key takeaways

The current developments in the EU highlight the critical importance of early engagement and proactive strategies for businesses to navigate EU policy changes effectively. Businesses can effectively mitigate risks, capitalise on emerging opportunities and sustain competitiveness within the dynamic EU market by:

- Having an understanding of the broader context of EU policies;
- Leveraging sector-specific insights; and
- Maintaining active engagement with EU policymakers.

As the regulatory landscape continues to evolve, businesses must remain adaptable and actively engaged to grow amidst the ever-changing policy environment within Europe.