What role can The Netherlands play for Ukrainian multinationals?

Kiev, September 5, 2013
Agenda

1. Introduction to the Dutch tax system
2. Update on the key features of the Dutch tax system
3. International developments & their impact on the Netherlands
4. Where can the Netherlands be of use?
The Netherlands: Intersection in an international environment
1. Position in the international (tax) environment

- General environment
- Tradition as holding country
- Treaty network
1. Position in the international (tax) environment: General environment

► Legal infrastructure
  - Advanced corporate legislation
    - New: Flex BV
  - Corporate governance
  - Independent courts
  - Balance between transparency and confidentiality

► Financial infrastructure
  - Reliable banking system
    - Low Euro exposure
  - Sophisticated financial services sector
  - High quality trust offices

► International image
  - No tax haven
  - Transparency with international requirements
  - Holding tradition

► Logistics
1. Position in the international (tax) environment: *Tradition as holding jurisdiction*

- The Dutch holding regime is considered one of the best in the world:
  - The Netherlands invented the participation exemption (i.e. introduced in 1893, hence more than 100 years ago)
  - The Dutch participation exemption is not a privilege but principally embedded in the tax system

- Various tax planning opportunities are available in the Netherlands or via the Netherlands
  - Netherlands tends to be leading in planning
  - But is often copied in a simplified manner

- Ruling Practice
  - Dutch ruling are civil law agreements that are binding for the tax authorities
  - Dutch tax authorities adhere to good faith principle in relation to treaty partners and other jurisdictions in general
  - Substance based
1. Position in the international (tax) environment: Treaty network

- High quality standard
  - Withholding taxes often reduced to 0%
  - The Netherlands opposes a real estate company ‘carve out’ in the capital gains provision
  - Restricted beneficial ownership exception
  - Limitation on Benefits provisions
    - Generous exceptions due to good image
  - Mainly exemption method applied

- Extensive network
  - It is internationally acknowledged that the Netherlands have one of the most extensive and favorable treaty network in the world
  - Over 90 tax treaties and 11 new treaties being negotiated
    - Including Barbados, Panama, UAE, several African countries, Vietnam, Indonesia
    - No treaty with Cyprus
    - Unilateral Decree as fall-back

“It is of the best interest of the Netherlands to have a broad tax treaty network and to embrace capital import neutrality and the exemption method for the avoidance of double taxation, leveling the playing field for Dutch residents who do business abroad.”

Mr F. Weekers,
Dutch State Secretary of Finance
1. Position in the international (tax) environment

_Ukraine – Netherlands tax treaty_

► Withholding tax rate card

<table>
<thead>
<tr>
<th>Tax on</th>
<th>Rate (%)</th>
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</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>0, 5 or 15</td>
</tr>
<tr>
<td>Interest</td>
<td>0, 2 or 10</td>
</tr>
<tr>
<td>Royalties</td>
<td>0 or 10</td>
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</tbody>
</table>

► Zero per cent dividend withholding tax rate subject to
► 50% ownership
► At least USD 300k investment “in the capital of the company paying the dividends”

► Zero per cent royalty withholding tax for industrial royalties, know how and royalties for trademarks, patents, software (?)

► 2% interest withholding tax rate for
► Interest on loans from banks and other financial institutions
► Interest on loans from suppliers of machinery and equipment (sale on credit)

► Zero rate for _inter alia_ - loans guaranteed or insured by the Government of the other State, or a financial institution owned or controlled by the other State.
1. Position in the international (tax) environment

_Ukraine - Netherlands tax treaty_

► 2% interest withholding tax rate for
   ► Interest on loans from banks and ‘other financial institutions’

► According to Dutch law a so-called ‘special financial institution’ must be registered with the Dutch Central Bank
   ► At the discretion of the Dutch Central Bank such special financial institution can be appointed as a reporting institution

► A company may qualify as a special financial institution if
   ► It is (indirectly) owned by one or more non-Dutch shareholders; and
   ► It owns ‘foreign assets’, such as shares in the capital of one or more non-Dutch companies, or claims against non-Dutch persons or companies

► A company registered as special financial institution can obtain a certificate of registration from the Dutch Central Bank
   ► Alternatively a legal opinion from a Dutch lawyer can be obtained confirming that the company qualifies and is duly registered as a special financial institution under the Dutch External Financial Relations Act 1994 and the Dutch Balance of Payment Reporting Instructions 2003 (and as the case may be qualifies as ‘financial institution’ under the Dutch Law on Financial Institutions).
1. Position in the international (tax) environment

Ukraine - Netherlands tax treaty

Reduced interest withholding tax rate for interest on loans from banks and other financial institutions in other Dutch treaties (examples)

<table>
<thead>
<tr>
<th>Treaty with</th>
<th>Reduced rate</th>
<th>Normal rate</th>
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<tbody>
<tr>
<td>Albania</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>7.5</td>
<td>10</td>
</tr>
<tr>
<td>Israel*</td>
<td>10</td>
<td>15</td>
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<tr>
<td>Mexico</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Pakistan</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Philippines</td>
<td>10</td>
<td>15</td>
</tr>
</tbody>
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*According to the commentary to the treaty the term ‘financial institution means any corporate body that within the normal course of its business acquires cash deposits and extends loans*
2. Update on key features Dutch tax system

- General
- Participation exemption
- Dividend withholding tax
- Substantial interest regime
- Substance requirements
2. Update on key features Dutch tax system

General

Tax rates

**Corporate income tax rate:**

- 25% with step-down for small enterprises

**ETR depending on**

- Exclusions (participation exemption)
- Special rules to calculate tax base (Innovation box)
- Disallowed expenses (interest - anti-base erosion measures)

**Dividend withholding tax rate:**

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<th>%</th>
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<tr>
<td><strong>Statutory rate</strong></td>
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<tr>
<td><strong>EU Parent-Subsidiary Directive</strong></td>
<td>0</td>
</tr>
<tr>
<td><strong>Tax treaty Ukraine</strong></td>
<td>0/15%</td>
</tr>
<tr>
<td><strong>Tax treaty Russia</strong></td>
<td>5%/15%</td>
</tr>
</tbody>
</table>
2. Update on key features Dutch tax system

*General*

- Although tax reporting is based on statutory reporting, differences (permanent as well as timing) between commercial and tax accounting are not uncommon.

- Accounts may be kept in the company’s functional currency.

- Dutch companies in the same group may be taxed as one fiscal unity.

- Financial year for financial and tax reporting purposes can deviate from calendar year.

- Arm’s length principle is generally applied in both directions, i.e. for income as well as expenses.
2. Update on key features Dutch tax system

General

► No withholding tax on payment in respect of the following types of income:
  - Interest
  - Royalties
  - Technical service / management fees

► Other taxes
  - No state or local taxes
  - No capital tax or stamp duties

► Foreign source income
  - Avoidance of double taxation with respect to foreign source income
  - Income attributable to a foreign permanent establishment (“PE”) is exempt (branch exemption)
    - Branch exemption is also available if PE is located in a non-treaty country
2. Update on key features Dutch tax system

Participation Exemption

- Dividends (100%) received by DutchCo are excluded from Dutch taxable base if participation exemption applies.

- Capital gains (100%) derived by the DutchCo from the sale of foreign subsidiary are excluded from Dutch taxable base if participation exemption applies.
Participation exemption - conditions:

► A participation of at least 5% is held
► This participation is not held as a portfolio investment (Motive Test)
  ► The Motive Test is based on longstanding Dutch case law and provides more durable certainty, and as such provides for a more reliable participation exemption regime
► If the motive test is not met, the participation exemption still applies if either one of the following alternative tests is satisfied:
  1. The participation is subject to a nominal tax rate of 10% resulting in a realistic tax levy based on Dutch tax standards
  2. The assets of the participation consist for no more than 50% of low taxed portfolio assets; or
  3. The assets of the participation consist for more than 50% of real estate assets
2. Update on key features Dutch tax system

**Participation Exemption**

- No subject to a profits tax requirement for active subsidiaries. Therefore, participation exemption available for, for example:
  - Dubai company
  - Hong Kong company
  - Offshore intermediate holding companies

- In case holding < 5% the participation exemption is not available, unless other group company has a shareholding of ≥ 5%

- Participation exemption covers wide variety of income from assets that are closely related to the participation, such as:
  - Hedge instruments with respect to a foreign participation
  - Options, warrants, conversion rights
  - Hybrid loans
  - Earn out arrangements
  - Certain non-compete clauses
2. Update on key features Dutch tax system

**Dividend Withholding Tax**

- Dividends received by BVI shareholder are subject to Dutch Dividend WHT rate of 15%
- Dividends received by CypriotCo may be exempt from Dutch dividend WHT
- Beware of dividend stripping rules
- No dividend WHT at CypCo level
A COOP is in principle not subject to Dutch dividend withholding tax
- This remains the main rule
- An exception applies for COOP’s used in abusive situations

Dividend withholding tax is levied on dividend distributions to a member of a COOP, as of January 1, 2012 if:
- the COOP holds (directly or indirectly) shares, profit-sharing certificates or hybrid loans; and
- with the primary aim (or one of the primary aims) to avoid the levy of Dutch dividend withholding tax or a foreign tax at the level of another person or entity; and
- the membership in the COOP is not attributable to a business enterprise of the member in the COOP.
2. Update on key features Dutch tax system

*Dividend withholding tax for Cooperatives (“COOP”)*

- **Special rule if COOP - directly or indirectly - holds shares etc. in Dutch companies**
  - Even if membership in COOP is attributable to business enterprise of a member
  - Any retained earning available in DutchCo at the moment that its shares have (indirectly) been acquired by COOP
  - Will proportionally be subject to dividend withholding tax when distributed by COOP to that member

- **Implications**
  - In fact this change intends to give the substantial interest regime real teeth with respect to COOPs by introducing a tax at source
  - Extension to membership that do not constitute a substantial interest (<5%)
  - Increased scrutiny
  - Can a COOP now issue shares with having dividend withholding tax exposure?
2. Update on key features Dutch tax system

Substantial Interest regime

- Substantial shareholder regime may apply if:
  - A non-resident entity holds (directly or indirectly) at least 5% in a DutchCo, and
  - Such holding (e.g. participation rights in the DutchCo) is not part of the business enterprise of the non-resident entity, and
  - The non-resident entity holds the substantial interest with the primary aim (or one of the primary aims) to avoid the levy of Dutch income or withholding

- If Substantial Shareholder regime applies the non-resident entity may be subject to Dutch income tax with respect to:
  - Dividends received from the DutchCo
  - Capital gains derived from the sale of DutchCo
  - Interest paid by the DutchCo

- Substantial interest regime does not apply if Double Tax Treaty does not allow Dutch taxation of the respective items of income
When can the substantial interest be attributed to the business enterprise of the foreign shareholder?

- General rule: if foreign shareholder carries on a genuine business enterprise, the Dutch shares can be attributed to that enterprise.

In (ruling) practice a refined approach has been developed to deal with holding companies:

- If a foreign holding itself does not carry on a business enterprise per se, it may still have a real function in the group that within the context of the substantial interest regime might constitute a business enterprise:
  - Such real function typically consist of being the ‘connecting link’ between real business activity above the foreign shareholder, and real business activity at the level of the Dutch entity or below it, or
  - If the foreign holding is a platform for active managerial and strategic involvement of the owners in the business operations elsewhere in the group
  - Real challenge when DutchCo is directly owned by foreign individuals.

Remember: very often substantial interest regime is neutralized by treaty.

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2. Update on key features Dutch tax system

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2. Update on key features Dutch tax system

Substantial interest regime

[I]
- Active business
  - DutchCo
    - Active business

[II]
- Active business
  - Passive holding
    - DutchCo
      - Active business

[III]
- Individuals 5% or more
  - DutchCo
    - Active Business

[IV]
- Individuals 5% or more
  - Tax haven Co
    - DutchCo
      - Active Business
2. Update on key features Dutch tax system

Substance requirements

- Is the term ‘substance’ well-defined or is it just jargon?

- From a Dutch perspective ‘substance’ is a concept that serves to establish the real presence of a corporate body apart from its legal existence under corporate law
  - Possession and use of fixed assets
  - Functions performed by natural persons for the account and at the risk of that corporate body

- Substance over form
  - Lack of substance cannot justify ignoring the existence of a legal entity, but
  - Substance is an important factor for determining where profits are generated
  - Substance can play a role when determining residency
  - Beneficial ownership concept is supplementary

- Limited codification of substance
  - For so-called ‘conduit’ companies
  - For active group financing companies/branches
  - For specific cases in rulings
  - In LOB provision in (new) tax treaties
2. Update on key features Dutch tax system
Substance requirements - tax residency

Tax Residency

► Determined by facts and circumstances
  • In addition, for Dutch tax purposes a company is deemed to be resident in the Netherlands if it is incorporated under Dutch law

► Focus on where is ‘effective place of management’
  • Effective place of management of the company, as opposed to effective place of management of the business

► Residency declarations are issued (almost) automatically to companies incorporated under Dutch corporate law
  • The actual residency of migrated foreign legal entities is typically scrutinized

► For ‘low substance’ activities minimum substance requirements have been developed to be eligible to a ruling
  • Intermediate holding company: at least 15% of the cost price of a subsidiary must be financed through equity
  • Intermediate service companies - safe harbor
2. Update on key features Dutch tax system

**Minimum Substance requirements**

- At least half of the directors of the company is resident in the Netherlands;
  - These Dutch resident directors should have the professional knowledge and skills to perform their duties.
  - These duties at least include independently taking decisions - within the framework of the usual governance policies within the group - on regular company transactions as well as with regard to the execution of these transactions.
  - The company will avail itself of adequate support (own personnel or outsourced) to run its business independently;
- the Board is actually taking the key decisions and is generally doing so in the Netherlands;
- the regular business address of the company is in the Netherlands;
- the principal bank account is kept in the Netherlands;
- the bookkeeping is done and kept in the Netherlands;
- the company is up-to-date with all its Dutch tax compliance obligations;
- the company runs a more than negligible risk with respect to the transactions entered into on its behalf;
- the company has an equity at risk that corresponds to the functions performed.
3. Trends & developments in international taxation

► Current debate on tax avoidance
► Multinational response
► BEPS
► Improved transparency
3. Trends & developments in international taxation – Current debate

► Increased focus on taxpayer’s behavior
  - Tax activism
  - Amazon, Google, Starbucks, Apple, etc. Cases

► Discussion is often driven by emotions
  - Crisis management
  - The ‘man in the street’ does not have the same tax planning opportunities as a MNC
  - Legal can be immoral - fair share discussion

► The notion of what is acceptable tax planning is changing
  - The overall outcome should make sense, no double dips etc.
  - More emphasis on substance, risks and people functions

► Strong multinational and supranational political support
  - G20, EU, OECD

► Increased tax controversy
  - Tax authorities feel strong
3. Trends & developments in international taxation - Paradigm shift

BEPS [Report Addressing Base Erosion and Profit Shifting of 12 February 2013]:

“Beyond a number of high profile cases, there is a more fundamental policy issue: the international common principles drawn from national experiences to share tax jurisdiction may not have kept pace with the changing business environment. Domestic rules for international taxation and internationally agreed standards are still grounded in an economic environment characterised by a lower degree of international integration across borders, rather than today’s environment of global taxpayers, which is characterised by the increasing importance of intellectual property as a value-driver and by constant developments of information and communication technologies.”
3. Trends & developments in international taxation – BEPS Action Plan

► 15 Actions defined to curb BEPS along 3 main themes
  • For each Action Plan outputs have been specified that need to be produced during 2014-2015

► Theme 1: Preventing double non-taxation resulting from gaps that exist between countries’ tax rules:
  • Address the challenges of the ‘digital economy’
  • Neutralize the effects of hybrid mismatch arrangements
  • Strengthen CFC rules
  • Limit base erosion via interest deduction and other financial payments.

► Theme 2: Aligning taxation with substance
  • Curb harmful tax practices by revamping transparency and substance
  • Prevent treaty abuse
  • Prevent the artificial avoidance of PE status
  • Assure that transfer pricing outcomes are in line with value creation.

► Theme 3: Improving transparency
3. Trends & developments in international taxation - Theme 3: Improving transparency

► Action Plan calls for
  • Improvement of data collection and analysis of BEPS
  • Mandatory disclosure of aggressive tax positions by taxpayers
  • Re-examination of TP documentation
  • Improvement of multinational dispute resolution mechanisms (Competent Authority)

► Global Forum on Transparency and Exchange of Information for Tax Purposes
  • Provides a platform for countries that are committed to implement common standards of transparency and exchange of information - Ukraine?
  • Supports the establishment of legal infrastructure for EoI in addition to regular tax treaties through the promotion of Tax information Exchange Agreements (TIEAs)
  • Continues raising the bar thru measuring effectiveness of domestic legal framework, doing peer reviews on implementation and making recommendations
  • Providing technical assistance, training and tools.

► Public evaluation list (?)

► Automatic Exchange of Information: The Next Step
3. Trends & developments in international taxation – Dutch position

► Dutch dilemma: retain current leading position in tax driven multinational structures, but avoid ‘bad image/reputation’

► Labor/socialist political parties ‘play the game’

► Ministry of Finance defends status quo, but
  • Is supportive of international initiatives taken
  • But insist on international instead of domestic action.

► Immediate effects
  • More conservative tax ruling policy
  • Anti-abuse clauses in new tax treaties
  • Netherlands has always paid attention to substance and principle of arm’s length.

► Bottom line: essentially business as usual?
3. Trends & developments in international taxation – Dutch position – latest developments

- Letter and memo from Dutch Minister of Finance to Dutch Parliament regarding the Dutch role in international tax planning dated 30 August 2013
- Confirmation that the Dutch government is actively cooperating with the respective international initiatives currently being undertaken
  - EU Action Plan
  - OECD Action Plan in relation to BEPS
  - Global Forum on Transparency and Exchange of Information
  - Country-by-country reporting
- Special attention for the interests of developing countries
  - Netherlands will suggest developing countries to include a specific anti-abuse provision in the treaty
- Emphasis is on the global nature of the issues involved; a solution should be global and binding in order to ensure a level playing field
- A limited number of ‘solo’ initiatives
3. Trends & developments in international taxation – Dutch position – latest developments

- A limited number of ‘solo’ initiatives are proposed:

- The minimum substance requirements applicable in practice to obtain an advance ruling for a ‘intermediate service company’ will become applicable to all similar companies, regardless of whether they apply for a ruling or not.

- If such company applies for tax treaty benefits in another country, it has to certify in its annual tax return that the minimum substance requirements are met.
  - If the requirements are not met this will be a reason for the Dutch tax authorities to spontaneously report this to the relevant foreign tax authorities.

- With respect to companies whose only activity in the Netherlands is interest or royalty flow-through, the Dutch tax authorities will spontaneously exchange information regarding the content of the ruling with the relevant foreign tax authorities.

- Participation exemption rulings will only be granted to companies that belong to a group with adequate ‘nexus’ with the Netherlands.
  - Adequate nexus = at least minimum substance requirements.
4. Where can the Netherlands be of use?

- The Holding Company for the future
- Hybrid financing
- Back-to-back financing
- Informal capital planning
4. Where can the Netherlands be of use?

The Holding Company for the future

Solution for:
- Increased attention for substance
- Complying with treaty or domestic LOBs
- Future inversion plan
- Better corporate transparency and enhances corporate governance

Corporate entity rationalization
- To improve transparency
- Concentrate corporate memory
- Manage corporate risk
- Reduce compliance cost
- Facilitate transfer pricing
- Tax drivers (e.g. loss compensation)
4. Where can the Netherlands be of use?

**The Holding Company for the future**

Investments in ‘real property rich companies’ (incl. REITS)

1. The mere investment in and/or holding of real estate is in many countries viewed to be passive investment
2. Many participation exemption regimes do not or only partially apply to passive investments
3. A so-called Foreign Real Estate Investment Trust (“REIT”) is usually not subject to tax
4. Many participation exemption regimes require the subsidiary to be subject to a reasonable tax
5. The Dutch participation exemption will be available provided that assets of the foreign subsidiary consist for 50% or more of real estate
4. Where can the Netherlands be of use?

The Holding Company for the future

Tax haven FinCo

1. Tax Haven FinCo is not subject to tax.
2. No subject to tax requirement under Dutch participation exemption
3. Dutch participation exemption available provided Motive or Asset test is met. This will be determined on a cumulative or aggregated basis (mixing principle)
4. BV entitled to reduced dividend withholding tax rates under the tax treaty with NL (or EU Parent-Subsidiary Directive)
4. Where can the Netherlands be of use?

The Holding Company for the future

- Reduction Dutch WHT on “Passed on Dividends”
  - to reduce withholding tax on outbound dividends received from a company that is resident in a treaty country
  - the Dutch company (together with related Dutch resident companies) must have an interest in the distributing foreign subsidiary of at least 25% of the par value of the paid-up share capital or
  - in case the treaty so dictates, 25% of the voting rights in that company, at the moment of distribution
  - the dividends must have been subject to a withholding tax of at least 5%
  - the shares in the distributing company held by the Dutch company must be eligible for the participation exemption with respect to the dividends received
  - redistribution must be made after receipt of the dividend, during the year of receipt or in the following two years

\[
5\% - 3\% = 2\% \text{ Dividend WHT}
\]
4. Where can the Netherlands be of use?

_Intra-group financing_

Most important aspects from a Dutch tax perspective

- Income on hybrid instrument 100% exempt from taxation in the Netherlands.
- No minimum holding period.
- No direct shareholding required.
- No subject-to-tax requirement for the subsidiary.

Instruments have been developed with amongst others*:

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of instrument</th>
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<td>Australia</td>
<td>MRPS</td>
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<td>FSA</td>
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Abbreviations:
- CCD: Compulsorily Convertible Debenture
- CD: Convertible Debenture
- FSA: Forward Subscription Agreement
- MCL: Mandatory Convertible Loan
- MPRS: Mandatory Redeemable Preference Shares
- ORA: Obligation Remboursable en Actions
- PPL: Profit Participating Loan
4. Where can the Netherlands be of use?

Intra-group financing

► Flow-through company
  • Use Dutch company as flow through company for royalty and interest payments to reduce local royalty withholding taxes
  • Arm’s length spread taxed against Dutch CIT rate

► Benefits:
  • Favorable WHT rates on interest or royalty payments to the Netherlands based on Dutch tax treaties
  • No interest or royalty WHT in the Netherlands

► Considerations
  • Beneficial ownership
  • LOB
  • Substance
4. Where can the Netherlands be of use?

Substance for ‘flow-through’ activities

► A flow-through entity should bear real economical risk

► A real risk is considered to be present if the Dutch flow-through entity has an equity of at least (which ever is the lowest):

**Financing activities**
- 1% of the amount of the outstanding loans, or
- EUR 2 million

**Licensing activities**
- 50% of the annual royalty flow, or whichever is the lowest
- EUR 2 million

► In this respect it needs to be sufficiently substantiated that the equity is available to cover the risks associated with the financing activities and that the equity will decrease if these risks occur/materialize

► DutchCo should be a Dutch tax resident (i.e. a certain level of physical substance in the Netherlands is required)
4. Where can the Netherlands be of use?

Informal capital

- Arm’s length principle is generally applied in both directions, i.e. for income as well as expenses
- Parent company allows NL Co to take over part of its business
  - No transfer of intangible asset
  - No charge or compensation
- NL Co benefits from ‘going concern’ advantages, e.g.
  - existing customer base
  - proven & tested business model
- For Dutch tax purposes the income attributable to these advantages ‘contributed by the parent may be excluded from taxable income
- Subject to strict TP rules and ruling recommended
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