The 2022 New Netherlands Transfer Pricing Decree

On 22 June 2022 the Netherlands published an update to the 2018 Transfer Pricing Decree. The main amendments concern the transfer pricing treatment of financial transactions and intra-group services.

1. Introduction

The Netherlands tax authorities have a longstanding tradition of publishing their view on the application of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines).1 The first Netherlands Transfer Pricing Decree was released on 30 March 2001.2 In 2002, a then new article 8b was introduced in the Corporate Income Tax Act that codified the arm's length principle. Since then, several updates of the Decree have been released. They have mostly been intended as a reaction to updates of the OECD Guidelines and/or to further clarify certain Netherlands positions.

The Decree of 14 June 20223 replaces the 2018 version of the Decree.4 The Deputy Minister of Finance wants the new decree to be referred to as the 2022 Transfer Pricing Decree (2022 Verrekenprijzbesluit).5 The new Decree entered into force on 2 July 2022.6 The main areas where changes have been made are:

- financial transactions (see section 5);
- intra-group services (see section 4);
- governmental policies, e.g. regarding the COVID-19 pandemic (see section 2); and
- textual amendments to align the decree with the language used in Netherlands legislation to the language used in the OECD Guidelines.

In section 1.3 of the 2022 Transfer Pricing Decree, the Netherlands tax authorities explicitly express their view that transfer pricing is not an exact science. This view is indeed, in practice, followed by the Netherlands tax authorities. The OECD Guidelines also encourage tax authorities to take a flexible approach and not to demand accuracy that is unrealistic in relation to the facts and circumstances. Further, in section 3.1, it is made clear that it is not required for taxpayers to search for the best possible transfer pricing method. The Netherlands tax authorities hold that it is important that both tax authorities and taxpayers understand the interest of the other party. It is comforting that it is explicitly stated in the Decree – if only in footnote 4 – that deviating from what is stated therein will not automatically lead to the imposition of a penalty.

Throughout the 2022 Transfer Pricing Decree, there are substantial parts where many textual changes have been made. In some sections, almost no paragraph has remained identical. One may wonder whether especially the minor textual changes are indeed mere clarifications or whether in relevant cases discussions may arise because of these changes. For example: in the 2018 Decree, it was stated in its section 2.1 that the OECD Guidelines were assumed to have a direct effect on the Netherlands legal practice. This sentence has now disappeared without further explanation. Does this mean that this assumption is no longer applicable? The reason for removing the statement is perhaps because that in section 1.5 of the 2022 Transfer Pricing Decree it is now included that where the application or interpretation of the OECD Guidelines leads to the non-taxation of part of the profit of the group, the Netherlands tax authorities may take a position that deviates from the Decree if the outcome is still in agreement with the arm’s length principle. The question is whether it was necessary to take out the previous statement entirely and whether such removal could be an argument in other instances to refuse or insist on the application of the OECD Guidelines.

2. Government Subsidies and the Application of the Arm’s Length Principle

The main change in section 2 of the 2022 Transfer Pricing Decree concerns the treatment of government subsidies. Section 2.8 starts with a statement that is probably inspired by the current sanctions regarding bank transactions to and from certain territories. The statement contains the well-known view of the Netherlands tax authorities that if another country hinders or blocks the actual payment of an amount due to a Netherlands resident taxpayer, that amount, in principle, still needs to be taken into account for corporate tax purposes. To determine whether the
claim and the costs made in relation to the transaction that gave rise to the claim may be depreciated, this needs to be judged on the basis of the Netherlands principle of “goed koopmansgebruik” (sound business principles). This concept is used to divide the entire lifetime profit made by Netherlands enterprises over the years in which they are active. For example, if it becomes unlikely that a virtually bankrupt client will ever be able to actually pay its debt, that claim may be depreciated.

If the profits of a part of the group are determined on a cost-plus basis, the question could be asked whether subsidies or tax benefits should be deducted from the cost base. Without distinguishing between inbound and outbound situations,7 the 2022 Transfer Pricing Decree enumerates the following main rules:

- if there is a direct link between the subsidy and the supply of the good or service and the subsidy takes the form of a discount or partial reimbursement of the costs, the subsidy is to be deducted from the cost base;
- newly introduced taxes or levies, for example on the use of environmental harmful raw materials, are to be added to the cost base;
- subsidies and tax benefits that are attributed to the taxpayer as such and that do not have a causal relationship with the activities for which the cost base determines the taxable profit, are not to be deducted from the cost base. If the subsidies are part of the taxable profit, they are to be added to the profit separately;
- tax benefits in the form of a deduction of the taxable profit are only to be deducted after the determination of the taxable profits on the basis of the cost base; and
- the Netherlands tax rules regarding the determination of the taxable profit contain several types of costs that are only to a certain extent deductible. This concerns, for example, representation costs (article 3.15(1) of the WIB) or the depreciation of real estate above certain thresholds (article 3.301 of the WIB). These costs do belong to the cost base, and the non-deductible costs are then to be added to the taxable profit determined on the basis of the cost base.

Attention is then given to the impact of aid measures on the setting of transfer prices between related entities. This may be relevant where related parties have agreed on transfer prices based on actual costs. If subsidies or aid measures that reduce the cost would be relevant for transactions between unrelated parties, then that would arguably also be the case for transactions between related parties. If a related taxpayer wants to amend the conditions of a transaction, it has to make it plausible that comparable unrelated entities would under similar circumstances and in a comparable way make the same amendments. Such amendments must not be aimed at realizing a decrease in turnover that would give rise to aid measures.

3. Transfer Pricing Methods, Secondary Adjustments and Intangible Property

TP methods

The part about the transfer pricing methods allowed remained virtually unchanged. Regarding the comparable uncontrolled price (CUP) method, the statement that this method can barely be found in practice has now been somewhat restricted by adding in a footnote that the CUP method is often used for financial transactions.8 In the part on financial transactions, situations where the CUP method is appropriate are indeed described (see section 5). One may wonder why oil and other commodities, for instance, were not added to this.

Secondary adjustment

As standard practice for transfer pricing corrections, the Netherlands insists also on making secondary transactions.9 These secondary transactions may take the form of an informal capital contribution or the distribution of a dividend. The secondary adjustment can then, for example, take the form of the levying of Netherlands dividend tax. If, in a particular case not concerning tax abuse, the dividend tax cannot be credited in the other state against corporate tax due by the recipient of the deemed dividend, the secondary adjustment can be omitted unless, for the relevant year, the other country is identified by the Decree on Low-Tax States and Non-Co-operative Jurisdictions Scheme for Tax Purposes.10

No changes have been made in the section of the 2022 Transfer Pricing Decree on intangible property.

4. Intra-Group Services

The main addition to the previous text on this topic is that in the 2011 Decree it was stated that a cost-based method was often chosen and now, in practice, a cost-based method on the basis of the transactional net margin method is often chosen.

The Netherlands tax authorities are keen on separating out activities that are solely undertaken for the benefit of the shareholder(s). For these activities, no intra-group charges are to be made. The Decree contains the same non-limitative enumeration of shareholder activities and examples thereof. For example, these include activities related to the legal structure of the company and those concerning the ever-growing corporate governance regarding the company itself or the group as a whole.

7. I.e. it appears to make no difference whether the subsidies are allotted by the Netherlands government to a Netherlands resident taxpayer or by another country to its resident taxpayer.
8. NL: Wet op de inkomstenbelasting 2001 (WIB).
9. Sec. 3.1, fn. 10 2022 Transfer Pricing Decree.
10. This may be different if a benefit is not subject to a profits tax in the other country (see NL: Netherlands Corporate Income Tax Act 1969 art. 8ba et seq.).
11. “Regeling laagbelastende staten en niet-coöperatieve rechtsgebieden voor belastingdoeleinden” of 31 December 2018. For 2022, the designated territories are: Anguilla, the Bahamas, Bahrain, Barbados, Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, Isle of Man, Jersey, Turkmenistan, Turks and Caicos Islands, Vanuatu and United Arab Emirates; and also the American Virgin Islands, American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago and Vanuatu.
Then there are mixed activities. These are activities that are partly related to intra-group services and partly to shareholders’ costs. There appears to be no change in the examples of costs mentioned. It is a pity that aside from the mentioning of costs of governance, nothing is stated about the costs of environmental, social and governance (ESG); costs that are becoming increasingly relevant for internationally operating enterprises. It would have been very useful to have the view of the Netherlands tax authorities on this.

In the 2018 Decree, the Netherlands tax authorities indicated under the heading “Approving policy” that they were prepared to forego adjustments if the taxpayer chose to charge all relevant costs for the services with limited additional services. If no profit markup was added, then the financing costs should still be included as relevant costs. Without further explanation this paragraph is no longer present, which may mean that such policy of only charging all relevant costs is no longer approved.

5. Financial Transactions

The 2022 Transfer Pricing Decree contains, in its paragraph 9, a new text dealing with financial transactions. The changes follow the 2020 amendments to the OECD Guidelines regarding financial transactions.

The following topics are dealt with:
- loans (section 5.1);
- intra-group services (section 5.2);
- cash pooling (section 5.3);
- guarantees (section 5.4); and
- captives (section 5.5).

5.1. Loans

On the basis of the OECD Guidelines (reference is made to the 2020 chapter X.B of the OECD Guidelines), the first step is the characterization of the transactions. The level of control and the financial capacity are important. Risks and the associated remuneration should be allocated to the party that exercises control and has sufficient capacity.

Once a transaction is considered a loan, the conditions need to be in agreement with the arm’s length principle and thus article 8b of the Netherlands Corporate Income Tax Act 1969. If the conditions are not in agreement, the loan may in extreme cases be wholly or partly negated or reclassified as equity.

Part of the analysis has to be a two-sided approach, where the position of the unrelated lender is the leading perspective. Such a lender will require a minimum level of creditability of the borrower. The 2022 Transfer Pricing Decree mentions that ratings from AAA to BBB- are considered high to sufficient creditability. This should regularly be tested while the loan is running.

It is also explained that the borrower needs to maintain such a position that the return on equity is not reduced by a too high level of financing costs. If this situation occurs, the group needs to explain why such a loan arrangement is still in agreement with the arm’s length principle.

Benefits from giving implicit support (which will have an impact on the creditability of the borrowing group company) may not be taken into account for corporate tax purposes since they are not in agreement with the arm’s length principle. Group members whose existence is essential for the group will have a credit rating that is the same or almost the same as the credit rating of the group. There is no indication in the Decree on how to determine whether there is implicit support, nor is there any indication of how to determine the value thereof.

The determination of the arm’s length interest rate can be done via various methods. The first preferred appears to be the CUP method, whereby the rate is equal to the rate that independent borrowers with the same credit ratings may obtain on the free market. The “cost of funds approach” is also mentioned, and, under that method, the costs of the related lenders for obtaining the funds may be increased with a plus for the costs of obtaining these funds, a risk premium and a reward for the required equity of the lending group company. Where the lending company only acts as agent or intermediate company and is not in control of the risks of the financing, it is only entitled to a cost plus on the basis of its own costs. The group company that is not in control of the risk is only entitled to a risk-free rate of return – in practice, the interest on government bonds. In such a situation, the borrowing company is nevertheless entitled to deduct the arm’s length interest amount. The difference between these amounts is to be allocated to the group company that is in control of the finance risk. In principle, the entire deducted amount of interest should be included in a tax that is levied on the basis of the profit. Where this is not the case (e.g. if the group company in charge of the finance risk is resident in a country without a tax levied on the basis of the profit) the Netherlands tax authorities state that they have the option to deviate from the above (see also section 1.). Although it is not specified in the 2022 Transfer Pricing Decree, an approach could then be to only allow the deduction of the interest due on the basis of the risk-free rate of return at the level of the borrowing group company.

In Netherlands case law, the Supreme Court\(^{13}\) has introduced a specific category of loans between group companies, namely those where depreciation of the loan cannot be deducted from the taxable income of the lender group company. The case law is not easy to explain, but for the purposes of this article the author will summarize it by stating that it occurs if an independent lender would not have been prepared to make the loan to the borrowing company under the same conditions and circumstances.

An interesting feature of these loans is that the interest payment must still be taken into account at the level of both the group lending company and the group borrow-

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12. For an overview of the possible tax treatments of environmental, social and governance costs, see I. Burgstaller, ESG Transformation and Transfer Pricing Implications, 29 Inttl. Transfer Pricing J. 1 (2022), Journal Articles & Opinion Pieces IBFD.

The financial service company has complete control about the credit risks and/or insufficient financial capacity. In this case, the 2022 Transfer Pricing Decree states that the obvious reward for the company should be related to its operational costs. It is stated that these risks are usually not material when compared to the credit risks.

5.2. Intra-group financial services companies

In section 9.2, the Deputy Minister of Finance deals with intra-group financial service companies. These companies are by law or in fact mainly dealing with receiving and/or making interest, royalties, rent or lease payments. Guarantees and transactions under guarantees are also covered.

For determining the remuneration of these group companies, chapter X of the OECD Guidelines is followed. The main starting point is whether the company is in control of the risks (debt and currency risks, market risks and operational risks) and has sufficient financial capacity to deal with the negative consequences of the risks taken. Taking debt and currency risks that are strongly associated with the cash flows may be a reason for a reward that is dependent on the principal amounts. Only operational risks that are associated with the supporting activities of the financial services company and will not lead to allocation of credit risk to the financial service company are therefore not sufficient.

Three situations can be distinguished:

1. The financial service company has complete control over the credit risks and sufficient financial capacity. Whether such company has sufficient capacity is to be judged by looking at whether that company could, without guarantees provided by other group companies, obtain loans from independent parties. The jurisprudence of the Netherlands Supreme Court deviates from the OECD Guidelines: if a taxpayer asks for advance security, the OECD Guidelines will be taken as guideline because unilaterally provided security needs to be defensible in an international context. In this case, for determining an arm’s length interest rate, the most logical starting point would be the CUP method. In practice, it would appear to be unlikely that a group company would have complete control over its financial transactions and positions.

2. The financial service company has no control about the credit risks and/or insufficient financial capacity. In this case, the 2022 Transfer Pricing Decree states that the obvious reward for the company should be related to its operational costs. It is stated that these risks are usually not material when compared to the credit risks.

3. The financial service company has shared control and the financial capacity needed for that. Also in this case, the financial service company needs to be (partially) both in control over the credit risk and have the corresponding financial capacity. If this is the case, it appears to be appropriate to divide the return pro rata. The Deputy Minister states that he assumes that shared control will rarely happen within a group.

5.3. Cash pooling

In section 9.3, the topic of cash pooling is dealt with in less than one page. For such a complicated issue, from a corporate tax perspective, this seems rather superficial. Two types of cash pooling are to be distinguished: zero balancing cash pooling (at the end of each working day the amounts are booked over to the main bank account) and notional cash pooling (where accounts are balanced outside the accounts themselves). According to the Deputy Minister of Finance, the cash pool leader in the case of notional cash pooling will add less value than in the case of zero balancing and therefore be entitled to a lower reward.

The position of the participants in the cash pool must be tested on whether or not a long-term credit or debt position exists. If that is the case, then these positions may have to be treated as borrowed or lent loans respectively, with arm’s length tax treatment thereof.

Group companies are only considered to take part in a cash pool if this does not lead to a disadvantageous result. Options realistically available need to be considered for each group company. Benefits will not only include advantageous interest rates but also less need for external financing, less administration and more effective management of the liquidity position. Benefits should be divided in relation to the credit and debit positions of the participants.
If cross-guarantees have been agreed on, the view of the Deputy Minister is that no guarantee fee will be owed and that support for another cash pool participant in case of default will be treated as an act in the sphere of capital and not have any effect on the taxable profit of the other participants.

5.4. Guarantees

The provision of a guarantee for debts by unrelated parties will not occur often, certainly not without a decent amount of security. In the case of a guarantee provided for a group company, it needs to be investigated whether there are conditions under which a commercial rational party would be prepared to provide a guarantee for an unrelated party.

The benefit for the borrower can be twofold:

(1) The borrower may be able to obtain a bigger loan than it could have by itself. The excess amount is to be considered as a loan to the provider of the guarantee, after which the latter company will then provide a loan to the borrower. Only for the “direct” loan to the borrower can a guarantee fee possibly be charged. For determining the benefit from the guarantee, the benefit from the implicit support needs to be excluded.

(2) The borrower may be able to obtain more favourable conditions for the loan, also considering the benefit from implicit support (see section 5.1.). If the borrower realizes a benefit through the guarantee (taking into account the possible implicit benefits), there may be an argument for paying a guarantee fee. For determining the benefit from the guarantee, the benefit from the implicit support needs to be excluded.

The Deputy Minister notes that it is unsure whether this treatment of the excess part of the loan would be agreed with in Netherlands jurisprudence.15

The Deputy Minister of Finance states that according to the current OECD Guidelines, the excess part of the loan is provided, in principle, as a shareholder. This means that if the unrelated lender invokes the guarantee, this will – at the level of the group company that provided the guarantee – first be allocated to the part of the loan that the borrower would not itself have been able to obtain. For that part then, no loss can be recognized for tax purposes.

The derivative rating is the one that follows from considering the implicit support and its consequences, considering the position of the borrowing company within the group. In this example, the guarantee fee cannot be higher than the difference between the derivative rating and the group rating. That difference is the maximum benefit the borrower can obtain from the explicit guarantee.

If in an individual case it is not possible to determine the specific arm’s length guarantee, it is approved that the guarantee fee may be 50% of the benefit for the borrowing company from the explicit guarantee.

5.5. Captives

The Deputy Minister makes it very clear that making a group insurance captive acceptable is very difficult. In line with chapter X of the OECD Guidelines, all of the following elements should in principle be present:

– there is diversification, as well as the pooling of risks;
– the equity position of group companies is improved by the diversification;
– the captive is a regulated entity subject to rules regarding actual risk-taking and the required equity;
– the risks can also be insured outside the group;
– the captive has the required knowledge and experience regarding the insurance business and the investment of the premiums received; and
– there is a real possibility that the captive will suffer losses.

The Deputy Minister describes the often lower level of diversification for groups and therefore higher risk premiums required when compared to an unrelated insurer. Less equity for the captive could justify a lower premium but would be insufficient to cover the entire insured risk. Thus the Deputy Minister reasons that the group company would be better off by insuring with an unrelated insurer, and making transactions with the group captive would not be possible.

Further, it needs to be determined whether the captive is in control of the insurance risk.16 The OECD states17 that the underwriting function is to be considered as the control function of the insurance risk. If the captive is not controlling this function, the reward from the premiums needs to be allocated to the company that does control that insurance risk.

A “passive pooler” is defined as an entity in which merely group risks are brought together and then those risks are transferred to unrelated (re)insurers. It is held that a passive pooler is an extension of the risk management department of the head office. In the view of the Deputy Minister, a passive pooler is merely performing an administrative or mediating function since it is not performing underwriting activities itself, is not diversifying and does not have expertise and experience in insurance activities.

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15. Fn. 35 2022 Transfer Pricing Decree.

16. This risk is to be distinguished from the insured risk, which is under the control of the insurance taker.

17. In the Decree, reference is made to para. 10.211 OECD Guidelines and to OECD, Report on attribution of Profits to Permanent Establishments (OECD 22 July 2010), Primary Sources IBFD.
and investing the paid premiums itself. The passive pooler is therefore entitled to only a limited reward. Additional benefits that, for instance, follow from bundling insurances and being able to better negotiate with (re)insurance companies would be attributable to the group companies that bundle the insured risks.

Benefits from good negotiation power may, in the author’s view, be attributable to the passive pooler if negotiation expertise is available. The volume of risks to be insured is probably not the only reason good negotiation results can be achieved.

6. Conclusions

Providing clarity to taxpayers about interpretations of areas in which the OECD Guidelines are not clear or leave options open to countries is to be welcomed. There is a risk that deviating positions could lead to controversies or that during audits the tax authorities could come up with their own interpretations not only of the OECD Guidelines but also of the 2022 Transfer Pricing Decree.

One of the areas where this may occur is where there are deviations between decisions of the Netherlands Supreme Court and the analysis found in the OECD Guidelines. It is quite remarkable that the Netherlands Deputy Minister of Finance indicated that in an international context preference will be given to the OECD approach under the condition that the outcome is in agreement with the arm’s length principle. In the Netherlands, taxes are levied on the basis of legislation, and the OECD Guidelines are not part of that. The arm’s length principle is not a general principle that is higher in rank than Netherlands legislation or decisions of the Supreme Court on interpreting Netherlands law.

It is to be welcomed that clarity is given on how to deal with governmental subsidies in relation to COVID-19. It is a pity that this opportunity had not been used to present the view on ESG costs.

The analysis of captive insurance group companies gives the impression that the Netherlands Deputy Minister of Finance is very critical regarding such arrangements. Underwriting and having sufficient equity are important elements that should indicate that the captive is in control of the insurance risk.

In the new analysis of financial transactions, implicit guarantees are given an important place. A first issue is to determine – for each relevant country – which subsidy is essential and which one is not. Then, in practice, it may be rather easy to state that there is an implicit guarantee, but it is more difficult to quantify the benefit of that.

Apart from these last topics, the Deputy Minister does stress that he thinks it is important to avoid international double taxation caused by transfer pricing corrections. This approach must be welcomed by MNEs and is probably also appreciated by their shareholders and the other countries with more demanding transfer pricing views. Nevertheless, the 2022 Transfer Pricing Decree does introduce several views and interpretations that may create new discussion points. What the outcome of the discussions will be in practice can only be awaited.