New Transfer Pricing Decree: No Longer Ahead of the Curve

The new Dutch transfer pricing decree confirms the Dutch adherence to the revised OECD Guidelines. This new decree very much underscores that the broader value chain perspective has always been an integral part of the Dutch approach to the arm’s length principle.

1. Introduction

On 11 May 2018, the Dutch State Secretary of Finance (the Finance Secretary) published a new and updated transfer pricing decree (the Decree). This new Decree was already announced in the letter from the Finance Secretary from 23 February 2018 which covered an explanation of the Dutch approach to tax avoidance and tax evasion. In this letter, it was announced that this new Decree was going to align the Dutch guidance with the current OECD Guidelines. The aforementioned letter already explained that the current OECD Guidelines entail a greater emphasis on alignment with value creation, new approaches for analysing the division of risks and more guidance around the allocation of income to intangible assets. This February letter also highlighted that so-called “downward adjustments” could potentially be at odds with the approach that the Dutch government wants to adopt for addressing tax avoidance and tax evasion issues. Although the Finance Secretary announced an investigation into the arm’s length principle for this purpose, so far it has not resulted in any different guidance in the new Decree. In fact, the Decree confirms that the application of the arm’s length principle under the Dutch legislative framework could lead to downward adjustments.

This article discusses the most important changes in comparing this Decree to the older version and highlights where the Dutch interpretation may differ from the general OECD guidance.

2. Objectives of the Decree

The Decree clearly emphasizes that the primary objective is to update the Dutch regulatory guidance in line with the OECD BEPS Project. It is remarkable though that the Finance Secretary explains that this new guidance is also relevant for years for which the new (OECD) guidance was not published yet. This article will delve into whether this can be aligned with the old guidance, including the older decree from 2013.

Although the Decree continues to acknowledge that transfer pricing is not an exact science, it does take a firm stance against shifting profits that are violating the arm’s length principle. The Decree highlights that the Dutch authorities want to scrutinize such profit shifting and, even more so, are willing to enforce penalties if the facts and circumstances would justify this. It has to be noted that this penalty threat is unprecedented in the Netherlands in relation to transfer pricing and it confirms that the authorities are determined to take a tougher position in cases where companies willingly deviate from the Dutch interpretation of the arm’s length principle.

Nonetheless, it is important that the Decree continues to reiterate that the OECD Guidelines state that tax authorities should maintain a level of flexibility (or pragmatism) and not expect unreasonable or unrealistic levels of accuracy considering all facts and circumstances. The Dutch tax authorities have always embraced the notion that a single arm’s length price is highly unlikely. Arm’s length conditions can typically only be defined in ranges of arm’s length outcomes. This raises the question on how much emphasis there will be on reducing complexity.

The application of the arm’s length principle has become very complex. There are arguably many different reasons for the increased complexity – not in the least because business models have evolved significantly over time and the accelerated pace of technological developments have changed the nature of intercompany arrangements. Furthermore, another important driver of increased complexity is the continuous change of international guidance. The specific (OECD) guidance around business restructuring, the recent changes to intellectual property approaches, the more detailed delineation of risks and emphasis on risk control functions are good examples of changed guidance that do not contribute to simplification but rather a much broader (and in practice inherently more subjective) interpretation of how facts and circumstances should be aligned with the new guidance. The broader themes around BEPS and the continuously changing attitude of many tax authorities across the globe have also fuelled a tendency towards diverging interpreta-
tions. One of the greatest challenges posed by the current complexity is the rise of controversy and double taxation coupled with a steep increase in uncertain tax positions.

3. The Historic Position under the Dutch Regulatory Framework

The first real Dutch transfer pricing decree dates back from 2001, even prior to the official (formal) codification of the arm’s length principle into the Dutch Corporate Income Tax Act (CITA) from 1 January 2002 (i.e. in article 8b). Although there were older decrees, explaining for example the use of the cost-plus method in the historic ruling context, the 2001 decree was the first decree that truly provided detailed guidance around the Dutch interpretation of the OECD Guidelines on a wide range of transfer pricing topics. It is perhaps interesting to note that, back then, the pricing of intangible property was already covered in this decree quite specifically. Instead of focusing on all different aspects of intangible property transactions, this original 2001 decree solely focused on the situation in which the valuation is highly uncertain at the time of the transaction. However, rather than outlining the important factors as described in the OECD Guidelines, the 2001 decree only emphasized the inclusion of a price adjustment clause. The old decree clearly emphasized the expectation of a price adjustment clause in situations in which the valuation is highly uncertain at the time of the transaction. The underlying rationale is that independent enterprises would not be willing to enter into a fixed arrangement when the valuation is highly uncertain.

In addition, the Dutch approach to transfer pricing already historically had a strong focus on actual functions and risks instead of too much emphasis on mere contractual arrangements. In the 2001 Decree, there is an example pertaining to contract manufacturing that covers a case whereby an affiliate acts as a contract manufacturer on behalf of a group company or principal. In this example, the contract manufacturer is solely producing for the principal. In such a situation, it is critical to examine which company would be bearing the capacity/utilization results. If the principal would bear those risks, the markup could be lower. This example effectively highlighted the importance of a thorough analysis of the functions and risks in order to ensure that the compensation would be in line with the functions performed and risks assumed. It is also relevant to note that this Decree also covers some other specific elements of applying the transactional net margin method (TNMM) under a cost-based PLI such as the relevant cost base. In referencing the OECD Guidelines, the original guidance already highlighted that the cost base should be limited to the supplier’s own costs of goods or services. The costs that relate to services for which the company assumes only an intermediary role (e.g. the coordination of services obtained from other (independent) enterprises) should not be included in the cost base.

As mentioned, the role of the functional analysis has always been at the heart of the Dutch transfer pricing approach. However, with the introduction of the 2004 decree it became clear that the Dutch transfer pricing approach was going to take the focus on (people) functions much further than the OECD Guidelines at that time. In this regard, the approach of the tax authorities placed more emphasis on paragraph 1.27 of the (original) OECD Guidelines, namely “in arm’s length dealings it generally makes sense for parties to be allocated a greater share of those risks over which they have relatively more control”. In fact, the Dutch guidance introduced concepts back in 2004 that were only introduced by the OECD many years later. This can be explained by looking at the example on contract research and development (R&D) in the 2004 decree that was illustrative for how much ahead of their time the Dutch authorities were in terms of focusing on actual people functions and requirements for risk control. This contract R&D example sets out the conditions under which a cost-based TNMM methodology can be considered appropriate for determining an arm’s length compensation for contract R&D activities. Contract R&D or contract development activities entail research, development and/or customization of products for the risk and account of a principal. The principal manages and controls the development or customization activities, bears the costs, assumes the business risks, and becomes the owner (both economic and legal) of any developed asset. The service provider only executes the development/customization activities. The relationship between the service provider and the principal under a contract development model is typically defined in a contractual arrangement. The service provider works under the guidance of the principal and does not incur any meaningful business risks, and would therefore receive only a basic cost-plus remuneration for the provision of the contract services. Consequently, the principal is entitled to any residual profit (or loss). This example clarified that the Dutch tax authorities would typically respect the division of risks and the associated transfer pricing model, as defined within legal agreements, to the extent that the allocation of risks adheres to the division of functions and responsibilities between the two parties (i.e. the principal should have the means to manage and control the underlying activities and risks). The division of functions and responsibilities should be reflected by the actual conduct of the parties and the principal’s financial position (i.e. its equity) to cover the business risks assumed. In illustrating the contract R&D example, it was already recognized in 2004 that the principal should truly “own” the development activities and should therefore be able to “to manage and control” the contractual product development activities and associated business risks. Important elements for justifying such a cost-based TNMM remuneration for a contract service approach entails that the


5. NL: Decree of 21 Aug. 2004 amending the transfer pricing policy, IFZ2004/680M.
functionality and competence requirements of the principal include involvement in decision-making and prioritizing projects, budget aspects, measuring success, defining commercial parameters, assessing opportunities (evaluating whether commercial requirements are technically feasible) and similar responsibilities. The principal is primarily responsible for these areas (and should therefore have the necessary commercial and technical competencies), while the local contract development activities should be geared towards an executive role under the guidance of the principal. In hindsight, this is aligned with the OECD’s emphasis on value creation avant la lettre.

The Dutch government continued to be ahead of the curve with the introduction of the transfer pricing decree of 2013. Many aspects of BEPS Action 8-10 were effectively embedded in Dutch regulatory guidance that was, again, ahead of its time. In particular, even more refined guidance around the importance of value-adding functions in relation to intangible property, specific guidance around synergy benefits/volume benefits for procurement and pooling benefits in relation to internal reinsurance were already introduced before BEPS fully came to live.

Arguably, this is one of the key reasons why the Finance Secretary believes that the new Decree is also applicable for years in which the new (OECD) guidance was not published yet. The Dutch government has always applied the “alignment with value creation” principles and has adopted a “BEPS-like” type of arm’s length standard. In fact, a “substance over form” approach combined with a broader value chain perspective had always been the prevailing approach to applying the arm’s length standard in the Netherlands. Also, in practice, many tax inspectors in the Netherlands generally had the attitude that a new decree did not really change the approach towards transfer pricing in the Netherlands. This was certainly not different back in 2013. Nonetheless, it is important to recognize that both the 2013 decree and certainly the current Decree have very much introduced evolving applications of the arm’s length principle. I specifically use the word “application” since it is much more than a mere different or evolving interpretation.

The key question is whether the current new Decree continues to follow the Dutch tradition to be ahead of the curve or whether it is merely affirmative in terms of embracing all the BEPS principles.

4. Key Aspects of the New Decree

4.1. Characterization of the transaction

In addressing the more general aspects of the arm’s length principle, the Decree starts with clarifying the process for characterizing the transaction. It is important to note that the Decree refers to an analysis of the relevant characteristics of a transaction and makes reference to paragraph 1.36 of the OECD Guidelines. However, where the OECD Guidelines clearly places this in the context of “comparability factors” for accurately delineating the actual transaction, the Dutch guidance suggests that the characterization issue above all is a key step in establishing whether the factual conduct between parties are aligned with the contractual relationships. In other words, the “characterization” as such is an important element of effectively grasping the true economic substance of a transaction. Furthermore, it is important to note that the Decree also refers to transactions that may not have been identified as such by the multinational enterprise. This notion, in combination with a broader economic approach, does suggest that in practice there could be a lot of room for establishing “deemed transactions” that could for example relate to implied transfers of know-how or some type of non-recognized creation of intangible property.

The Decree does follow the OECD’s six-step framework to analyse risks (which is described in a different manner as compared to the OECD Guidelines), as outlined below:

1) Identification of the economically significant risks.
2) Analysis of how these risks are contractually divided between parties based on the agreement and the actual conduct surrounding the transaction characterization.
3) Analysis of how the parties in the transaction relate to the risks based on the following questions:
   a. Who exercises the “control” and “risk mitigation functions” regarding risks?
   b. Who actually bears the positive and negative consequences of the incurred risks?
   c. Who has the “financial” capacity to bear the consequences of the risks?
4) Interpretation of the allocation of risks on the basis of the analysis under questions a. through c. for which it is necessary to assess whether the party that actually assumes these risks does exercise control over these risks and has the “financial capacity” to bear the possible consequences of these risks.
5) If the allocation of risks between (affiliated) parties is similar to the risk allocation between independent parties under comparable circumstances, the underlying risk allocation should be respected.
6) Assessment whether a reallocation of risks is required considering whether or not there is actual control of the underlying risks and/or the required financial capacity to bear these risks.

Although one can observe that the six steps have been described in (quite) a different manner as in the OECD Guidelines, this does not suggest a truly different approach as compared to the OECD Guidelines. Arguably, the most important point is the more explicit reference to a reallocation of risks under item 6 which underscores the continued (and arguably increased) Dutch emphasis on the actual “substance” of the underlying transaction.

However, there is additional guidance that does provide a real differentiation in comparison to the OECD Guidelines.

6. The five factors mentioned under para. 1.36 of the OECD Guidelines are very similar to the original five comparability factors that were already introduced in the OECD Guidelines in 1995, whereby the more sophisticated/refined approach to the functional analysis reflects the most notable change in comparison to the 1995 guidance.
lines. In cases where there are multiple parties controlling risks, whereby only one party is contractually assuming the risks, the Dutch authorities give their interpretation of paragraph 1.105 of the OECD Guidelines. The Finance Secretary states that in such cases, the transactional profit split method can be considered appropriate. So far, there have been many practitioners that considered that paragraph 1.105 could also be interpreted as a “higher or lower” routine remuneration for shared control functions depending on the underlying risk levels. The new Dutch guidance suggests that the Dutch default position will lean more towards a transactional profit split model. The author certainly does not believe that in practice this will always be so black and white. In most companies and complex business models, there is always some level of risk control that occurs in more than one place. It would be unrealistic to expect that every transfer pricing model is subsequently transformed into a transactional profit split model. Strong viewpoints on further aspects of the arm’s length principle can still go hand in hand with a pragmatic attitude towards the realities of how to manage a business on a day-to-day basis. One should arguably read this guidance more in the context of cases where it is crystal clear that the real entrepreneurial risks that drive entrepreneurial profits are controlled in more than one location whilst the contractual allocation of risks centralizes all the entrepreneurial profits in one location.

Furthermore, there is considerable guidance in relation to the notion of disregarding transactions. The Decree emphasizes the importance of the commercial rationale and the two-sided (or multi-sided) perspective. Nonetheless, despite the fact that this Decree has a few paragraphs dedicated to this topic, there is nothing in the Decree that would suggest that the Dutch authorities would like to apply a lower threshold for disregarding transactions relative to the OECD Guidelines. Arguably, in relation to intangible assets this could be different, as further discussed in paragraph 4.3.

4.2. The comparability analysis versus analysing transactions

The Decree acknowledges that the characterization of the transaction is (ultimately) leading to the actual comparability analysis (including the aforementioned factors that are key for defining the characterization). Historically, there has never been too much guidance around specific interpretation aspects in relation to comparability factors and the Decree is not too different in relation to the older regulatory guidance in this area. Not surprisingly, given the Dutch focus on substance, there are specific considerations highlighted in relation to “alternative options realistically available” and the multi-sided perspective. However, it is important to note that in the current Dutch guidance it is clear that in analysing an individual transaction, or set of transactions, there should always be an overall assessment whether or not the profit/ result of the affiliated company involved is still considered arm’s length in light of its (broader) functions, assets and risks. Such an assessment should also consider the price/conditions in other transactions and/or with other affiliated companies. This theme is very consistent with the original guidance from 2001 since one of the three main aspects of the application of the arm’s length principle was as follows:

enterprises involved in intercompany transactions should receive a consideration that reflects the function that each enterprise performs (taking into account assets used and risks assumed).

Already back then, this was purposely phrased differently as compared to the original guidance from paragraph 1.20 from the 1995 OECD Guidelines:

In dealings between two independent enterprises, compensation usually will reflect the functions that each enterprise performs (taking into account assets used and risks assumed).

The (overall) relative contribution to functions, assets and risks is effectively leading in determining an arm’s length result.

Thus, under the Dutch approach, one should not simply look at one transaction in isolation but always take into account the broader perspective. This is not only very much aligned with the overall value chain perspective but the broader perspective also has its roots in older transfer pricing jurisprudence. In an older decision of the Supreme Court, it rejected the Finance Secretary’s appeal against a decision by the Tax Court of ’s Hertogenbosch in a case that pertained to a car importer. The Finance Secretary’s appeal focused on a number of elements that included, amongst others, the division of the burden of proof between the tax authorities and the taxpayer. Although the actual case was rather specific, and surrounded by a number of factual uncertainties, the Supreme Court’s ruling not only pertained to the burden of proof but also dealt with the application of the arm’s length principle. The Supreme Court stated that there are no legislative conditions dictating that the arm’s length principle should be applied on a transactional basis. This implies that the arm’s length principle could be applied at the level of a series of transactions rather than an individual transaction. The Supreme Court even provided their interpretation of the OECD Guidelines and stated that the OECD Guidelines do not provide for a different way of applying the arm’s length principle. The Supreme Court even went one step further by stating that under certain circumstances, one should not look at individual prices but rather at the profitability as a whole of a controlled entity in light of its risks and capital employed. Thus, the true functional approach reflecting the broader set of intercompany arrangements has a solid foundation in the Dutch approach to transfer pricing.

This broader perspective should also be seen in light of the fact that the OECD Guidelines always acknowledged that multinational enterprises can adopt a greater variety of contracts and arrangements as one may observe seen.

7. See Oosterhoff, supra n. 4.
8. NL. Hoge Raad (SC), 28 June 2002, nr. 3446, and NL. Tax Court’s Hertogenbosch, 20 June 2000, nr. 96/03012.
9. It must be noted that the Supreme Court’s ruling pertained to the legislation prior to 1 Jan. 2002.
amongst third parties. This mere difference is not necessarily a problem as long as arm's length conditions can be established. In this context, it is crucial to always consider the broader perspective of intercompany transactions to better understand whether such arrangements are inherently linked. The Decree continues to refer to paragraphs 3.9 through 3.12 of the OECD Guidelines in relation to aggregation of transactions.

4.3. Specific considerations in applying transfer pricing methods

Consistent with the original guidance that was applicable since 2001, the Decree still confirms that all OECD transfer pricing methods are acceptable in the Netherlands. Furthermore, it also continues to confirm that the Dutch authorities, in case of a transfer pricing investigation, should use the method that was applied by the taxpayer to set its prices. The Dutch authorities still do not favour the “best method rule”. However, despite the absence of a best method rule, the taxpayer should be able to substantiate the choice of a certain transfer pricing method. Also, the Decree continues to acknowledge that several methods could also be used in conjunction.

There is a specific consideration in relation to the application of the CUP method. The Decree specifically acknowledges that in practice, it is very difficult to apply this method since in most cases there are hardly any CUP references that can be used to apply it (and adhere to the comparability standards) in a reliable manner. For this reason, the Decree acknowledges that in practice, the TNMM often needs to be applied as the most appropriate transfer pricing method instead. In relation to applying the TNMM, the Decree also specifically explains that the TNMM should only be applied to the least complex entity and that this will typically not be the party that is entitled to the return on intangible assets considering the division of functions, assets and risks. In practice, this approach has always been followed in the Netherlands but it is certainly helpful to specifically also acknowledge this in the Decree in light of the broader discussions around the applicability of the TNMM in certain cases—. It is important to note here, following the broader discussion under paragraph 4.2, that, for the application of the TNMM, it is essential to consider the broader value chain perspective by not merely looking at individual transactions in isolation, as well as the possible aggregation aspects. Under this approach, the Dutch perspective on a (factual) two-sided analysis has always been a multi-sided perspective with full recognition of the broader set of arrangements that can be interlinked.

Furthermore, in paragraph 5.5 of the Decree there is a specific section around the remuneration for using intangible assets. Specifically in the context of intangible assets, the Decree emphasizes that the Dutch tax authorities are very critical of external CUP analyses through database studies since there typically is no sufficient reliable information to assess whether comparability standards can be met. This has been the policy of the Dutch tax authorities ever since the Coordination Group Transfer Pricing was established in 1998 and which has since become well known among practitioners. However, it is the first time that this is so clearly articulated as part of the regulatory framework. The Decree also explains that one-sided methods, like the TNMM, can be applied to indirectly determine an arm’s length result for the intangible asset by first determining the remuneration for the tested party. This can be done in cases whereby the residual profit can be allocated to the intangible asset and the associated functions in relation to this asset. More specifically, if a Dutch entity is performing routine activities and the key functions in relation to foreign-owned IP are also performed outside the Netherlands, the TNMM may be used to indirectly determine the value of the foreign-owned IP. A key condition under this approach is that all other functions, assets and risks are adequately compensated. Again, this policy has been in place since (at least) 1998 but has not yet been described in this level of detail in any administrative decree. Since there are many cases whereby there are a) no internal CUPS in relation to intangible assets and b) no external CUPS that are sufficiently comparable (or with sufficient data to validate the comparability standards), it is crucial that indirect approaches accounting for the arm’s length remuneration of the other functions can be used for substantiating the residual profit that can be allocated to intangible assets (and the underlying functions associated with these intangible assets). The broader value chain approach is also clearly described in the current OECD Guidelines in paragraph 6.3.2 in stating that “other members of the legal owner’s MNE group may have performed functions, used assets, or assumed risks that are expected to contribute to the value of the intangible”. This is further echoed in paragraph 6.4.2: “The return ultimately retained by or attributed to the legal owner depends upon the functions it performs, the assets it uses, and the risks it assumes, and upon the contributions made by other MNE group members through their functions performed, assets used, and risks assumed.

The Decree also provides important guidance around cost-based PLIs. If a third party would not realize a profit on certain costs, such costs should also not be included in the context of intercompany transactions. A specific example is provided in relation to intermediary roles (with a reference to paragraph 7.3.4 of the OECD Guidelines) that clarifies that in such cases, the cost base on which a markup should be applied needs to be limited to the costs for which the company contributes through its own functions, risks and assets but not in relation to services supplied by third parties. This guidance is not new and the Decree continues to refer to costs with a “disbursement nature” that should not be included in the cost base. However, the Decree also contains a helpful example that illustrates that this may also pertain to services/activities provided by other group companies and that the underlying costs should therefore not be included in the cost base.

The actual example pertains to a manufacturer whereby the manufacturing affiliate is engaged in processing raw materials but that, in light of its functions, does not incur any risks in relation to these raw materials. The relevant functions in relation to raw materials are performed by
other (group) companies. In such cases, the relevant cost base for applying a markup should be limited to the cost base that can be associated with the affiliated manufacturer’s own functions, risks and assets but not the underlying raw materials. In a separate footnote, such an example is referred to as a toll manufacturer. Consistent with the broader Dutch focus on economic substance, this example clarifies that the legal arrangement or the underlying administrative arrangements are not leading for characterization of a transaction. The underlying (functional) characterization of the transaction (i.e. toll manufacturer) should be based on the relevant facts and circumstances whereby the mere legal title is not decisive but the underlying functions, risks and assets drive the characterization. Although all practitioners recognize that this approach has always been adopted in the Netherlands, it is nonetheless very helpful that the Decree explicitly confirms this.

Another helpful example, following a similar aspect around an approach that has always been applied in the Netherlands, pertains to legal buy-sell arrangements whereby the underlying functional contribution is limited to an administrative contribution to a sales transaction (and the sales function is performed elsewhere in or outside the group). In this example, a Dutch affiliate may engage in a legal buy-sell arrangement and therefore record revenue on its books but it does not perform any sales or revenue-generating functions. Consistent with paragraph 2.39 of the OECD Guidelines, the intermediary company in such a case is not considered to add any value to the actual sales activity (not does it incur any risk) and should therefore also not be entitled to sales related return. More specifically, this means that a revenue-based remuneration would not be appropriate but instead a cost-based profit level indicator should be applied that accounts for the relevant operating costs of the intermediary company. This approach recognizes that the revenue that is recorded in the profit & loss statement of such an intermediary is not leading for the underlying characterization if the functional contribution does not include a sales function but a mere administrative function. Given the geographic position of the Netherlands and its role in logistics and warehousing, it is relevant to note that there are many logistics facilities based in the Netherlands whereby, for the sake of administrative simplicity, the revenue is often legally recorded in their books. In all these cases where there is a mere logistics activity without any sales functionality, the arm’s length remuneration should be based on the relevant operating costs instead of the revenue that is booked/administered in their profit and loss statements.

In the annual report from the APA/ATR team in 201710 this was also specifically discussed. Specifically for APA purposes, it is recognized that if the revenue is legally booked in the profit and loss statement without the underlying sales functionality, it is possible to obtain an APA whereby the remuneration is based on a cost-based PLI if it is clear that the underlying rationale for the revenue reporting is based on valid business reasons. In practice, this is often driven by the need to reduce administrative complexity through a reduction of the number of (individual) flows.

### 4.4. Valuation approaches and asset transfers

The Decree acknowledges that the applicable valuation methods as discussed under the OECD Guidelines are applicable in the Netherlands. However, the Decree also very much emphasizes that valuations should account for the perspective of all parties involved. In other words, both the buyer and seller perspective should be accounted for. It is important to note that under the Dutch approach it is expected that the buyer perspective reflects a higher price as compared to the seller perspective and that the two-sided approach would typically reflect a value that falls within the range established by the buyer versus seller perspective. It goes even further to note that the value resulting from a valuation analysis is therefore not the same as the resulting arm’s length price for a transaction. In relation to the buyer versus seller perspective, the Decree works with the “fiction” that a transaction between third parties would never take place if the buyer perspective does not reflect a higher value as compared to the seller perspective. According to the Decree, under arm’s length conditions both parties have a more attractive alternative under such a fact pattern and that is not to engage in this transaction. Unfortunately, the international application of the arm’s length principle is increasingly moving away from the actual comparison with third-party conditions to predetermined “fictions” that effectively dictate what is considered arm’s length behaviour. The above is a good example that simplifies the world of real third-party transactions for a preconceived notion of what is expected to reflects arm’s length conditions. In the real third-party world there any many aspects around bargaining positions that could provide for a very different answer than this outlined “fiction”.

Specifically in relation to both tangible and (even more so) intangible assets, the Decree continues to apply the condition that a transfer of such an asset to an affiliated company will not meet the arm’s length standard if the acquiring company is not able to enhance the value of this asset because the underlying functionality is not there and the underlying risks cannot be actively managed. Further to the aforementioned “fiction” around the buyer and seller perspective, the Decree explicitly states that if the overall profit of the multinational enterprise does not increase as part of the asset transaction, the transaction will not be recognized under the application of the arm’s length standard. It will be very important to carefully consider this guidance since the Dutch tax authorities are very determined to follow this guidance and in particular in outbound transactions whereby the Dutch tax authorities suspect that the foreign buyer’s functionality is limited.

Furthermore, and not surprisingly, the Decree acknowledges the importance of DEMPE (i.e. development, enhancement, maintenance, protection and exploitation of intangibles) (control) functions. It specifically states that the “development” and “enhancement” function

---

10. See Letter of the State Secretary for Finance, supra n. 2, at appendix V.
will be assigned a higher weight in measuring the relative importance of the different DEMPE contributions in relation to intangible assets. It would be expected that in many Western countries, a similar interpretation will be followed. However, in countries like China and India one should expect a very different perspective on this with more emphasis on the unique attributes of its local market. Furthermore, given the more recent developments in the area of digital taxation, it is somewhat ironic that the European perspective on value creation for digital companies with no or a limited local presence seems to move very much in an opposite direction.

In relation to intangible assets where there is high uncertainty around the valuation as such, the Decree continues to emphasize the Dutch preference for including a price adjustment clause. Such a price adjustment clause can provide for both an upward and a downward adjustment of the price. The guidance around hard-to-value intangibles introduces something new under the Dutch regulatory framework and this entails the adoption of (effectively) using hindsight. If there are significant deviations between the actual results and the forecasted results that were the basis for the original valuation, this can trigger an adjustment. The Finance Secretary has stated that a deviation of more than 20%, which will materialize in the first 5 years after the transfer, will be considered a significant deviation that can justify an adjustment to the original established arm’s length value on the basis of the valuation.

There is also specific guidance around certain cases that the Dutch authorities have often observed in practice. For example, an acquisition of a company through a share deal is often accompanied with a subsequent step whereby the intangible assets of the acquired company are transferred to an affiliated company. In such cases, the State Secretary for Finance states that the following is relevant:

- The substantiation of the market/arm’s length value of the shares can include relevant information in relation to the value of the assets (and should therefore be included in the transfer pricing documentation covering the transfer of the intangible asset).
- In addition to the general OECD valuation guidance, there should be a specific focus on the allocation of synergy benefits, the tax qualification of the so-called control premium, the valuation of the remaining routine functions and the impact of taxation.
- The original purchase price allocation from the perspective of the buyer can provide a good indication of the market value of the intangible asset. It must be noted that it is suggested that this is a “minimum” reference considering the Dutch “fiction” that an intangible transfer will only take place if the buyer will increase the value of the underlying intangible asset.
- The selling party should consider the impact of the taxation of a potential capital gain in case of an asset transfer. In general, the selling party is expected to at least realize a value that includes a compensation for the taxation due on a capital gain. It must be noted that the OECD Guidelines are less decisive in how a tax amortization benefit should be considered. It is a factor that may need to be included in the overall assessment of the value. However, the Dutch tax authorities seem to have introduced a new “fiction”, i.e. that in a negotiation between two independent parties, the selling party will always be able to negotiate a value whereby the buyer pays a premium for the tax cost of the seller. One can argue that the relative bargaining positions could also dictate very different outcome, depending on the facts and circumstances. This guidance is clearly written from the outbound transfer perspective.

- If routine functions are not transferred and stay with the selling entity, the Dutch tax authorities do not necessarily accept that the remuneration of these functions are treated as a “going concern” for valuation purposes. The underlying rationale is that the Dutch tax authorities believe that the performance of routine functions (for one principal) typically have a short economic life and can therefore not reflect a perpetual value. In practice, the Dutch tax authorities have scrutinized cases whereby this approach was used to effectively lower the value of the transferred intangible asset.

4.5. Other aspects of the Decree

The Decree also covers a number of other topics. In relation to intra-group services, the Decree introduces the option of the simplified method for determining arm’s length fees for low value-adding services. Following the OECD Guidelines, this approach can be followed in the Netherlands provided that it meets the following conditions:
- the services are supportive in the overall business processes;
- the services are not part of the primary business processes of the multinational enterprise;
- the services do not require the use of unique and valuable intangibles and do not lead to the creation of such intangibles; and
- the services are not associated with the key risks that the company is faced with.

Under these conditions, 5% of the markup, without the need for a comparability study, can be applied. This approach cannot be applied if these services are also rendered to third parties. Furthermore, a pragmatic approach will be followed in relation to the benefit test through a general approach instead of a benefit test on all the individual services. If the taxpayer does not opt for the simplified approach for such services, it is still possible to charge all relevant costs without a markup if the underlying services meet the low valued-adding criteria, consistent with the original Dutch guidance. However, this approach will only be accepted if all relevant costs are charged including financing costs. The guidance of low value-adding services is helpful since it reflects one of the (very) few aspects
of the new BEPS Actions 8-10 guidance that is geared specifically towards reducing complexity.

In relation to the other topics of the Decree, including contract research, cost contribution arrangements, intragroup purchasing, guarantee fees, internal reinsurance and financing transactions, the underlying changes in terms of new guidance are much more limited. Broadly speaking, the 2013 guidance is still very much relevant in these areas and has not been impacted much by evolving interpretation of the arm’s length principle.

The Decree does offer some additional insight into the Dutch transfer pricing documentation requirements. In particular, it clarifies that if a Dutch taxpayer prepares documentation in accordance with article 29g of the CITA, the taxpayer will have also complied with the (original) Dutch transfer pricing documentation requirements from article 8b of the CITA. It is noted that the original documentation requirements have a broader reach, covering both cross-border and domestic transactions. For instance, the new requirements under article 29, for qualifying taxpayers, pertain to cross-border transactions and the allocation of profits to permanent establishments.

5. Reflections and Conclusions

In observing the historic transfer pricing decrees, in particular the ones from 2004 and 2013, it was clear that the Dutch regulatory guidance was ahead of the curve and in many ways set the stage for the later OECD guidance. The current Decree is not so much ahead of the curve; overall, it is merely a confirmation of how the Dutch authorities embrace the new BEPS guidance. It is certainly not a bad thing to no longer be in the lead. The reality of all the current OECD guidance is that the application of the arm’s length principle has become too complex. In all the efforts to refine the arm’s length principle, companies are now facing very complicated challenges in terms of how to interpret the guidance and how to translate this to something practical that can be implemented in a workable manner. Part of the complexity is that the new BEPS guidance provides much more room for interpretation and it is certainly not a secret that taxpayers are increasingly confronted with diverging interpretations of different tax authorities. The number of MAP cases continues to rise and in many cases the country’s respective position papers are often miles apart.

Another aspect of concern regarding the current international guidance is that the original simple application of the arm’s length standard and the real comparison with third-party transactions have frequently been replaced by “fictions” of what is considered arm’s length behaviour. Instead of observing the market reality between third parties, there is an increasing reliance on prescribed notions of what is considered to reflect arm’s length conditions. Instead of testing arm’s length conditions, the balance has shifted more towards guidance on how arm’s length conditions should be “simulated” with very specific and complex interpretation aspects. Although the Decree offers very helpful and practical guidance, it unfortunately also introduces some of these aforementioned “fictions” which are not only undesirable but which even seem to go a bit further than the OECD Guidelines, in particular in relation to the conditions around intangible transfers and some of the underlying valuation aspects.

Despite my concerns on the overall direction of international transfer pricing, it is very helpful that the Decree clarifies a number of points. The Dutch approach to the characterization furthers the emphasis that the Dutch authorities always placed on true economic substance. The approach to transfer pricing in the Netherlands had always been founded on “substance over form” analyses. The current Decree guidance around the use of the TNMM, also in relation to specific intangible asset transactions, and the approach towards the CUP may not be groundbreaking as such but it has never been described as clearly as it is done now. This also holds true for applying cost-based PLIs versus revenue-based PLIs, clarified in relation to broader intermediary roles and specific manufacturing roles. In essence, the true nature of transfer pricing – focusing on the actual division of functions, risks and assets instead of too much emphasis on the underlying legal or administrative arrangement, including the topic of whether or not revenue is recorded in the books, has never been described as clearly as it is stated now. From that perspective, one can argue that the Decree does in fact also contribute to reduced complexity. It provides less room for interpretation in these areas and this should be welcomed from both a Dutch and international perspective.

However, it is important to note that taxpayers should be ready for more audit activity and more scrutiny in the Netherlands. The reference to penalties, which reflects a greater willingness to really scrutinize taxpayer arrangements in cases were positions are taken that are very much different as the Dutch tax authority position, combined with the aforementioned specific guidance on characterization aspects, intangible assets and valuations, will make the preparation of robust documentation more relevant than ever before. It is expected that the documentation requirements under article 29 will be enforced rigorously given how determined the Dutch government is in embracing and in some aspects even spearheading the broader BEPS initiatives. If Dutch transfer pricing policies are not (yet) aligned with the OECD guidance set out in the BEPS Actions 8-10 Final Reports, it is certainly key to undertake the required steps. The “dynamic interpretation” of the OECD Guidelines is probably fuelled by an inherent belief in the Netherlands that the main principles behind the BEPS guidance were always followed already in the Netherlands. In hindsight, one can certainly confirm that in many ways the Dutch policy was ahead of its time, but it is a good thing that we are now more in a confirmation mode instead of trying to be ahead of the curve. Simplification ultimately beats adding more complexity.

---
