

Dutch anti-base erosion rule in violation of EU law?

- The Dutch Supreme Court has recently requested a preliminary ruling from the Court of Justice of the European Union ('CJEU') on whether the Dutch anti-base erosion rule (article 10a CITA) is a violation of EU law.
- The deduction of interest expenses on related party debt may be denied under the Dutch anti-base erosion rule if such debt is used for specific 'tainted transactions', including the acquisition of an entity that is or becomes a related party. Counter evidence rules may apply.
- The preliminary request is triggered by the recent CJEU *Lexel* ruling in which the CJEU ruled that the denial of deduction of at arm's-length interest expenses under a Swedish interest deduction limitation rule (similar to the Dutch anti-base rule) is in violation with EU law.
- In its case law on direct taxation, the CJEU has held that the need to prevent tax avoidance or abuse can constitute an overriding reason in the public interest capable of justifying a restriction on fundamental freedoms. The notion of tax avoidance is however limited to '*wholly artificial arrangements aimed at circumventing the application of the legislation of the member state concerned*'.
- The Dutch Supreme Court has consistently ruled that debt in scope of the Dutch anti-base erosion rule should be considered 'a wholly artificial arrangement' regardless of interest expenses being at arm's length.
- However in *Lexel*, the CJEU ruled that 'transactions which are carried out at arm's length and which, consequently, are not purely artificial or fictitious arrangements' cannot be a justification for a restriction on fundamental freedoms even if this is based on the fight against tax evasion and tax.
- According to the Dutch Supreme Court (in double negative), a correct interpretation of the *Lexel* ruling should not be that all transactions that are entered into at arm's length conditions do, by definition, not constitute wholly artificial arrangements.
- If the CJEU follows its judgement in the *Lexel* ruling, the Dutch anti-base erosion rule could be considered in violation of EU law to the extent that the deduction of at arm's-length interest expenses are denied.

Taxand Netherland's Take

- The question arises how to assess 'transactions which are carried out at arm's length'. Should this be assessed on an isolated basis for the loan itself (and interest rate) or is assessment of the series of transactions as a whole required (e.g. funding within in the group).
- If the CJEU rules that the Dutch anti-base erosion rule is a violation of EU law for at arm's length interest expenses, the impact of such ruling is expected to be substantial for the Dutch tax practice, especially for (international) M&A transactions and private equity structures.

- The *Lexel* ruling once more confirms the importance of having proper transfer pricing documentation available. Our dedicated Transfer Pricing team is able to provide the support and documentation you need.
- Please reach out to your trusted Taxand Netherlands advisor to discuss the potential impact of the preliminary ruling request and to keep you informed on future developments.