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RSM Netherlands International Tax Services is a key service line with dedicated staff who manage solely international inquiries and align both the offshore with domestic specialist services. This provides a holistic approach to clients' international needs. This structure is further enhanced by the commitment of RSM Netherlands partners and staff who actively lead international specialist areas and consistently work with their worldwide counterparts on providing solutions to internationally active companies.

New decree on the allocation of profits to a (Dutch) Permanent Establishment

Companies that conduct business activities abroad without having a separate legal entity could be subject to local corporate income tax if the business activities qualify as a permanent establishment ("PE"). The income to be reported by a PE is often quite difficult to determine. On January 27, 2011, the Dutch Ministry of Finance published a decree on the allocation of profits to Dutch PEs.

Since a PE is not a "separate legal entity", the assets and liabilities as well as the profit and loss items at the level of the head office need to be attributed to the PE in accordance with the activities of the PE. The starting point for such allocation is the identification of the so-called "significant people" functions, a term that was introduced several years ago by the OECD. A significant people function is for instance available if employees in a certain country are (operationally) managing certain business assets (or liabilities) and also managing the resulting business risks. From a transfer pricing perspective, generally assets and liabilities should be allocated to the country where the significant people functions are located.

In its decree, the Dutch Ministry of Finance outlines different scenarios with respect to the allocation of (intangible) fixed assets and the recognition of internal dealings (services rendered between the head office and the PE). If the asset allocation and the risk profile of the Dutch business activities are clear, the funding of the Dutch business should follow. Capital or funding allocation rules could be quite detailed and complicated and require immediate attention for most tax payers. In general, no more debt can be allocated to the PE than the company as a whole. The actual allocation of capital (or debt) is often a risk weighted percentage of the company's total. If the actual finance structure of the (entire) company is not at arm's length (or feasible), the Dutch Revenue may look at independent third party comparables for the actual finance position of the PE.

Although the profit allocation approach using significant people functions is relatively new, the Dutch Ministry of Finance believes that this approach can immediately be applied. In the view of the Dutch Revenue, the existing tax treaties should not prevent the application of this new concept. Although many countries do apply OECD principles, we believe that the new allocation and profit determination approach of the Dutch Ministry of Finance may result in double taxation if the tax authorities of the foreign head office do not apply the same principles. Nevertheless, the Dutch Ministry of Finance is willing to provide advance agreements to taxpayers and start discussions with foreign tax authorities to reduce the possible risk of double taxation. Finally, it should be emphasized that the view of the Dutch Revenue is not always decisive, since there are always circumstances and situations that may justify that other approaches provide a more accurate at arm's length result.

The Dutch tax returns of most Dutch PEs are derived from separate commercial statements or the general ledger that has been prepared for the Dutch PE. We recommend reviewing whether the commercial allocation rules and internal recognised dealings are in line with the principles outlined in the decree. If there are significant differences, we believe that in most occasions solutions can be found to mitigate possible risks of double taxation. The decree may also impact the wording and substantiation of existing transfer pricing documentation. This issue can be verified by conducting a transfer pricing quick scan which provides recommendations for improvement and optimization of the existing transfer pricing framework.

If you need further information or assistance with the implementation of our recommendations, please do not hesitate to contact us or your local RSM contact person.

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