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A: Anti-avoidance measures of general nature and scope – GAAR and other rules

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Summary and conclusions

In the Netherlands, there is a statutory GAAR, namely *richtige heffing* and a court developed GAAR, namely *fraus legis*. Both are aimed at tax-avoidance situations that contravene the object and purpose of the law. The court-developed GAAR was introduced in a case of 26 May 1926 and is currently (effectively) the only applicable GAAR in the Netherlands.

The statutory GAAR has not been applied since 1987. Therefore, this report mainly focuses on the court-developed GAAR of *fraus legis*.

In the Netherlands, as developed by case law, there are two requirements for applying *fraus legis*, namely (i) the essential motive (the only or predominant objective) for entering into a legal act or a set of legal acts is to avoid Dutch taxation (the subjective requirement); and (ii) the arrangement is contrary to the object and purpose of the legislation (the normative requirement).

When *fraus legis* is applied by the courts, it is important to keep in mind that the application of *fraus legis* is considered to be an '*ultimum remedium*' and, therefore, only after all normal interpretation methods have been exhausted, does *fraus legis* come into play.

Another important feature in the application of *fraus legis* is that it will not and cannot always be (successfully) used by the tax authorities to tackle tax avoidance and/or aggressive tax planning. This is especially due to the normative requirement of *fraus legis*. The application of *fraus legis* to tax avoidance and aggressive tax planning will be limited to transactions for which the motive of the taxpayer is to prevent the levying of Dutch tax by creating arrangements that are *contrary to the object and purpose of Dutch legislation*. This implies that, even if the only objective of an arrangement is a tax reason, *fraus legis* will only apply if the arrangement is contrary to the object and purpose of the Dutch legislation (normative requirement). For example, the fact that an international mismatch occurs does not mean that the structure contravenes the object and purpose of the law.

Unlike the *richtige heffing*, the application of *fraus legis* makes it possible not only to ignore the arrangement but also to recharacterise the arrangement in such a way that taxation complies with the object and purpose of the relevant tax legislation. The result of *richtige heffing* was limited to disregarding the arrangement.

In general, for the application of *fraus legis*, the tax administration bears the burden of proof. Once there is *fraus legis*, either disregard or recharacterisation will take place depending on the facts of the case.

Finally, another important element in the Netherlands is that the existence of *fraus legis* does not involve, in itself, the imposition of a penalty. A penalty will not be imposed if the taxpayer, in its tax return, took a position that was incorrect, yet that position was defensible

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to a certain degree and, as a result, the taxpayer could reasonably assume that he was taking the correct position. This is called a 'defensible position'.

To determine whether a position is 'defensible', one has to look to the arguments that the taxpayer used (or could have used) to come to its position. As *fraus legis* is an '*ultimum remedium*', apparently the structure could not be successfully challenged on the basis of other interpretation methods, such as looking at the wording of the law. In such a case, the fact that the wording of the law favours the position of the taxpayer is a strong argument that the taxpayer has a 'defensible position'. The taxpayer can argue that it had a defensible position in respect of tax structures that were used by the taxpayer by taking into account the legislation available at that moment and concerning which there were no precedents in case law that may result in such a transaction being regarded as *fraus legis*. However, the possibility to argue that there was a defensible position of the taxpayer will be limited, for instance, in cases involving prior case law that could be characterised as dealing with a similar or identical transaction to which *fraus legis* was considered to be applicable. Nevertheless, if the taxpayer can still argue that the case law was not applicable because there were differences between the past case and the current transaction, then the defensible position of the taxpayer will still be upheld and the fine should, in principle, not be levied.

Introduction

In the Netherlands there is a statutory GAAR, namely *richtige heffing*[3] and a court-developed GAAR, namely *fraus legis*. The statutory GAAR was introduced in 1925. The court-developed GAAR was introduced in a case of 26 May 1926 and is currently (effectively) the only applicable GAAR in the Netherlands,[4] because *richtige heffing* has not been applied since 1987, as we will explain below. Both are aimed at tax-avoidance situations that contravene the object and purpose of the law.

There are no relevant distinctions in the substantive conditions for the application of *richtige heffing* and *fraus legis*.[5] However, there is a difference regarding the type of taxes to which *richtige heffing* and *fraus legis* are applicable.[6] Another difference is that, unlike *fraus legis*, *richtige heffing* does not make it possible to recharacterise transactions, but only ignores

[3] Probably best translated as 'rightful taxation' or 'correct taxation'. It was introduced in the *Wet tot bevordering van de richtige heffing der directe belastingen* (Act to promote the rightful levying of direct taxes) of 29 April 1925. In 1959, *richtige heffing* was transferred to art. 31-36 of the *Algemene Wet Inzake Rijksbelastingen* (General Tax Act).

[4] Some of the recent literature in English that have addressed the GAARs, including also the differences between *richtige heffing* and *fraus legis*, are S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD, section 21.1.1.; M. de Wilde and C. Wisman, Chapter 19: *The Netherlands, in Tax Avoidance Revisited in the EU BEPS Context*. A. P. Dourado ed., IBFD 2017. 2016 European Association of Tax Law Professors (EATLP Congress Munich 2-4 June 2016.

[5] Reference is made to Supreme Court, 21 November 1984, BNB 1985/32 and Supreme Court, 20 March 1985, BNB 1985/171. See also R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002; S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD section 21.2.4. See also *Kamerstukken II* 1986-1987, 17050, no. 80, pp. 8-10.

[6] Richtige heffing could only be applied to direct taxes, such as personal income tax and corporate income tax, whereas fraus legis can also be applied to indirect taxes, such as value added tax.

transactions.[7] Another difference between *richtige heffing* and *fraus legis* is the procedure to apply it. For *richtige heffing* to be invoked by a tax inspector to challenge a tax-avoidance structure, prior approval by the Minister of Finance is necessary. Such approval is not required for *fraus legis.*[8]

As of 1 August 1987, the Ministry of Finance *"decided to promote the use of fraus legis by denying approvals for the application of* richtige heffing."[9] Therefore, even though still in the statute, the application of *richtige heffing* has become obsolete.

In light of the above, this report will mainly focus on the court-developed GAAR of *fraus legis*[10] [11] with very limited reference to the statutory GAAR of *richtige heffing* (see section 2.2 below for some selected case law).

It is important to note that the application of *fraus legis* is been considered an '*ultimum remedium*'. This means that the application of *fraus legis* in the Netherlands *"can only be considered after interpretation and characterisation, according to the normal interpretation methods, have been fully utilised without this leading to an outcome that can be regarded as consistent with the object and purpose of the law*".[12] This approach will have consequences for the application of *fraus legis* to tax avoidance and aggressive tax planning, as will be addressed in section 1.2 below.

This report is structured as follows: part one will provide a description of the main elements of *fraus legis* and its relationship to SAARs and tax treaties; in part two, some selected case law regarding *richtige heffing* and *fraus legis* will be discussed; part three will stipulate the safeguards for taxpayers.

7 *Kamerstukken II* 1986-1987, 17050, no. 80, p. 9. The EATLP Dutch report states that: *fraus legis* "allows the courts to either ignore or substitute legal arrangements, whereas the application of *richtige heffing* only allows these arrangements to be set aside". M. de Wilde and C. Wisman, *Supra* n. 4 at 477.

8 The differences between *fraus legis* and *richtige heffing* have been already addressed in the 2002 Dutch Report. See R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, SDU Uitgevers, the Netherlands, 2002, pp. 451-472.

9 *Kamerstukken II* 1986-1987, 17050, no. 80, pp. 10 and 11. See J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD. Section 21.1.1. See also R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002, p. 453.

10 This report is limited to *direct* taxation and, therefore, value added tax will not be dealt with here. For an overview of the application of *fraus legis* to value added tax, see S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD Section 21.2.2.

11 This report focuses on *tax* law. For civil law purposes, R.L.H. IJzerman has stated that the criteria used to interpret the intention of the parties is not *fraus legis,* but rather the criteria for reasonableness and fairness (*redelijkheid* and *billijkheid*), and therefore, *fraus legis* is rarely applied in civil law. See R.L.H. IJzerman, 'Over fraus legis' *Tijdschrift Formeel Belastingrecht*, 2002/11-12, p. 3.

12 R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002, pp. 452 and 455.

Part One: General Anti-Avoidance Rules or Doctrines

1.1. General overview

This section focuses on the discussion of the court-developed *fraus legis* doctrine as applicable in tax law. In general, it has been regarded by scholarship that *fraus legis* was first introduced by the courts in a decision of 26 May 1926.[13] There are two requirements to apply *fraus legis*. They are as follows:

1. the essential[14] motive (the only or predominant objective) for entering into a legal act or a set of legal acts is to avoid Dutch taxation (the subjective requirement); and
2. the arrangement is contrary to the object and purpose of the legislation (the normative requirement).

The main elements of *fraus legis* and the consequences of the application of the GAARs will be addressed in sections 1.2 to 1.5 below.[15] Some selected case law regarding the application of the Dutch GAARs will be addressed in part two below.

1.2. Fraus legis and tax avoidance and aggressive tax planning

In section 1.1 we have mentioned the two conditions for the applicability of *fraus legis*. Before we discuss these two conditions in some detail in sections 1.3 (the normative requirement) and 1.4 (the subjective requirement), we discuss the general concepts of 'tax avoidance' and 'aggressive tax planning' below. We also explain that 'tax avoidance' or (depending on the definition used; see below) 'aggressive tax planning' can, in many cases, not be successfully challenged on the basis of *fraus legis*.

In the Netherlands, there is no (legal) definition of tax avoidance or aggressive tax planning. Despite this lack of definitions, it can be safely argued that generally the OECD description of tax avoidance is followed in the Netherlands in the fiscal discourse. In this regard, the OECD has stated that tax avoidance is *"a term that is difficult to define, but which is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that although the arrangement could strictly be legal [...] is usually contrary to the intent of the law it purports to follow"*.[16]

Generally, the term aggressive tax planning has been used when referring to tax practices that result in base erosion and profit shifting by multinationals. Tax schemes used by high net-worth individuals are also sometimes described as aggressive tax planning.

In 2008, the OECD published a study into the Role of Tax Intermediaries and their

[13] Supreme Court, 26 May 1926, *NJ* 1926, 723.

[14] In Dutch: *doorslaggevende*.

[15] The normative and subjective test described in sections 1.3 and 1.4 below have also been addressed in the 2002 IFA Report by IJzerman. This report will address the main elements, primarily taking into account the use of GAAR for tax avoidance and aggressive tax planning, as well as new cases that may also influence the application of *fraus legis*. See R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002, pp. 454-457.

[16] OECD Glossary of terms. http://www.oecd.org/ctp/glossaryoftaxterms.htm.

engagement in aggressive tax planning.[17] In this study, the OECD referred to aggressive tax planning without providing a specific or clear definition. The study's glossary, however, stated that aggressive tax planning refers to (i) planning that involves a tax position that is tenable but has unintended and unexpected tax revenue consequences and (ii) taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty as to whether significant matters in the tax return accord with the law. The study further elaborates that the first situation may result in *"tax legislation being misused to achieve results that were not foreseen by the legislators."* The second situation addresses the concern of revenue bodies to *"the risk that taxpayers will not disclose their view on the uncertainty or risk taken involved in relation to grey areas of law"*.[18]

The term 'aggressive tax planning', without a clear definition, has also been used by the OECD in the BEPS Action Plan when referring to tax practices resulting in base erosion and profit shifting by multinationals. In the BEPS Action Plan, the OECD stated that aggressive tax planning has reduced the tax burden of multinationals, leading *"to a tense situation in which citizens have become more sensitive to tax fairness issues"*.[19]

The European Union has defined aggressive tax planning in the European Commission Recommendation of 6 December 2012 on Aggressive Tax Planning. The European Commission stated in its recommendation that *"aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability"*.[20] This definition, however, was provided by the EU only in a non-binding (recommendation) instrument, therefore EU countries are not required to introduce this definition in their domestic law.

As mentioned above, it is important to keep in mind that, in the Netherlands, the application of *fraus legis* will not and cannot always be (successfully) used by the tax authorities to tackle tax avoidance and/or aggressive tax planning (depending on the definition used). This is mainly due to the following features of Dutch tax law and the application of *fraus legis* in the Netherlands.

Firstly, it is important to note that a transaction can be ignored on the basis of the 'sham transaction doctrine'. As IJzerman points out, *"for the application of tax law, the actual relationship between the parties is at issue, and not their misrepresentation of the facts. Only after a configuration of facts has been cleansed of simulated relationships, and thus has become clear in factual and civil law terms, can it be given a tax characterisation and interpretation."*[21] Another important item is the 'fiscal qualification' of the facts. If the tax consequences of a certain legal form are not acceptable in light of the economic result and in light of the object and purpose of the tax law, it can be justified that, for tax purposes, the legal reality is replaced by a fiscal reality. An example of this is the qualification of financing instruments. In principle, for tax purposes, the legal form is decisive for the qualification of an instrument as a loan, but if a loan (from a civil law point of view) has various equity-like elements, it can be

[17] Tax intermediaries is a collective term used by the OECD for tax advisers and financial institutions. See OECD *Study into the Role of Tax Intermediaries* (2008). Glossary at p. 88.

[18] *Ibid.* at p. 87.

[19] OECD (2013), *Action Plan*, p. 8.

[20] European Commission Recommendation of 6 December 2012 on Aggressive Tax Planning, (2012/772/EU) L 338/41 p. 2.

[21] R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002, at. p. 453.

qualified as equity for tax purposes.[22] If one has established the facts, potentially on the basis of the aforementioned methods, then one can look at the verbatim wording of the law to determine the tax consequences of the fact pattern at hand. Also, other interpetation methods (historical, systematic and teleological) will be relevant in determining the tax consequences of a fact pattern.[23] Only after all normal interpretation methods have been exhausted, does *fraus legis* come into play. *Fraus legis* is therefore typically seen as '*ultimum remedium*'.

Secondly, in the Netherlands, especially due to the normative requirement of *fraus legis*, the application of *fraus legis* to tax avoidance and aggressive tax planning is limited to transactions for which the motive of the taxpayer is to prevent the levying of Dutch tax by creating arrangements that are *contrary to the object and purpose of Dutch legislation*. This implies that, even if the only objective of an arrangement is a tax reason, *fraus legis* will only apply if the arrangement is contrary to the object and purpose of the Dutch legislation (normative test). For example, as will follow from the case law to be discussed in section 2.3, the fact that an international mismatch occurs, does not mean that the structure contravenes the object and purpose of the law.

Thirdly, the application of *fraus legis* can be limited by tax treaties. An example is Dutch case law in which a capital gain was recharacterised as a dividend based on a domestic GAAR.[24] Does that also mean that, for treaty purposes, the capital gain should be treated as a dividend? According to the Supreme Court that is not the case if it cannot be demonstrated that the intention of the tax treaty partners was to tackle the abuse.[25] Only a few tax treaties concluded by the Netherlands allow the applicability of *fraus legis*. An example is the double taxation treaty concluded by the Netherlands with Panama (article 27).[26] A second example

22 Supreme Court, 28 January 1988, *BNB* 1988/217.

23 IJzerman in the 2002 IFA report has addressed the interpretation methods used in the Netherlands to find out the purport of the law, being the grammatical, historical, systematic and teleological methods. R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002, at. 458.

24 Reference is made to s. 2.2.

25 In this regard, the IFA 2010 Report stated that "the *Hoge Raad* is very reluctant to apply the domestic *fraus legis* doctrine in treaty situations. The same holds true for the approach of the *Hoge Raad* to counteracting abuse of the tax treaty itself (*fraus conventionis/tractatus*). In its decisions of 15 December 1993, *BNB* 1994/259, regarding a cash-box structure, and 29 June 1994, *BNB* 1994/294, regarding an international holding structure (...), the *Hoge Raad* also held that neither the treaty text nor the explanatory notes of the treaty partners supported the view that the purpose and intent of the treaty would be ignored if the income were not taxed in the Netherlands. It should be noted, though, that it is often difficult to distinguish between *fraus legis* and *fraus conventionis* and that there is no substantial difference between the doctrines." F. Peters and A. Roelofsen, the Netherlands, *Tax treaties and tax avoidance: application of anti-avoidance provisions. Cahiers de droit Fiscal International. International Fiscal Association*, Volume 95A, IBFD, 2010, p. 570. See also S. van Weeghel and R. de Boer. *Anti-abuse measures and the application of tax treaties in the Netherlands*, August-September 2006, pp. 358-364 and L. De Broe et al., *Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions*, 65 Bull. Intl. Taxn. 7 (2011), Journals IBFD.

26 Art. 27 DTC with Panama, signed in October 2010 and in force as of 1 December 2011 states: "Nothing in this Convention shall prejudice the right of each Contracting Party to apply any of its domestic laws and measures for preventing, discouraging, avoiding or counteracting the effect of any transaction, arrangement or practice which has the purpose or effect of improperly conferring a tax benefit to any person. The Contracting States shall designate, by mutual agreement, the domestic laws and measures concerned."

is the double taxation treaty concluded by the Netherlands with Hong Kong (article 27).[27] A third example is the double taxation treaty concluded by the Netherlands with Germany (article 23).[28]

1.3. Normative test

In the Netherlands, the normative test aims to find out whether the arrangement chosen by the taxpayer is contrary to the object and purpose of the legislation.[29] The taxpayer therefore has the freedom to choose the most tax-favourable approach if it does not contravene the object and purpose of the national legislation. This is the case also if such an approach results in the use of a tax structure that takes advantage of mismatches between two or more jurisdictions.[30] An example that can illustrate this is the fact that the Supreme Court has refrained from using *fraus legis* in cases involving a hybrid instrument to address the disparities between tax systems. This case dealt with redeemable preference shares and will be explained in part two below.

Foreign taxation, however, can be important to determine whether a certain arrangement is contrary to the object and purpose of the Dutch legislation. If a Dutch corporate taxpayer tries to erode the Dutch tax basis – in an artificial way – by creating interest costs (e.g. by means of acquiring a group company from another group company against a debt without business reasons being present), then the normative requirement for application would not be met – according to the Supreme Court – if the corresponding interest income were to be taxed in the hands of the group company at a 'reasonable' tax rate.[31] Please note, for the sake

[27] Art. 27 DTC with Hong Kong, signed in March 2010 and in force as of 24 October 2011 states: "1. Nothing in this Agreement shall prejudice the right of each Contracting Party to apply its domestic laws and measures concerning tax avoidance, whether or not described as such. 2. For the purposes of this Article, "laws and measures concerning tax avoidance" includes laws and measures for preventing, discouraging, avoiding or counteracting the effect of any transaction, arrangement or practice which has the purpose or effect of conferring a tax benefit on any person."

[28] Art. 23 DTC with Germany, signed in April 2012 and in force as of 1 December 2015 states: "1. This convention shall not be interpreted to mean that each Contracting State is prevented from applying its domestic legal provisions on the prevention of tax evasion or tax avoidance. 2. Upon the request of the taxpayer, the competent authorities shall consult each other, pursuant to paragraph 3 of article 25, if the domestic legal provisions referred to in paragraph 1 result in double-taxation or if the taxpayer considers the taxation to be not in accordance with the provisions of this Convention."

[29] As rightly stated by IJzerman in the 2002 IFA report, this can be done by the taxpayer placing itself "beyond the letter of a provision that increases its tax burden or under the letter of a tax-reducing provision. In both cases, it abuses the purpose and intent of those provisions." IJzerman has also addressed the cases in which there could be a conflict with the object and purpose of the law. R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002, p. 455 and pp. 461-464.

[30] Hybrid mismatches are dealt with in BEPS Action 2 and in ATAD. See, for BEPS, Action 2 and ATAD in the Netherlands: M. Lukkien and A. Roelofsen, the Netherlands, *Assessing BEPS: origins, standards, and responses, Tax treaties and tax avoidance: application of anti-avoidance provisions. Cahiers de droit Fiscal International. International Fiscal Association*, Volume 102A, IBFD, 2017. pp. 558-560.

[31] See, for example Supreme Court, 10 March 1993, BNB 1993/194; Supreme Court, 10 March 1993, *BNB* 1993/196; Supreme Court, 23 August 1995, BNB 1996/3; Supreme Court, 8 February 2002, *BNB* 2002/118. If interest income in the hands of the creditor was offset against tax losses, the compensatory tax test could be met, except for cases where the losses were so-called 'acquired' losses.

of clarity, that taxation in the hands of the creditor can also mean that there was no tax benefit at all (as a result of which, the subjective test would not have been met), but in the case law at hand, the 'compensatory taxation' was not part of the subjective test of *fraus legis*, but rather part of the normative test.

In some cases, the court has considered that, because the consequences of the legislation were (or could have easily been) foreseen or if the legislature was aware of the possibility of there being an improper use of a provision but still did not make any changes to the legislation, then the arrangement will be valid.[32] However, in other cases, the court has considered that *fraus legis* can be applied if the legislature was aware of the avoidance possibility but did not introduce legislation to prevent such an outcome.[33]

It is sometimes argued that the more detailed the legislation is, the less likely it is that a tax planning structure contravenes the object and purpose of the legislation. The reasoning here is quite simple. If the legislature lays down (in the legislation) in detail what is not acceptable in its view, doesn't it then implicitly accept structures that it does not mention? The Supreme Court has rejected this argument in the context of very specific interest deduction limitations.[34]

Some other aspects of the normative test will be discussed in the context of the discussion of case law in part two below.

1.4. Subjective test

The subjective test entails the reasoning for the taxpayer to enter into the legal arrangement, which should not be to frustrate Dutch taxation. This means, therefore, that the envisaged tax benefit should not be the only reason or the predominant motive for the taxpayer to enter into a legal arrangement, but that the taxpayer should also have a business (commercial) motive.[35]

If the result of a transaction, apart from the tax benefits, is foreseeably negative, then that is a clear indication that the only reason for entering into the transaction was the tax reason.[36]

Interestingly, from case law it might be derived that the purpose of avoiding foreign tax

[32] See, for example, Supreme Court, 11 December 1991, *BNB* 1992/62. S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD. S. 21.2.3. See s. 2.3.

[33] See, for example, Supreme Court, 15 March 2013, *BNB* 2013/151. See a.o. S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD. S. 21.2.3. See s. 2.3.

[34] See s. 2.3.

[35] According to IJzerman in the 2002 report, some examples of commercial motives accepted by the Supreme Court are (i) foreign tax motives: to avoid foreign taxes; (ii) the creation of a holding company structure; and iii) business succession or acquisition. See R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002, p. 460.

[36] Compare Supreme Court, 2 March 1988, *BNB* 1988/135.

is regarded as a business motive.[37] [38]

Sometimes a set of transactions in a step plan can have a business motive, but some of the steps of that step plan are (almost) only driven by tax reasons. In such cases, the 'multiple-ways doctrine' is relevant.[39] The multiple-ways doctrine means that "*taxpayers are allowed to choose the most beneficial arrangement from a tax point of view. However, if they have different options, the decisive reason for choosing a certain option may not be the avoidance of taxation*."[40] An example of this is a business reorganisation in which companies are transferred within a group, but the companies are transferred against a loan (with a low-taxed entity as creditor) instead of being contributed as equity into another company.[41] In the wording of the Supreme Court: "*The circumstance that the set of transactions, in total, has a business motive does not exclude that therein transactions are included that are not necessary to obtain that [business] objective and which – if accepted – would result in an arbitrary and continuing avoidance of taxation*." From this quote, it can be derived that two elements are important for applying the multiple-ways doctrine: the necessity of a transaction and the arbitrary and continuing avoidance of taxation. The first requirement has been criticised by Marres because a loan is never necessary: there will always be the option to finance the transaction by means of a capital contribution or dividend.[42] The second requirement means that the taxpayer could repeat the transaction over and over again in order to continue to erode its tax basis. Marres has argued that this requirement is somewhat odd because the fact that there were business motives for the step plan prevents the transaction from being repeated over and over again, because any repetition of the steps will most likely not have business motives.[43]

1.5. The consequences of the GAAR application

Unlike the *richtige heffing*, the application of *fraus legis* makes it possible not only to ignore the arrangement but also to recharacterise the arrangement in such a way that taxation is in compliance with the object and purpose of the relevant tax legislation.[44] The result of *richtige heffing* was limited to disregarding of the arrangement in the tax assessment.

In general, for the application of *fraus legis*, the tax administration bears the burden of proof.[45] Once there is *fraus legis*, either the disregard or the recharacterisation will take place depending on the facts of the case.

37 Supreme Court, 21 September 1983, *BNB* 1983/316. See R.L.H. IJzerman, *Form and substance in tax law, Cahiers de droit Fiscal International. International Fiscal Association*, Volume 87a, Sdu Uitgevers, the Netherlands, 2002, p. 460

38 It is however noted that in Supreme Court, 27 September 1995, *BNB* 1996/6 the fact that no foreign tax was being avoided seemed to be an (important) element in the decision of the Supreme Court that the *normative* test of *fraus legis* was not met (and therefore *fraus legis* did not apply).

39 See about the multiple-ways doctrine R.J. de Vries, 'Kwaliteit van fiscale rechtsvinding en fiscale regelgeving', *WFR* 2010/114.

40 S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD. Section 21.2.1.

41 E.g. Supreme Court, 6 September 1995, *BNB* 1996/4.

42 O.C.R. Marres, *Winstdrainage door renteaftrek*, 2nd edition, Kluwer, Deventer 2008, p. 50.

43 O.C.R. Marres, *Winstdrainage door renteaftrek*, 2nd edition, Kluwer, Deventer 2008, p. 51.

44 See S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD Section 21.3.

45 Supreme Court, 13 December 1995, BNB 1996/89. See also S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD. S. 21.2.5.

One important element in the Netherlands is that the existence of *fraus legis* does not involve, in itself, the imposition of a penalty – on the contrary. In part three of this report, we will refer to a relevant court case in this respect.

1.6. Conflicts between domestic and international GAARs or between domestic GAARs and SAARs

In the Netherlands, the application of the specific anti-avoidance rules (SAARs) by the courts and the Dutch Tax Administration is preferred to the application of *fraus legis*. This is the natural consequence of *fraus legis* being the '*ultimum remedium*' as explained in section 1.2. The legislature clearly does not want to rely only on the applicability of *fraus legis* to protect the Dutch tax base. As a result, the legislature prefers SAARs, resulting in various provisions being introduced to prevent the erosion of the Dutch tax base.[46]

In light of the EU and BEPS developments, scholars have discussed whether the application of *fraus legis* is broader or restricted compared with the GAAR introduced in the Parent and Subsidiary Directive, the Proposal of a Directive for a Common Consolidated Corporate Tax Base (C(C)CTB), and the Anti-Tax-Avoidance Directive.[47] The Dutch government was, in principle, reluctant to include a GAAR in the proposal to amend the Parent Subsidiary Directive. Later on, however, the government decided not to oppose to such a GAAR.[48]

Questions may be raised as to the compatibility of the *fraus legis* with the GAAR in ATAD

[46] The SAARs have been addressed in the EATLP Dutch report, which includes (amongst others), in addition to the limitation on interest:
– provisions addressing non-resident corporate shareholder taxation for both equity income and debt-receivable income;
– provisions addressing dividend tax-avoidance arrangements and dividend-stripping strategies;
– provisions to prevent undue tax deferral in cases of shareholding transfers;
– mechanisms countering undue tax avoidance in the area of certain shareholding and asset transfers involving the tax consolation regime; and
– mechanisms countering undue tax avoidance and tax deferral relating to business restructurings.
M. de Wilde and C. Wisman. *Supra* n. 4 pp. 458-459.

[47] For an analysis of ATAD 1 provisions and BEPS Action 6 see M. Lukkien and A. Roelofsen, the Netherlands, *Assessing BEPS: origins, standards, and responses. Tax treaties and tax avoidance: application of anti-avoidance provisions. Cahiers de droit Fiscal International. International Fiscal Association*, Volume 102A, IBFD, 2017 at pp. 555 and 559-561. See also S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD, Section 21.7 regarding the CCCTB GAAR and M. de Wilde and C. Wisman. *Supra* n. 4 pp. 468-470.

[48] See S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD, s, 21.7, stating the arguments of the Dutch government in opposing the introduction of the GAAR, and also the developments following the changes to the GAAR. The first argument was that the wording of the GAAR was too general and subjective. The second argument was the shifting of the competence to tackle tax avoidance from the Netherlands to the European Union, which may have a negative impact on the effectiveness of *fraus legis*. However, these objections were not further pursued during the approval of the Parent Subsidiary Directive. See S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD s. 21.7 and Press Release of 8 July 2014, 11647/14 (OR.en), Presse 387. See also for the analysis of the GAAR in the Parent Subsidiary Directive. M. Lukkien and A. Roelofsen, the Netherlands, *Assessing BEPS: origins, standards, and responses. Tax treaties and tax avoidance: application of anti-avoidance provisions. Cahiers de droit Fiscal International. International Fiscal Association*, Volume 102A, IBFD, 2017 at pp. 561-562.

and in the C(C)CTB. In respect of ATAD 1, the State Secretary of Finance has stated that the Netherlands already has *fraus legis*, and that the GAAR from ATAD 1 does not have to be implemented because, in essence, it is the same as *fraus legis*.[49]

In respect of tax avoidance in the C(C)CTB Proposal for Directive, it is noted that the position of the Netherlands is that there is not much value in introducing a common corporate tax base. For this reason, the Netherlands has raised its objections in the EU Council to the application of the C(C)CTB in light of the principle of subsidiarity and proportionality.[50]

Part Two: Case law on statutory or court-developed GAARs

2.1. General overview

As outlined in the introduction section, in the Netherlands there is a statutory GAAR provision known as *richtige heffing* and a court-developed GAAR known as *fraus legis*. As mentioned previously, because of the fact that the conditions for the application of *richtige heffing* and *fraus legis* are equal, the Ministry of Finance announced in 1987 that it would no longer grant approval to invoke *richtige heffing*.[51] In section 2.2 below, we discuss some case law regarding *richtige heffing*. In section 2.3, we discuss some case law regarding *fraus legis*.

The overview of the case law below is not exhaustive. We have tried to select cases that give an insight into the arguments used by the tax authorities to invoke *richtige heffing* and *fraus legis* and by the taxpayers to avoid the applicability of *richtige heffing* and *fraus legis*.

2.2. Noteworthy cases on the operation of the statutory GAAR

An important case is the decision of the Supreme Court of 27 December 1967, BNB 1968/80. To understand this decision, one has to know that (until 1997) in the Personal Income Tax Act dividend income from a shareholding of a certain size (a so-called 'substantial interest') was taxed at a relatively high progressive tax rate, whilst capital gains on these shareholdings were taxed at a relatively low flat rate. The taxpayers therefore wanted to 'convert' dividend income into a capital gain. In the case at hand, taxpayers owned a substantial interest in a Dutch corporation B. They sold their shares to a (new) Dutch corporation A, which was also

[49] *Kamerbrief vragen over pakket anti-belastingontwijking*, 29 April 2016. See also the 'consultation document' of the Dutch Ministry of Finance of 10 July 2017 about the implementation of ATAD 1. See also for discussion and controversy regarding the BEPS Actions, the ATAD and the position of the Netherlands in the 2017 Dutch Report. M. Lukkien and A. Roelofsen, the Netherlands, *Assessing BEPS: origins, standards, and responses. Tax treaties and tax avoidance: application of anti-avoidance provisions. Cahiers de droit Fiscal International. International Fiscal Association*, Volume 102A, IBFD, 2017 pp. 553-554.

[50] *Brief regering; Fiche: Richtlijnen gemeenschappelijke (geconsolideerde) heffingsgrondslag voor de vennootschapsbelasting (CCTB en CCCTB). Ministerie van Buitenlandse Zaken – 34.604, TK, 4.* https://www.eerstekamer.nl/eu/behandeling/20161118/brief_regering_fiche_richtlijnen/document3/f=/vk9fksa4m5yc.pdf. See also Netherlands; European Union - Netherlands does not support CCCTB proposal (17 May 2017), News IBFD.

[51] See H. Vermeulen, *Cursus Belastingrecht, Formeel Belastingrecht*, paragraph 7.3.1, for an overview of the application of *richtig heffing*. See also S.J.C. Hemels, *GAARs – A key Element of Tax Systems in the Post-BEPS Tax World*, s. 21.2.4.

held by them, against a loan. Dutch corporation A repaid the loan from dividend proceeds it received from corporation B.[52] For the taxpayers, economically the outcome was the same as if company B had distributed a dividend to them. The Supreme Court ruled that *richtige heffing* could be applied. As a result, the sale of the shares in corporation B to corporation A was ignored, and the dividends paid by corporation B to corporation A were taxed in the hands of the individuals (against the progressive tax rate).

As said previously, the aforementioned case was important. It was the first case in which the tax authorities successfully used the GAAR to challenge the conversion of (high-taxed) dividend income into (low-taxed) capital gains. To avoid misunderstandings, the case law is – in this specific context – no longer relevant as the way the Netherlands taxes dividends and capital gains in the Personal Income Tax Act has changed since 1997.

This case was the first case in a string of cases involving the conversion of dividend income into capital gains. Interestingly, although in the aforementioned case the concept of *richtige heffing* was used, in similar cases *fraus legis* was used by the tax authorities. An example of this is the decision of the Supreme Court of 24 September 1980, BNB 1980/331. In this case, the shareholders in corporation M sold their shares to corporation X, in which they were also shareholders for the same relative interests. Corporation X paid the purchase price out of its own liquidities and from the proceeds of a loan taken out from company M. Again, by doing so, the shareholders tried to convert the personal income tax claim at a high tax rate on the retained earnings in company M into a personal income tax claim at a low tax rate on the capital gain. The Supreme Court ruled that the retained earnings that were realised in this way should be taxed in the hands of the shareholders at the tax rate applicable for dividends. As mentioned previously, *fraus legis* was used in this case and not the concept of *richtige heffing*. It would be outside the scope of this report to discuss all the case law regarding the conversion of dividends into capital gains and related case law regarding the taxation of 'income from shares'.[53]

In the case of the decision of the Supreme Court of 22 July 1982, BNB 1982/245, a taxpayer took out a loan from a bank at an interest rate of 8.25 per cent for a term of 1.5 years. He used the proceeds to make a capital contribution into a fully owned Netherlands Antilles company. That company lent the money to a foreign branch of the same bank at an interest rate of 7.5 per cent, also for a term of 1.5 years. Although these transactions were foreseeably negative from a commercial point of view, there was a tax benefit: the interest costs were tax deductible (at a high tax rate), while the value increase of the shares in the Netherlands Antilles company would (when the shares were sold) be taxed at a low tax rate. The deduction of the interest costs was successfully challenged by the tax authorities by making use of the concept of *richtige heffing*.[54]

Another example of the application of the concept of *richtige heffing* is the so-called 'Diamond construction' case.[55] Here, too, the Supreme Court ruled that if one enters into a transaction that has – apart from the tax consequences – a foreseeable negative outcome,

[52] This dividend is normally exempt in the hands of corporation A because of the applicability of the participation exemption of art. 13 CITA.

[53] There is a lot of literature regarding this case law. Reference is made, amongst others, to the dissertation on this subject of E.J.W. Heithuis, *Opbrengsten van aandelen; het nieuwe regime geëvalueerd*, Kluwer, Deventer 1999.

[54] The Supreme Court noted that because the interest would be non-deductible based on the concept of *richtige heffing*, it would be reasonable not to tax a capital gain when the shares in the Netherlands Antilles company were to be sold.

[55] Supreme Court, 2 March 1988, *BNB* 1988/135. See also Supreme Court, 4 May 1988, *BNB* 1988/206.

but one enters into that transaction because the tax benefits make it into a profitable transaction, then *richtige heffing* can be applied.[56]

All the aforementioned decisions are related to the personal income tax and, especially, to two topics: (1) the deduction of interest costs, and (2) the taxation of income from shareholdings. This is no coincidence. Until legislative changes were introduced in 1997 and 2001, these two areas were very popular for tax planning structures. Some of these tax planning structures were acceptable, whilst others were challenged by the tax authorities. Over time, it became more and more clear that the Dutch tax system had to change. The aforementioned case law might not be the direct cause for this change in law, but the case law is a symptom of the fact that the legislation was becoming too 'old fashioned' and needed to be reformed.

An important case concerning *richtige heffing* is also the decision of 26 April 1989, BNB 1989/217. In this decision, the Supreme Court had to deal with the following situation. A Netherlands Antilles company held all the shares in a Dutch BV (A BV). The Netherlands Antilles company sold all of its shares in A BV to a new Dutch BV (B BV) against a loan, the interest income on which was (probably) low taxed on the Netherlands Antilles. Subsequently, B BV and A BV formed a fiscal unity for corporate income tax purposes. The intention of the Dutch taxpayers was that the interest costs on the debt to the Netherlands Antilles company would be deductible for corporate income tax purposes and, as a consequence of the fiscal unity being in place, could be offset against the income of A BV. The Supreme Court ruled that if the interest deduction were to be allowed, the taxpayers could at will create interest costs to lower their taxable income without there being a change in the assets/liabilities of A BV, nor in the interest of the Netherlands Antilles company in its subsidiary (A BV is still held by the Netherlands Antilles company, albeit indirectly). This would be contrary to the object and purpose of the law, as the legislature would not have had the aim of allowing the deduction of interest costs on debts that do not have a function in financing the enterprise of the taxpayer.

In the decision of the Supreme Court of 6 September 1995, BNB 1996/4, an internal reorganisation of a group took place, whereby a tax-exempt foundation sold the shares in a Dutch BV to another Dutch BV against a loan. The debtor of this loan wanted to deduct the interest costs. The corresponding interest income was not taxable in the hands of the creditor because – as mentioned – this was a tax-exempt foundation. This case is similar to the Supreme Court case of 26 April 1989, BNB 1989/217, but the difference is that, in that case, there were no business motives for the sale of the shares in the Dutch BV to another Dutch BV, whilst in the case at hand there were business motives for the internal reorganisation. Notwithstanding these business motives, the Supreme Court denied the deduction of interest costs because, although there were business motives for the end result of the reorganisation, there were no business motives for the choice to transfer the shares in the Dutch BV against a debt (instead of against equity).[57] Although these cases were *richtige heffing* cases, in other cases regarding the deductibility of interest costs from corporate income tax, *fraus legis* was used. Some of these cases and their impact on the legislation will be discussed in the next paragraph.

[56] In Supreme Court, 21 November 1984, *BNB* 1985/32 the 'foreseeable negative outcome' criterion was also used in a *fraus legis* case.

[57] This case is an example of the multiple-ways doctrine as discussed in s. 1.4.

2.3. Noteworthy cases on the operation of the judge-made GAAR

The tax authorities have often used the concept of *fraus legis* to challenge aggressive tax structures. Hereunder we will discuss some landmark cases. On the basis of these decisions, we also try to provide a better understanding of the subjective test and the normative test of *fraus legis*. The majority of the cases to be discussed below relates to corporate income tax. This does not mean that *fraus legis* is predominantly used in corporate income tax cases. In 2014, Hemels conducted a very high level search in the Dutch tax jurisprudence journal BNB, which publishes the most important (Supreme Court) tax cases. It turned out that many *fraus legis* cases were related to personal income tax.[58] Nevertheless, we have selected some landmark corporate income tax cases, as they might have more appeal to an international reader audience. But we will also refer to some cases involving other types of tax.

We start our discussion of some landmark *fraus legis* cases with the first decision in which *fraus legis* was applied by the Supreme Court in a tax context. An individual (A) gave to two other individuals (B and his wife) an amount of *f* 50,000. In return, A was granted the right to an annuity payment that would stop three days before the death of A. The background to choosing a termination date three days before the death of A instead of choosing the moment of death as the termination date was that, if the annuity were to exist up to the death of A, the *f* 50,000 would have been subject to inheritance tax upon the death of A (which occurred several years after the gift). The Supreme Court ruled that an annuity that stopped three days before the death of A was almost the same as an annuity that would have stopped at the death of A and that "*the legal situation created by the parties [a termination date three days before the death of A] is that similar to the situation that would have been taxed under the law [the moment of death being the termination date] that the object and purpose of the law would not have been achieved if the act that was concluded* in fraudem legis *would were not have been taxed in the same way as the act that would have been subject to tax under the law.*" In Dutch tax literature, this ruling is referred to as the 'three-days ruling'.[59]

Many *fraus legis* cases relate to the deduction of interest for corporate income tax purposes. In the previous paragraph, the *richtige heffing* decisions of the Supreme Court of 26 April 1989, BNB 1989/217 and of 6 September 1995, BNB 1996/4 were discussed. Hereunder we will discuss some *fraus legis* cases regarding interest deduction in the corporate income tax.

In its decision of 17 December 2004, BNB 2005/169, the Supreme Court dealt with the following case. A Dutch BV acquired the shares in another company. That acquired company was previously not part of the group (an 'external' acquisition). To finance this acquisition, the Dutch BV took out a loan from a related Irish company. The loan was interest free. Under Dutch tax-at-arm's-length principles, deemed (at-arm's-length) interest costs on an interest free loan were taken into account. In Ireland, no deemed interest income had to be taken into account. This resulted in an international mismatch: a deemed deduction of interest costs in the Netherlands and no corresponding interest pick-up in Ireland. The tax authorities tried to challenge the deemed deduction on the basis of the concept of *fraus legis*. The Supreme Court came to the conclusion that *fraus legis* could not be applied. Given the fact that it was an acquisition of a company from a third party, neither the fact that the taxpayer

[58] See S.J.C. Hemels, Chapter 21: *Netherlands in GAARs – A Key Element of Tax Systems in the Post-BEPS Tax World* (M. Lang et al. eds., IBFD 2016), Online Books IBFD, s. 2.1.2.4.

[59] Supreme Court, 26 May 1926, *NJ* 1926, 723.

could also have attracted equity (instead of a debt) to finance the acquisition, nor the fact that no interest pick-up on the loan took place in Ireland, could – according to the Supreme Court – result in the conclusion that deducting the deemed interest costs was contrary to the object and purpose of the legislation.

As interest deduction is an important method of base erosion, it will not come as a surprise that the case law regarding interest deduction was very important and was closely monitored by the legislature. Although, in some cases, as outlined above, the tax authorities were successful in denying the deduction of interest costs on the basis of *richtige heffing* or *fraus legis*, the fact that the GAARs could not be applied in cases in which the interest income in the hands of the creditor was set off against 'genuine' (not acquired) losses was regarded as a problem.[60] This is one of the reasons that in 1997 specific anti-base-erosion provisions were introduced in the corporate income tax legislation (article 10a CITA). In this legislation, part of the case law was codified, but with regard to the compensatory tax test, it was decreed that the compensatory tax test is not met if the interest income is set off against losses.

One of the tests of *fraus legis* is the normative test: is the outcome of a fact pattern contrary to the object and purpose of the law? This begs the question: how can one know the object and purpose of the law? It is sometimes argued that the more detailed the legislation is, the less likely it is that a tax planning structure contravenes the object and purpose of the legislation. The reasoning is quite simple. If the legislature describes in detail what is not acceptable to it, doesn't it then implicitly accept structures that it does not mention? Although this reasoning is appealing, there is case law that contradicts this reasoning. Again, this case law relates to the deduction of interest costs. As mentioned above, in 1997 detailed anti-base-erosion provisions were included in the corporate income tax legislation (article 10a). One could therefore argue that base erosion strategies that are not covered by article 10a cannot be attacked with *fraus legis*, as apparently these structures were (implicitly) approved by the legislature. This argument turned out to be incorrect in two cases.

In Supreme Court case of 11 July 2008, BNB 2008/266, a taxpayer converted a debt that would fall under the scope of article 10a of the CITA into a life annuity and the taxpayer argued that only debts fall under the scope of article 10a CITA. The Supreme Court ruled that, if the predominant reason for the conversion of the debt into a life annuity was a tax reason (avoiding application of article 10a CITA), then deducting the accrual on the life annuity would be contrary to the object and purpose of article 10a of the CITA.

The case in Supreme Court on 1 June 2012, BNB 2012/213 was (somewhat simplified) as follows. Company A was a tax resident of the island of Aruba and company B was tax resident of the Netherlands. Company A was part of a fiscal unity for Dutch corporate income tax purposes, of which also company B was a part.[61] Company A sold (Dutch) real estate to company B against a debt. Because the transfer of the real estate took place within fiscal unity, this did not result in taxation on the built-in gains in the real estate. Furthermore, a loan relationship within a fiscal unity is 'invisible' for tax purposes. However, after the transfer of the real estate, the fiscal unity was terminated. As a result, the loan relationship between company A and company B became visible. The interest income (in the hands of company A) was low-taxed on Aruba and the interest costs were to be deductible in the hands of company B at the standard Dutch corporate income tax rate. This fact pattern does not fall under the scope of article 10a CITA. The tax authorities tried to challenge the interest

[60] See s. 1.3.

[61] Until 2003 it was possible to form a fiscal unity for corporate income tax purposes in such a situation.

deduction at the level of company B with *fraus legis*. The Supreme Court ruled that article 10a CITA did not give a limitative list of transactions that are unacceptable to the legislature and that, therefore, also transactions that create an interest deduction (without compensatory taxation in the hands of the creditor) that lie outside the scope of article 10a CITA can be successfully challenged with *fraus legis*.

Another important question is the applicability of *fraus legis* to international mismatches. The creation of international mismatches, in itself, does not contravene the object and purpose of the law. We already mentioned the decision of the Supreme Court of 17 December 2004, BNB 2005/169. An even more important landmark decision is the decision of the Supreme Court of 7 February 2014, BNB 2014/79. In the case at hand, a Dutch corporate taxpayer held a receivable against an Australian company. The interest income on that loan was taxable in the Netherlands. The taxpayer converted that receivable into redeemable preferred shares. These redeemable preferred shares qualified as equity for Dutch tax purposes[62] and the income could therefore, in principle, be exempt under the Dutch participation exemption. However, the payments on the redeemable preferred shares were deductible in Australia. The Dutch tax authorities argued that the only reason for the conversion of the receivable into the redeemable preferred shares was to avoid taxation on interest income from the receivable and that exempting the income from the redeemable preferred shares would contravene the object and purpose of the law, because it would imply that part of the group profit would remain untaxed. The Supreme Court ruled that a taxpayer is free to choose the way it finances a subsidiary. Making use of that freedom does not – according to the Supreme Court – contravene the object and purpose of the law. In our view, the distinction between equity financing and debt financing and the freedom to make use of the differences is so fundamental to the system of the corporate income tax legislation that, indeed, it would be very difficult to have imagined a different outcome of this case.

Also in the case of ownership thresholds, it is difficult to argue that it would be contravening the object and purpose of the law if a taxpayer, purely for tax reasons, decides to stay (just) below the threshold.[63]

Obviously, parliamentary history is an important factor to determine the object and purpose of the legislation. If, during the parliamentary discussions of a legislative proposal, a tax planning structure is being discussed and the legislature fails to act, it is argued that it will be difficult for the tax authorities to invoke *fraus legis* at a later stage. That is also the case if the tax planning opportunity is not explicitly discussed, but is so obvious that it should have been discussed or countered if the legislature did not agree with it.[64] This, of course, makes sense, but taxpayers should not be overly optimistic because the bar to successfully apply these arguments is high and it is definitely not a general rule. Reference is – for example – made to the decision of the Supreme Court of 15 March 2013, BNB 2013/151.[65] This

[62] The qualification question was also part of the court case, but it was ruled that the redeemable preferred shares qualified as equity for Dutch tax purposes. We will not discuss the underlying analysis, but only focus on the '*fraus legis*' aspects of this case.

[63] See, for example, Supreme Court, 11 May 1988, *BNB* 1988/289 (about the ownership threshold in the so-called 'substantial interest' rules in the personal income tax) and Supreme Court, 15 June 2012, *BNB* 2012/239 (about the ownership rules in the real-estate transfer tax). It should be noted that Supreme Court, 11 May 1988, *BNB* 1988/289 was not a *fraus legis* case, but a *richtige heffing* case.

[64] Compare Supreme Court, 11 December 1991, *BNB* 1992/62 and Supreme Court, 19 April 2000, *BNB* 2000/261.

[65] Compare also Supreme Court, 10 July 2009, *BNB* 2009/237. We refer also to the annotation of R.J. de Vries under Supreme Court, 13 November 2009, *BNB* 2010/24 in which he discusses these arguments.

case regarded the real-estate transfer tax. In the Netherlands, real-estate transfer tax is due on the transfer of real estate. However, if real estate is transferred as a result of the dissolution of a registered civil partnership, an exemption applies. To simplify the case: individual A had real estate and wanted to transfer that to individual B. However, that would attract real estate transfer tax. In order to make it possible to transfer real estate from individual A to individual B, they went into a registered civil partnership and, after one day, dissolved that registered civil partnership and, upon dissolution, they apportioned the real estate to individual B. Although when introducing the exemption for dissolution of a registered civil partnership it was recognised that one could abuse the registered civil partnership in order to avoid real-estate transfer tax, the Supreme Court ruled that *fraus legis* could be applied to the case at hand.

Part Three: GAAR and taxpayer's safeguards

In the Netherlands, a penalty will not be imposed if the taxpayer, on its tax return, took a position that was incorrect, yet that position was defensible to a certain degree and, as a result, the taxpayer could reasonably assume that he had taken the correct position. This is called a 'defensible position'. To determine whether a position is 'defensible', one therefore has to look to the arguments that the taxpayer used (or could have used) to come to its position. As *fraus legis* is an '*ultimum remedium*', apparently the structure could not be successfully challenged on the basis of other interpretation methods, such as looking at the wording of the law. In such a case, the fact that the wording of the law favours the position of the taxpayer is a strong argument that the taxpayer has a 'defensible position'. As said, in cases involving a defensible position, the penalty will not be levied.[66]

However, the possibility of the taxpayer to invoke the defensible position argument will be limited, for instance, if in prior case law, dealing with a similar or identical transaction, it has already been ruled that *fraus legis* was applicable. Nevertheless, if the taxpayer can argue that the case law is not applicable because there are differences between the past case and the current transaction, then the defensible position argument by the taxpayer can still be upheld and the fine should, in principle, not be levied.[67]

As a general comment, it is noted that to obtain more certainty in the application of the law to a specific tax structure, the taxpayer can consult with the tax administration regarding the consequences of the transaction and request for a tax ruling.[68] Another way to obtain more certainty is by means of horizontal supervision, which is based on trust and transparency and for which the tax authorities are prepared to respond to the taxpayer's need for certainty by signing an agreement between the tax administration and the taxpayer. This horizontal supervision requires the taxpayer to be completely transparent and not to be

[66] Supreme Court, 21 April 2017, *BNB* 2017/162.

[67] See *Geschriften van de Vereniging voor Belastingwetenschap. Misbruik van recht. Een nationaal, internationaal en Unierechtelijk perspectief*. 2016, nr. 256, p. 16 and cases in footnote 53.

[68] For completeness sake, it is noted that only rulings that are in line with the legislation will be granted. As a consequence, obviously, amonst others no rulings will be granted on tax patterns to which *fraus legis* would be applicable.

engaged in aggressive tax planning.[69] The use of a tax ruling and/or horizontal supervision mechanisms requires a certain level of trust between the authorities and the taxpayer. This is possible in the Netherlands mainly due to (in general) the relationship of trust between the tax administration and the taxpayer.

[69] In this regard, Gribnau argues that, due to horizontal monitoring, multinational corporations are moving from aggressive tax planning towards tax-risk management and certainty in the Netherlands. For Gribnau, this change of attitude by the multinationals is mainly due to horizontal monitoring, which means that, on "the basis of trust and transparency, the tax authorities are prepared to respond to the multinationals' need for certainty." See H. Gribnau, *Soft Law and Taxation: The Case of the Netherland*s, 3 Legisprudence, 325 (2007).

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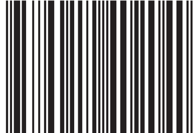
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