INDONESIA

The Netherlands Finance Structure in Practice

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Contents

1. GENERAL BACKGROUND

In our article titled "Indonesia: The New Income Tax Treaty with the Netherlands in Practice", which appeared in the August issue of the *Asia-Pacific Tax Bulletin*, we discussed the Dutch finance structure in some detail. We mentioned that new decrees relating to intermediary finance activities were about to be issued by the Dutch State Secretary of Finance (SSF). These decrees were in fact issued on 11 and 21 August 2004, just after our article went to press. The effect of these decrees is to ensure that the Netherlands' tax regime continues to comply in full with European Union (EU) and Organisation for Economic Co-operation and Development (OECD) taxation standards, while the benefits of using a Dutch finance company have been retained.

For the past several years, the Dutch tax regime for intermediary finance activities was embodied in several decrees issued by the SSF on 30 March 2001[1] and in various provisions of the Dutch Corporate Tax Income Act 1969.[2] Those decrees have now been replaced and updated[3] by the decrees of 11[4] and 21 August 2004[5] and a new Question & Answer Decree (Q&A Decree) also dated 11 August 2004[6] has provided further clarification of the rules as amended.

The new decrees are to a large extent a "codification" of the Advance Pricing Agreement (APA) practice that has developed since March 2001. The Q&A Decree sheds additional light on a number of open issues, but unfortunately by its nature also raises a number of new questions.[7]

This article will summarize the main impact of these decrees, in particular the Q&A Decree, on the use of a Dutch finance company for an Indonesian group, and the relevant tax treaty provisions. Although it updates our August article, it is written to be read on a stand-alone basis.[8]

Since the new decrees are together more than 75 pages, we have limited our analysis to the most important points.

2. NEW TAX TREATY

The Republic of Indonesia (Indonesia) and the Kingdom of the Netherlands (the Netherlands) signed a favourable

1. APA Decree of the SSF, dated 30 March 2001, No. IFZ 2001/292, the ATR Decree of the SSF, dated 30 March 2001, No. IFZ 2001/293, the Service Providing Companies Decree of the SSF, dated 30 March 2001, No. IFZ 2001/294, the Transfer Pricing Decree of the SSF, dated 30 March 2001, No. IFZ 2001/295, and, the decrees No. RTB 2001/1195, No. RTB 2001/1379, No. BOB 2001/698 and No. RTB 2001/1365.
2. Arts. 8b and 8c of the Dutch Corporate Income Tax Act 1969 (CITA).
3. Except for the Decree on Hybrid Loans of the SSF, dated 30 March 2001, No. RTB2001/1379.
4. APA Decree of the SSF, dated 11 August 2004, No. IFZ2004/124, the ATR Decree of the SSF, dated 11 August 2004, No. IFZ2004/125, the Service Providing Companies Decree of the SSF, dated 11 August 2004, No. IFZ2004/126, and Decrees No. DGB2004/1337, No. DGB2004/1338, No. DGB2004/1339 and No. IFZ2004/680.
5. Transfer Pricing Decree of the SSF dated 21 August, No. IFZ 2004/680, which replaced the new Transfer Pricing Decree of the SSF dated 16 August 2004, No. IFZ 2004/653 in order to correct various typographical errors, which in its turn replaced the old Transfer Pricing Decree of the SSF, dated 30 March 2001, No. IFZ 2001/295.
6. Q&A Decree of the SSF dated 11 August 2004, No. IFZ 2004/127.
7. As we are applying for APAs for Dutch finance companies on behalf of our clients on an almost continual basis, these questions will be addressed during further APA negotiations.
8. We could not avoid simply incorporating parts of our previous article in this article. However, we did not include all the footnotes. As the publishing deadline for this article was in September 2004, and the eight new decrees were issued on 11 and 21 August 2004, little practical experience as to their interpretation could be obtained. However, we have already sent a preliminary set of questions about the new decrees to the competent inspectorate of the Dutch tax authority on 18 August 2004 and we had some pre-filing meetings (see note 25 as to the contents of these meetings). The inspectorate informed us that a general seminar would be held in the course of this year to provide some background information on the Q&A Decree. Our questions should, at least, be answered at this seminar. We hope to include the newly gathered information (from, amongst other sources, this seminar) in a more general article we are writing entitled "The Netherlands Finance Structure In Practice", which will be published in the BNA International Tax Planning Review.

double taxation agreement (DTA) on 29 January 2002. The ratification procedures were completed in December 2003 and the new DTA became effective on 1 January 2004.

The most important difference between the old and new DTA is the introduction under the latter of an *exemption from withholding tax* for certain categories of interest.[9] This exemption is *unique for Indonesian DTAs*.

Pursuant to Art. 11(4) of the new DTA, an exemption from interest withholding tax applies if (i) the recipient is the beneficial owner of the interest, (ii) this recipient is a resident of the other state and (iii) the interest is paid (a) on a loan made for a period of more than two years *or* (b) in connection with the sale on credit of any industrial, commercial or scientific equipment.

If only the first two conditions are met, a reduced interest withholding tax rate of 10% is applicable. A 10% rate was also the general rule under the interest provision of the old DTA.

The above exemption, in combination with the fact that the Netherlands generally does not levy interest withholding tax pursuant to Dutch domestic law, enables Dutch companies[10] to finance Indonesian companies without interest withholding tax[11] costs.[12]

3. INTERMEDIARY FINANCE COMPANY

If an Indonesian group intends to attract debt capital from the international capital markets, it would normally structure the issued debt via a foreign special purpose company. The reasons for interposing a foreign finance company are generally the following:

– easier access to international capital markets;
– currency regulations;
– political factors; and
– reduction of the domestic Indonesian withholding taxes.

The intermediary finance company is often located in the Netherlands. Until recently, Mauritian companies were also popular for this purpose.[13] In principle, however, the Indonesian DTA with Mauritius will cease to apply to Indonesia as of 1 January 2005. Consequently, it would be prudent for Indonesian companies that are currently using a Mauritian finance structure to start reconsidering their position.

The Netherlands has traditionally been, and still is, a popular finance company jurisdiction and could therefore provide an interesting alternative. The main reasons for this popularity are the extensive Dutch DTA network with low or zero withholding tax rates on incoming interest payments and the absence of a domestic withholding tax on outgoing interest payments on non-hybrid loans/notes. Although the traditional tax regime for Dutch intermediary finance companies can no longer be used,[14] the current tax regime for Dutch finance companies (as set out below) is good or even better in meeting today's international taxation standards as advocated by the OECD[15] and EU.[16]

As tax authorities increasingly focus on the potential misuse of intermediary finance companies for tax purposes, they are more likely to question whether an intermediary finance company qualifies as a "beneficial owner" within the meaning of Art. 11 of the OECD Model tax treaty[17] and Art. 11 of the UN Model tax treaty 2001. Consequently, it is possible that the Indonesian tax authority may adopt this focus with respect to Art. 11(4) of the new DTA for Indonesian tax purposes. Generally, such a finance company does not have much substance, runs no economic

9. The Indonesian interest withholding tax rate for non-residents is, in principle, 20% (see International Bureau of Fiscal Documentation (IBFD), *Taxes and Investment in Asia and the Pacific*, p. 23, Suppl. No. 214 (June 2002)).
10. Such as Dutch banks, financial institutions and special purpose companies.
11. To avoid Dutch dividend withholding tax being levied on interest payments made by a Dutch company, it is important that the notes/loan issued by the Dutch company are not characterized as a hybrid loan. Basically, this means that the interest should not be profit-dependent or the maturity of the loan should not exceed ten years (Art. 10(1)(d) of the Dutch Corporate Income Tax Act 1969 (CITA)).
12. However, in three different cases, district courts in Indonesia were not charmed by a Dutch intermediary finance structure (see (i) decision dated 12 May 2004 of the Indonesian Serang District Court, (ii) decision dated 16 September 2004 of the District Court of Kuala Tungal and (iii) decision dated 29 September 2004 of the District Court of Bengkalis). In each case, the court declared an issuing of bonds by an Indonesian company via its Dutch subsidiary to be void, as it was undertaken only for tax reasons and not for commercial reasons. See press releases in, among other publications, the *Associated Press* dated 12 May 2004, *Het Financieele Dagblad* (Dutch financial newspaper) dated 22 May 2004 and 30 September 2004, *PR Newswire* dated 17 September 2004 at <www.prnewswire.com/news/index_mail.shtml?ACCT=104&STORY=/www/story/09-17-2004/0002252319&EDATE=>, *Financial Times* dated 24 May 2004 and 30 September 2004 and IBFD *Tax News Service*, No. 106 (2004). It should be noted that, at least, the decision of 16 September 2004 is under appeal. Pending the appeal process under the Indonesian law, the decision is not effective or enforceable. With regard to similar issues related to the investment climate in Indonesia, we refer to the petition dated 29 March 2004 filed by the US Securities Industry Association and the US-ASEAN Business Council, Inc. at <www.sia.com/international/pdf/BoyceTriPolyta32904.pdf>.
13. By using a Mauritian finance structure, for instance, the Indonesian withholding tax is reduced to 10% under the DTA between Mauritius and Indonesia and very little or no Mauritian corporate income tax is due on the remuneration.
14. Under the old Dutch intermediary finance regime (see model tax rulings published by the tax authority/large enterprises of Rotterdam in September 1993), the Dutch tax authority allowed a standard net spread of at most 12.5 basis points, provided the finance company did not run any currency risk or debtor risk. Pursuant to "grandfathering" provisions as set out below in 10. of this article, Dutch finance companies that were active prior to 1 April 2001 may continue to apply the old ruling provisions until 31 December 2005.
15. Part II (16), in conjunction with Table of Conclusions of the "OECD's Project on Harmful Tax Practices: The 2004 Progress Report" dated 4 February 2004, explicitly states that the current tax regime for Dutch finance companies, unlike the old regime (see (i) OECD Report 1998, Harmful Tax Competition. An Emerging Global Issue, and (ii) Sec. III (A) OECD Report 2000, Towards Global Tax Co-operation), is not considered potentially harmful.
16. The old Dutch intermediary finance company tax regime (see model tax rulings published by the tax authority/large enterprises of Rotterdam in September 1993) was considered potentially harmful (see Sec. (j)(i) financial services, group financing and royalty payments and measure A010 to the Report of the Code of Conduct Group on Business Taxation (a group set up in response to the ECOFIN conclusions of 1 December 1997 on the so-called "tax-package") as submitted to the ECOFIN Council on 29 November 1999).
17. See also Paras. 8-17 of the OECD Commentary on Art. 11 and the report from the Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" dated November 1997, reproduced in Vol. II at page R(6)-1. Para. 8 of the OECD Commentary on Art. 11 states that, "The term 'beneficial owner' is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance". The Committee report concludes "that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties".

risks, and pays little or no corporate income tax on the remuneration received from its finance activities. These characteristics could endanger a finance company's ability to meet the "beneficial owner" test.

The Netherlands radically changed its domestic tax rules for intermediary finance companies in 2001 in order to make these rules comply with relevant OECD taxation standards,[18] and to dispel the criticism of other EU member states[19] which characterized the old regime as a potentially harmful tax practice. Due to the changes, there is good reason to assume that a Dutch finance company, which qualifies under the new tax regime for such companies, will be deemed to meet the "beneficial owner" test.[20] Under the new regime, a Dutch finance company is basically required to have substance, to run economic risks and to report an arm's length remuneration[21] on its finance activities in conformity with the OECD Transfer Pricing Guidelines.

4. ADVANCE PRICING AGREEMENT

A Dutch company whose activities consist largely of borrowing funds from (i) group companies and/or (ii) third parties (e.g. banks/financial institutions/note holders), with a group guarantee, and lending those funds on to group companies[22] (Dutch finance company) can obtain advance certainty on the arm's length character of its gross remuneration for Dutch corporate tax purposes[23] by concluding an advance pricing agreement (APA)[24] with the Dutch tax authority.[25] An APA confirms that the gross remuneration to be reported by the Dutch finance company in respect of its finance activities will be considered at arm's length by the Dutch tax authority and normally applies for four years.[26]

An APA can only be entered into if the Dutch finance company satisfies two conditions:[27] (i) it must have sufficient substance in the Netherlands and (ii) it must be exposed to economic risks in respect of its finance activities.

5. SUBSTANCE REQUIREMENTS

For the Dutch finance company to have sufficient *substance* in the Netherlands, certain minimum requirements must be met.[28] The minimum substance requirements are:

- at least half of the company's management board must be resident in the Netherlands;
- the board members residing in the Netherlands must have the professional expertise necessary to fulfil their duties. The duties of the board members collectively include, at a minimum, the making of decisions, within a context of normal group influence but for which the company itself is responsible, about all transactions entered into by the company and the proper implementation of such transactions. The company must have personnel who are qualified to carry out and register the transactions entered into;
- the key management decisions must be made in the Netherlands;
- the company's main bank account must be kept in the Netherlands;
- the books and records must be kept in the Netherlands;
- the company must fulfil all its filing obligations (tax returns, etc.);
- the company's business address must be in the Netherlands and the company must not also be resident in another country for tax purposes; and

18. See note 15.
19. See note 16.
20. This is ultimately an Indonesian tax issue to be decided by the competent Indonesian tax authority. Indonesia is not a member of the OECD or the EU. However, it cooperates with the OECD in the field of international taxation on topics such as transfer pricing and advanced pricing arrangements via the OECD Centre for Co-operation with Non-Members (see, among other publications, the taxation reports of the Centre for Co-operation with Non-Members entitled "Emerging Asian Economics Programme 2001" and "Asian and China Programme Report 2003").
21. Indonesia also applies the arm's length principle. (See IBFD, *Taxes and Investment in Asia and the Pacific*, Indonesia, p. 81, Suppl. No. 214, (June 2002)).
22. Q&A number 1. This Q&A clarifies that if the Dutch company could have borrowed the funds without a group guarantee on a stand-alone basis, the Dutch company will not be qualified as a Dutch finance company within the meaning of the Service Providing Companies Decree of the SSF, dated 11 August 2004, No. IFZ 2004/126. As a consequence, the substance and economic risk requirements of this Decree would not need to be met for obtaining an APA.
23. Pursuant to Art. 11(1)(j) of the Dutch Value Added Tax (VAT) Act 1968, the remuneration received for finance activities, such as the issuing of interest-bearing loans, is exempt for VAT purposes. As a consequence, the VAT on costs that can be attributed to such finance activities is, in principle, not recoverable. An exception to this rule applies where the finance activities are performed for a recipient established outside the EU (Art. 15(2) of the Dutch VAT Act 1968). The Dutch finance company is, therefore, entitled to deduct the VAT on the costs incurred, provided that these costs relate to the finance activity performed for the Indonesian group. We note that certain costs paid by the Dutch finance company, such as foreign commission, and legal and advisory fees, require special attention as to the VAT aspects. Under the so-called reverse charge mechanism, which is laid down in Art. 12(3) of the Dutch VAT Act 1968, the VAT liability for such services is shifted to the recipient, i.e. the Dutch finance company. As a consequence, the Dutch finance company must report the 19% Dutch VAT to the Dutch tax authority by filing a VAT return. This VAT can be deducted as input VAT on the same VAT return, if these costs can be allocated to the finance activity performed for the Indonesian group company. As a result, no VAT will be payable.
24. The 2004 Progress Report by the OECD, referred to in note 15, explicitly states that it does consider the Dutch APA practice to be not potentially harmful.
25. It should normally take eight weeks to obtain an APA from the Dutch tax authority. In practice, however, it can take much longer for these types of APAs. The timing will largely depend on the adequacy of the information contained in the transfer pricing report. To avoid a lengthy procedure, the timing and contents of the APA can be discussed, in a meeting with the Dutch tax authority prior to the actual filing of a draft APA (pre-filing meeting) pursuant to the APA Decree of the SSF, dated 11 August 2004, No. IFZ2004/124 and a letter from the SSF dated 16 April 2003, No. IFZ 2003/526. Although preferable, it is not necessary to obtain the APA before commencing the financing activities. Further negotiations on the contents of the APA can take place even where the financing activities have already commenced.
26. Pursuant to Para. 6 of the APA Decree of the SSF dated 11 August 2004, No. IFZ 2004/124, the Dutch finance company must submit certain information to the Dutch tax authority, such as information on the relevant transactions, the enterprises involved, the worldwide group structure and the ultimate beneficiaries as well as a description of the proposed transfer pricing method.
27. A Dutch finance company must also take into account the Dutch securities and banking laws and regulations. In short, this means that it must comply with the exemption regulations issued pursuant to the Securities Trade Supervision Act 1995, as amended, and the Credit System Supervision Act 1992, as amended, in order to be exempt from the prohibitions contained in both these Acts.
28. See the annex to the Service Providing Companies Decree of the SFF, dated 11 August 2004, No. IFZ 2004/126.

– the company's equity must be appropriate in light of its activities, taking into account both the assets used and the risks incurred.

The most important points in the Q&A Decree which clarify the substance requirements are as follows:
– the decision-making powers of the Dutch resident members of the company's management board must be equal to those of the non-Dutch resident members;[29]
– the duties of the Dutch resident members of the company's management board must go beyond attending to the company's local, and often administrative, day-to-day concerns. Their duties must, for instance, include the settlement of transactions from a legal point of view, the management of loans, and the proper implementation of these transactions. They may, however, hire personnel to perform these activities or outsource these activities to to third parties, provided that the personnel or third parties remain under their supervision;[30]
– the key management decisions must be made in the Netherlands. It is, therefore, not sufficient that the decisions are only formalized in the Netherlands. Board meetings must be held in the Netherlands on a regular basis. It is possible, however, that the underlying preparatory activities take place outside the Netherlands, provided that the management board is in control of these preparatory activities;[31]
– the company's main bank account must be operated and controlled from the Netherlands, but may be held with a bank abroad;[32]
– the company's books and records must be kept physically in the Netherlands. It is not sufficient that the records are administered abroad and turned over to the Dutch finance company once a year;[33]
– the company's equity must be appropriate in view of its activities (substance equity capital requirement). This requirement supplements the economic equity capital risk requirements described in 6. below.[34] The Q&A Decree indicates that the Basel Capital Accord[35] could be the starting point for determining how much equity capital is deemed appropriate. Methods other than ones based on this Accord could also be used. The question of which other methods are suitable, however, has not been answered.[36]

6. ECONOMIC RISK REQUIREMENTS

The Dutch finance company must be exposed to credit risks (debtors and currency risks), market risks and operational risks. The extent to which the Dutch finance company is exposed to a particular risk is considered to be reflected in the extent to which its equity capital can actually be affected if the risk materializes.[37]

The Dutch finance company will be deemed to bear sufficient economic risk if its equity capital[38] equals or exceeds the lesser of (i) 1% of its outstanding loans, or (ii) EUR 2 million, on the condition that the Dutch finance company can prove that its equity capital will actually be affected if a risk materializes (economic equity capital risk requirements).[39]

The most important points in the Q&A Decree which clarify the economic equity capital risk requirements are as follows:
– the relevant test is an ongoing one. If, however, a certain risk has already materialized, no additional equity capital contribution is required;[40]

29. Q&A number 13. The question remains whether this also includes the authority to represent the finance company towards third parties. In one of our previously obtained APAs such equal authority to represent the company towards third parties was not required. Our letter to the Dutch tax authority of 18 August 2004 with preliminary questions includes this particular question.
30. Q&A number 14.
31. Q&A number 16. The main questions are (i) from what point in time must the Dutch resident management board member be involved in the (borrowing) procedure and (ii) in view of the internationalization of management boards, would conference calls not be sufficient. These questions are included in our letter to the Dutch tax authority of 18 August 2004. In representing one of our clients, we have already experienced that the competent Dutch tax inspectorate takes the view that at least the general decision to issue the notes/borrow funds must be made at a physical board meeting held in the Netherlands following the Indonesian group treasury department's main decision that new debt capital is required.
32. Q&A number 17. It is likely that this has been included to avoid violating the rules on the free movement of capital within the EU (see Art. 56 of the EU treaty). Obviously, from a "place of effective management" perspective as set out in note 71 below, a foreign bank account may not be recommendable.
33. Q&A number 18.
34. Q&A number 21.
35. See (i) 1988 Basel Committee on Banking Supervision report "International Convergence of Capital Measurement and Capital Standards", (ii) draft 2003 paper "Overview of the New Basel Capital Accord", and (iii) Basel Committee on Banking Supervision June 2004 Report "International Convergence of Capital Measurement and Capital Standards", most of the provisions of which will be effective as from 1 January 2007 according to a press release in, inter alia, *Het Financieel Dagblad* (Dutch financial newspaper) dated 28 June 2004. A detailed press release dated 26 June 2004 can also be found at <www.bis.org/press/p040626.htm>. The amount required will depend mainly on the facts and circumstances of each specific case, including risk weightings, whether any guarantees have been issued, the solvency of the Indonesian group, the availability of credit ratings, etc. The question naturally arises as to whether the new Basel Capital Accord may already be used together with Dutch implementation papers, such as the "Standaard-benadering Kredietrisico" consultation paper of the Dutch Central Bank, dated March 2004, nr. K02A/NL, even though most of its provisions have not yet come into effect. In response to a client-specific question in a pre-filing meeting, the Dutch tax inspectorate confirmed that the new Basel Capital Accord together with the Dutch implementation papers could already be used, as they provide for up to date guidelines on minimum capital requirements.
36. This question is included in our letter to the Dutch tax authority of 18 August 2004.
37. Art. 8c of the Dutch CITA and the Service Providing Companies Decree dated 11 August 2004, No. IFZ 2004/126.
38. In practice, the equity capital contribution can be met either by an up-front equity contribution by the Indonesian company or as follows: the Dutch finance company attracts funds from the market or from a group company and lends the funds on to the Indonesian company. The Indonesian company contributes part of the borrowed funds to the Dutch finance company as equity capital. This equity capital can, if desired, be lent on again to the Indonesian company. This also follows from Q&A number 31.
39. Q&A number 28 clarifies that the economic equity capital risk requirement as set out in Art. 8c of the Dutch CITA applies per taxpayer, while the economic equity capital risk requirement as set out in Para. 6 of the Service Providing Companies Decree dated 11 August 2004, No. IFZ 2004/126 applies per loan. One could argue that requiring a separate economic equity capital risk requirement per loan under the Decree would be "contra legem", as the equity capital risk requirement under Art. 8c of the Dutch CITA applies only per taxpayer. However, it should be noted that the objectives of both requirements are different. The Service Providing Companies Decree economic equity capital risk test is relevant for the Dutch tax authority's policy in practice, while the Art. 8c of the Dutch CITA economic equity capital risk test is relevant for qualifying for the tax credit for foreign withholding tax. As the APA practice is still developing, we believe that ultimately only one equity capital requirement is necessary.
40. Q&A number 22 clarifies that this also applies to the substance equity capital requirement as mentioned in 5. of this article.

– if all of a Dutch finance company's borrowings are guaranteed by a group company to the Dutch finance company's lenders, the Dutch finance company's equity capital will be considered to be not at risk.[41] If, however, this guarantee is invoked by a lender, resulting in subrogation rights of the corporate guarantor towards the Dutch finance company for an amount equal to the latter's equity capital, the Dutch tax authority will consider the finance company's economic equity capital to be at risk;[42]
– the economic equity capital risk requirement under the Service Providing Companies Decree applies *per loan*.[43] This implies that if (i) a Dutch finance company has obtained two loans, (ii) it has an equity capital of EUR 2 million and (iii) a full guarantee has been given for one of the loans, the Dutch finance company is not considered to meet the economic equity capital risk requirement under the Service Providing Companies Decree regarding the fully guaranteed loan.[44] As this economic equity capital risk requirement applies to each loan, the equity capital must also be at risk under additional future loans. In such a case, however, on balance, a *total equity capital of EUR 2 million is sufficient to satisfy the economic equity capital risk requirements under both the Service Providing Companies Decree and Art. 8c of the Dutch CITA*;[45] and
– the substance equity capital requirement referred to above in 5. is apparently not equivalent to the economic equity capital risk requirements described in here in 6. The Dutch tax authority now distinguishes three equity capital requirements, unlike its practice under the old decrees.[46]

7. ARM'S LENGTH REMUNERATION REQUIREMENTS

If the Dutch finance company meets the substance and economic risk requirements, an appropriate arm's length gross remuneration for its activities must subsequently be determined.[47] This remuneration (minus deductible costs) will be subject to Dutch corporate income tax at a rate of 34.5%[48] (29% on the first EUR 22,689).

The most important points in the Q&A Decree which clarify the arm's length remuneration are as follows:
– the Dutch finance company's total *gross* arm's length remuneration for its instance activities must consist of two components: (i) a risk fee as consideration for the exposure of its equity capital and (ii) a handling fee for originating and managing the finance activities;[49]
– both components need to be included in the arm's length interest spread margin, i.e. the difference between the interest received and paid. The margin should be sufficient to cover all costs and to realize a reasonable profit. Additionally, a return on the Dutch finance company's equity capital investment (for example interest income) may need to be realized;[50]
– the Dutch tax authority has developed a formula for calculating the risk fee based on the similarity in function and risk between secured loans and subordinated loans. The risk fee must be based on the difference between an arm's length interest rate on these two types of loans;[51]
– the conceptual model which the Dutch tax authority wants companies to apply in determining a handling fee is based on a functional analysis of the services to be performed using third party comparables.[52] It indicates that other methods can also be used, provided these methods are in line with the OECD Transfer Pricing Guidelines, but also takes the view that the cost-plus method is, in general, not a reliable method.[53] We, however, note that the Court of Appeal of Amsterdam approved the cost-plus method for intermediary group finance activities in its decision dated 20 August 2003;[54]
– if the treasury department of a group company is also involved in the finance activities, the handling fee can be split between the Dutch finance company and the

41. Example 2 of Para. 6 of the Service Providing Companies Decree dated 11 August 2004, No. IFZ 2004/126.
42. Q&A number 27.
43. The per loan economic equity capital risk requirement has been introduced in the new Service Providing Companies Decree dated 11 August 2004, No. IFZ 2004/126 and this has been clarified in Q&A number 28. However, this per loan requirement is not required under Art. 8c of the Dutch CITA (see note 39).
44. This follows from Q&A number 29.
45. Q&A number 29.
46. This follows from Q&A number 21 and number 28.
47. An underlying transfer pricing report substantiating the amount of the remuneration is required under Art. 8b(3) of the Dutch CITA. The taxpayer is obliged to keep records which adequately document, amongst other things, the manner in which the transfer price was determined. If the taxpayer has clearly failed to fulfil this obligation and a discussion arises on the use of a particular transfer price (and if the matter comes before a court), the burden of proving that transfer pricing took place on an arm's length basis will rest on the taxpayer. If the obligation has been fulfilled, the burden of proof will be on the tax authority to demonstrate that a different transfer price should have been used.
48. The rate of 34.5% will be reduced in three stages from 34.5% now to 30% in 2007 (2005: rate of 31.5%), and the rate of 29% will be reduced in three stages to 25% in 2007, pursuant to an e-mail press release of the Dutch Ministry of Finance dated 21 September 2004.
49. Q&A number 31. We note that the Q&A Decree does not address the issue of any fee for the guarantee issued by a group company to the lenders/noteholders on behalf of the Dutch finance company. We often see in practice that no separate fee is charged by the group company for benefiting from the guarantee. Third parties would, however, require a fee for issuing such a guarantee. Although, requiring a fee would be in line with the arm's length principle, we note that it is not in the interest of the Dutch tax authority to require such a fee payment, as this would normally constitute a deductible cost for the Dutch finance company.
50. Q&A number 31.
51. Q&A number 31.
52. Q&A number 31.
53. Q&A number 30.
54. Court of Appeal of Amsterdam, decision dated 20 August 2003, No. 4 01/4083. The Dutch SSF explicitly withdrew its appeal to the Dutch Supreme Court on 6 May 2004, but continued to assert that a spread depending on the principal amount outstanding is the only correct way for an arm's length remuneration (see his explanatory decree of 9 April 2004, No. 4 DGB2004/1122). Based on this case law and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 1995-1999, we feel, however, that good arguments can be made in support of the application of the cost-plus method as the basis for an arm's length calculation, provided that the company does not run any risk. Pursuant to Chapter 2 in conjunction with Paras. 1.68 and 4.9 of these OECD Transfer Pricing Guidelines, an arm's length remuneration can be calculated in different ways. These guidelines also apply in the Netherlands pursuant to the Transfer Pricing and Advance Pricing Agreement Decree dated 11 August 2004, No. IFZ 2004/124. The main question is, however, whether a simple cost-plus remuneration would be sufficient to pass the beneficial owner test for Indonesian tax purposes (see also our comments regarding "beneficial owner" in 3. of this article).

other group company, for example, based on the amount of time spent on these activities;[55] and
– a fee quote cannot be the basis for a third party comparison, as parties are not bound by such a quote. The fee quote can, however, serve as a starting point.[56]

8. FULL TAX CREDIT FOR INDONESIAN WITHHOLDING TAX

If a loan is not made (i) for a period of more than two years or (ii) in connection with the sale on credit of any industrial, commercial or scientific equipment, the exemption from interest withholding tax under the new DTA, as mentioned above, is not applicable and consequently a reduced Indonesian interest withholding tax rate of 10% may apply under Art. 11(2) of the new DTA.

Contrary to past practice, the Q&A Decree confirms that such Indonesian withholding tax is fully creditable,[57] which implies that the withholding tax can be offset[58] against the Dutch finance company's corporate income tax liability.[59] As a result, the ultimate corporate income tax liability of the Dutch finance company may, in fact, be reduced to possibly nil.

9. EXCHANGE OF INFORMATION WITH THE INDONESIAN TAX AUTHORITY

If the Dutch finance company fails to meet the economic risk requirements, but does meet the substance requirements, it can still obtain an APA if it agrees to a spontaneous exchange of information between the Dutch tax authority and the Indonesian tax authority.[60,61]

If neither the substance nor the economic risk requirements are met, a Dutch finance company is nonetheless free to conduct its finance activities without an APA. However, the Dutch tax authority may, in principle, initiate a spontaneous exchange of information with the Indonesian tax authority.[62]

The most important points in the Q&A Decree which clarify the rules on exchanging information are as follows:
– the information exchanged may relate to the following aspects of a Dutch finance structure: (i) structure, (ii) functions, (iii) risks, and (iv) remuneration;[63]
– a decision of the Dutch tax authority to spontaneously exchange information can normally be appealed by the Dutch finance company and the exchange will, therefore, not necessarily be effected;[64] and
– if the substance and economic capital equity risk requirements are met, no spontaneous exchange of information with the foreign tax authority of the Dutch finance company's debtor will take place. However, such a spontaneous exchange of information could still take place with other foreign tax authorities.[65]

10. GRANDFATHERING

Dutch finance companies that were active prior to 1 April 2001 may continue to rely on the old tax regime until 31 December 2005.[66] Dutch finance companies, which became active after 1 April 2001 are not entitled to benefit from the transitional period and are required to comply in full with the new regime[67] from the outset of their activities. The potential adverse consequences of not complying with the new tax regime are basically, (i) uncertainty as to corporate income tax liability,[68] (ii) no tax credit for Indonesian withholding tax, if any,[69] (iii) spontaneous exchange of information with Indonesian tax authority,[70] and (iv) uncertainty as to DTA protection.[71]

55. Q&A number 31.
56. Q&A number 32. We do not see why a fee quote cannot be used for this reason, but only signed contracts. We note that contractual obligations in ongoing transactions can also be cancelled or changed by the contracting parties.
57. Q&A number 12.
58. This credit can be denied if the economic equity risk requirement under Art. 8c of the Dutch CITA, as explained above, is not met. Pursuant to Art. 8c of the Dutch CITA, the interest paid and received by a Dutch finance company is excluded from its tax base if this economic equity risk requirement is not met. Where interest paid to the Dutch finance company does not form part of its tax base, Art. 24(4) of the new DTA does not require the Netherlands to grant a tax credit for Indonesian withholding tax (similar to Art. 22(3) of the old DTA).
59. In practice, the Dutch tax authority requires that a commercial profit be realized after the deduction of foreign withholding taxes. This results in a higher intercompany interest rate and, therefore, higher interest costs from a group perspective.
60. Para. 3 of the Service Providing Companies Decree dated 11 August 2004, No. IFZ 2004/126.
61. On the basis of such information, the Indonesian tax authority may decide that (i) the Dutch finance company's place of effective management is located not in the Netherlands but in Indonesia under Art. 4(3) of the new DTA (see further note 70 below), and/or (ii) the Dutch finance company conducts its activities via its permanent establishment in Indonesia under Art. 7(1) in conjunction with Art. 5 of the new DTA, which would basically mean that no DTA protection is available and that Indonesia is entitled to tax the Dutch finance company's activities, and/or (iii) the Dutch finance company is not the beneficial owner of the interest income relevant for qualifying under Art. 11(4) of the new DTA (see 3. of this article).
62. Para. 3 of the Service Providing Companies Decree dated 11 August 2004, No. IFZ 2004/126.
63. Q&A number 9.
64. This follows implicitly from Q&A number 10 in conjunction with Art. 7 of the Dutch Act for International Assistance in Levying Taxes 1986.
65. Q&A number 8.
66. A decree of the Dutch SSF dated 21 December 2000, No. RTB 2000/3227.
67. See note 1 for the relevant decrees.
68. Pursuant to the Service Providing Companies Decree dated 11 August 2004, no APA can be obtained if the minimum substance requirements are not met.
69. Art. 8c of the Dutch CITA.
70. Para. 3 of the Service Providing Companies Decree dated 11 August 2004, No. IFZ 2004/126. For the potential adverse consequences of such an exchange of information see note 61.
71. Pursuant to Art. 4(3) of the new DTA (similar to the old DTA), a Dutch finance company's place of residence is where the place of effective management is situated. If both Indonesia and the Netherlands consider this to be in their state, they will settle this question (of fact) by mutual agreement (see Art. 27 of the new DTA). It is important that the Dutch finance company's place of effective management be situated in the Netherlands. Otherwise, the Dutch finance company will be held to be resident in Indonesia by both Indonesia and the Netherlands. Consequently, the Dutch finance company will be unable to benefit from the new DTA and, as a result, the Dutch finance structure will be unable to benefit from the zero Indonesian withholding tax on interest payments and will also be subject to Indonesian income tax. For further background information on the underlying "place of effective management" concept, see (i) Para. 24 of the OECD Commentary on Art. 4(3), (ii) the OECD draft discussion paper "The Impact of the Communications Revolution on the Application of 'Place of Effective Management' as a Tie Breaker Rule" dated February 2001, and (iii) OECD discussion draft paper "Place of Effective Management Concept: Suggestions for Changes to the OECD Model Tax Convention" dated 27 May 2003. Additionally, the beneficial ownership test of Art. 11 of the new DTA may also not be met (see 3. of this article).

The Q&A Decree makes clear that the deadline of 31 December 2005 will be strictly applied as it is based on international agreements with other countries.[72] It is therefore necessary to apply for an APA with the Dutch tax authority or restructure finance activities based on the new regime prior to 1 January 2006.

11. SUMMARY AND CONCLUSION

As tax authorities become more sophisticated, they are more likely to question (i) whether an intermediary finance company qualifies as a "beneficial owner", and (ii) whether its "place of effective management" is actually situated in the jurisdiction of the intermediary finance company for the purposes of DTA protection. Generally, an intermediary finance company does not have much substance, runs no economic risks, and pays little or no corporate income tax on the remuneration received from its activities. These characteristics could endanger its ability to meet the "beneficial ownership" and "effective place of management" tests.

Under the decrees dated 11 and 21 August 2004, a Dutch finance company is basically required to have substance, to run economic risks, and to report an arm's length remuneration for its finance activities in conformity with the OECD Transfer Pricing Guidelines. The EU and OECD have acknowledged that the Netherlands' tax regime for intermediary finance companies is EU- and OECD-compliant. These latest decrees are designed to clarify certain aspects of this new Dutch tax regime, while maintaining the full compliance of the Netherlands' tax regime for Dutch finance companies with all applicable EU and OECD taxation standards. We note, however, that it is ultimately the Indonesian tax authority's opinion that matters with respect to these tests.

Together with its extensive DTA network, both as such and in combination with non-tax factors (such as an easy access to the international capital markets, currency regulations and a stable political situation), this new Dutch tax regime makes the Netherlands an attractive host country for Indonesian finance structures in today's international tax environment.

72. Q&A number 39. See Part II (4) of the "OECD's Project on Harmful Tax Practices: The 2004 Progress Report" dated 4 February 2004.

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