



Meijburg & Co
Tax & Legal

Debt to equity

**New guidance in relation
to the requalification of
loans**

January 2023



What?

On 1 July 2022, the Dutch Ministry of Finance published a new Transfer Pricing Decree, which includes new guidance in relation to the requalification of loans.

In the TP Decree, the State Secretary of Finance refers to Chapter X of the OECD Guidelines for guidance on an at arm's-length remuneration and (re-)classification of financial services and loans. According to the OECD Guidelines, the lack of control over risk and/or the lack of

financial capacity of an entity to bear risks in relation to a loan may mean that the relevant risks and the associated income should be allocated to an (affiliated) entity that exercises control over those risks and that has adequate financial capacity to assume the risks.

Consequences?

Potential recharacterization of a loan into a capital contribution at the level of the borrower.

Making reference to the OECD Guidelines, the State Secretary of Finance is of the opinion that (the part of the) funding that could only be obtained with guarantees from related parties, should be regarded as effectively a loan from the creditor to the guarantor followed by a capital contribution by the guarantor to the borrower. In essence, this leads to a recharacterization of the (part of the) funding into a capital contribution at the level of the borrower. The recharacterization of the (part of the) funding into a capital contribution could lead to non-deductible interest expenses at

the level of the borrower and (from Dutch perspective) dividend income for the guarantor.

In this respect, the TP Decree recognizes that it is uncertain whether the TP Decree's position regarding the recharacterization of loans into capital would be recognized by the Dutch Supreme Court, as it is not in line with the prevailing Dutch jurisprudence. In particular, the TP Decree opposes the long-standing jurisprudence that prescribes the three strictly defined instances in which a loan can be reclassified as an equity contribution.



Please note that jurisprudence is ranking prior to the Decree. Therefore, the position that the debt is qualified as debt (leading to interest deductions) may still be taken by taxpayers in their tax returns, in line with case law. Albeit that the Decree is a working instruction of the Dutch tax authorities and controversy may be expected when the Decree is not followed by taxpayers.

Action required?

In cases where loans are obtained in connection with an intercompany guarantee the debt capacity and debt/equity position should be considered. As such, it should be assessed to what extent an entity would be able to attract debt from a third party on a standalone basis (i.e. without guarantees from affiliated entities).

Contact us

Would you like to receive more information about this topic? Or do you need advice to assess the current trends and manage their impact on your transfer pricing model? Meijburg & Co would be happy to discuss with you. Feel free to contact one of our transfer pricing specialists.



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