

All about:

application of Section 408 of the
Dutch Civil Code consolidation
exemption for intermediate
holding companies

February 2017





'All about' is a new publication, with in every edition another Dutch GAAP topic that is being explored in depth. This means you have everything that you need to know about that subject in a convenient form. This document has been prepared in April 2018 so any developments in legislation or similar since then have not been taken into account.

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Introduction

On the basis of Section 408 of the Dutch Civil Code a Dutch intermediate holding company can use the consolidation exemption. In this 'All about' you can read everything about this matter, such as the various criteria that must be met and the concurrence with the group exemption of Section 403 of the Dutch Civil Code. The examples and practical applications give you concrete points of reference.

***All
about:***

Section 408
of the Dutch
Civil Code



1. Consolidation obligation - general provisions

Pursuant to Section 406(1) Book 2 of the Dutch Civil Code, the legal entity which, alone or together with another group company, is the head of its group, prepares consolidated financial statements. The group concept, as defined in Section 24b Book 2 of the Dutch Civil Code, is important in determining whether a legal entity is the parent company and therefore has an obligation to consolidate.

The legal description of the concept contains two criteria that must be met if there is to be a group:

- *economic unity; and*
- *organisational affiliation.*

From the legislative history, it can be concluded that the element of central management is also essential. There is a relationship between these three criteria. After all, an economic unity assumes an organisational affiliation and/or central management. A characteristic of a group is therefore that there is a composition of legal entities and companies (hereinafter referred to collectively as companies) that are under central management in such a way that they constitute an economic unity.

This means that a so-called ‘intermediate holding company’¹ with at least one subsidiary in its group component in principle always has a requirement to consolidate, even if it does not exercise a de facto policy-making influence in its group component. This consolidation obligation applies because the intermediate holding company can exercise predominant control over its subsidiaries via the share structure. This is regardless of the fact that the policy of the group will usually be determined from the holding company at the top. This situation therefore looks at the formal control relationships based on legal provisions, articles of association, agreements and such like.

Based on Section 408 there may be an exemption from the consolidation obligation. The conditions that apply to this are further explained below.

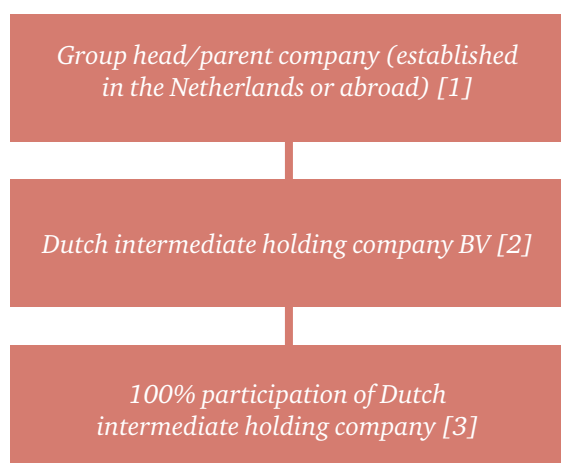
If an intermediate holding company fails to comply with all conditions, then it cannot apply the exemption from Section 408 Book 2 of the Dutch Civil Code. This means that the intermediate holding company must still prepare consolidated financial statements.

1 An intermediate holding company or intermediary is a Dutch company,
- which has one or more consolidated holdings and,
- of which the majority of the shares (of the intermediate holding company) are held by a foreign or Dutch group head in such a way that the intermediate holding company is part of the group (this group head can also be part of a larger entity again and thus be an intermediate holding company).

2. Legal exemption under Section 408 of the Dutch Civil Code 2 - general rule

To qualify for the exemption, various conditions must be met, see here below under section 3). The section of law is dealt with integrally based on the various components.

Structure when applying Section 408



The financial statements of the intermediate holding company [2] state that the consolidation exemption is used. The text for this could read as follows:

‘The company uses the consolidation exemption for intermediates as referred to in Section 408 Book 2 of the Dutch Civil Code. The financial data of the company and its subsidiaries are included in the consolidated financial statements 20x8 of [name of parent company] in [place]. These consolidated financial statements have been filed with the Chamber of Commerce in Woerden.’

The conditions for exemption are further discussed in paragraph 3. Not all Dutch legal entities are eligible for the application of the facility.

First of all the general rule:

Paragraph 1: Consolidation of a group component may be omitted (provided):

If an intermediate holding company in the Netherlands [2] applies this exemption than under certain conditions (which are further elaborated on below, under paragraph 3) it does not have to prepare consolidated financial statement. This implies, among other things, that the intermediate holding company may measure its subsidiaries [3] at cost, see paragraph 6. An important condition is that the financial data of [2] and [3] are included in the consolidated financial statements of the parent company [1], see the structure when applying Section 408 above. With regard to the notes, the provisions of paragraph 3 apply:

Paragraph 3: The legal entity must disclose the application of paragraph 1 in the explanatory notes.

Paragraph 4: This Section does not apply to a legal entity whose securities are admitted to trading on a regulated market as referred to in the Financial Supervision Act or a system similar to a regulated market from a non-Member State.

This provision applies to the intermediate holding company [2], which may not have issued any shares or bonds on a regulated market such as Euronext N.V. It must be established whether the market is regulated or not. The exploitation or management of a regulated market in the Netherlands is prohibited without a licence as referred to in Section 5: 26(1) of the Financial Supervision Act.

The parent company may have admitted securities, in other words, the parent company could also be a listed company.

3. Conditions for exemption

The exemption from consolidation is a legal facility. This is subject to various conditions by law (Section 408(1)(a) to (e) Book 2 of the Dutch Civil Code) which will be dealt with in full here below.

And once again, the exemption cannot be applied by legal entities with admitted securities as indicated above.

Conditions

No objection from shareholders

Letter a: *within six months after the start of the financial year a written objection has not been made to the legal entity by at least one tenth of the members or by holders of at least one-tenth of the issued capital;;*

In concrete terms, this means that the shareholders, or at least 10% of them, must have filed a written objection before 1 July of the current financial year. It demonstrates prudence if the management informs the shareholders in good time about whether or not this 408 facility is being used so that they - the shareholders - have the opportunity to exercise the right of objection referred to here.

You may wonder whether this is also necessary if the intermediate holding company has been using the exemption for years, perhaps the shareholders can assume that the exemption will be used again in the current year.

If at least 10% of the shareholders make a written request within six months of the current financial year for consolidated financial statements at the intermediate holding level, this must be honoured.

Including financial data in a larger entity

Letter b: *the financial data that the legal entity should consolidate are included in the consolidated financial statements of a larger entity;*

RJ 217.214: (...) The provisions under letter b are not satisfied if the financial data have been proportionally consolidated in the consolidated financial statements of a larger entity because there is no question of a group component as referred to in Section 408(1) Book 2 of the Dutch Civil Code.

As a result of this requirement, the data of both the intermediate holding company and its group companies (intermediate holding company et al) are fully consolidated at a higher level. Suppose the parent company [1] holds all the shares in the intermediate holding company [2]. In that case, the primary statements of the intermediate holding company [2] and of its group companies [3], including the balance sheet and the profit and loss account, must be processed (read: fully consolidated) in the consolidated financial statements of the parent company, in this case the larger entity. The consolidated financial statements of the parent company thus contain the integral financial data of the underlying entities [2] and [3] in the group.

Example (1) where exemption cannot be applied (two 50% shareholders)

Two companies each hold a 50% interest in an underlying company, the intermediate holding company. For both companies, the intermediate holding company qualifies as a joint venture. The intermediate holding company only has 100% subsidiaries. The intermediate holding company may not use the consolidation exemption of Section 408 under these circumstances.

This is also the case if one BV, or both BVs, incorporate the joint venture into its financial statements according to the proportional consolidation method. Neither of the two BVs is the parent company. RJ 217.214 states that the intermediate holding company with its 100% subsidiaries in proportionate consolidation is not a group component.

Example (2) where exemption cannot be applied (idem with proportional consolidation)

See example (1). Suppose now that the 50% shareholder not only consolidates proportionally, but also lists the financial data of the intermediate holding company and its subsidiaries (balance sheet and profit and loss account) in the notes to its financial statements. This too is not enough, because mentioning or including in the explanatory notes is not enough, there must actually be integral consolidation.

The consolidation exemption therefore only applies if the financial data are consolidated integrally in the group financial statements of a larger entity, where the larger entity is actually the parent entity and therefore has an integral consolidation obligation.

Another situation: what to do if an acquisition takes place during the year, such that the financial data for the entire year are not included in the group financial statements of [1]. Can the intermediate holding company still use the exemption of Section 408?

Example (3) where participation [3] or intermediate holding company [2] is acquired during the year

Participation [3] is acquired by the Dutch intermediate holding company in the course of the year [2]. This means that the financial data of [3] will be included in the group financial statements of the parent company [1] from the acquisition date. However, application of Section 408 does not have to stand in the way of the intermediate holding company [2], because ‘the financial data’ does not mean the financial data for the entire financial year, but the financial data that the parent company [1] must incorporate in its consolidated financial statements. Of course, all other conditions of Section 408 should be met.

The same conclusion can be drawn if the intermediate holding company is taken over by another party in the course of the year. Even then, only part of the financial data will be processed, namely at the acquiring party, the new parent company [1].

If such an acquisition takes place shortly before the end of the financial year (for example in mid-December, with a financial year ending on 31 December), a very limited part of the profit and loss account is consolidated in the group financial statements of the new parent company. In that case, a solution could be to include, in addition to the statutory consolidated profit and loss account of the parent company (in which the results of the intermediate holding company are included from the acquisition date) a consolidated profit and loss account in which the intermediate holding company includes results for the entire financial year. This would mean information is not withheld from stakeholders and the intermediate holding company can still apply Section 408 Book 2 of the Dutch Civil Code.

Applicable reporting system as well as equivalence requirement

Letter c: the consolidated financial statements and the board report have been prepared in accordance with the requirements of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ EU 2013, L 182), and if these rules do not have to be followed, in an equivalent way;

Paragraph 2: Our Minister of Justice can designate regulations for the financial statements, which, if necessary supplemented by regulations he issues, will apply as equivalent to regulations in accordance with Directive 2013/34/EU (...). Withdrawal of a designation can only concern financial years that have not yet commenced.

If the group financial statements are drawn up by a parent company established in the European Union, the provisions in letter c are almost always met. After all, the group financial statements must then be drawn up under the regime of the European Directive on financial statements or based on IFRS as approved by the European Commission. In any case, US GAAP is also regarded as equivalent, as are reporting systems of many countries in the western world, especially when there is (far-reaching) convergence with IFRS. ‘Equivalent’ means that these consolidated financial statements provide at least the same information as defined by the EU Directives.

The term ‘equivalent’ has also been further specified by the European Union. Although this has been done in the context of the Prospectus Directive, it can be assumed that the Commission’s decision – see below – can also be applied to Section 408.

In this decision of the European Commission of 12 December 2008, countries are mentioned with a reporting system that is considered equivalent; at that time, they included Japan, the United States (US GAAP, as already mentioned above) and China. The overview is subject to change, for a current state of affairs, please refer to the relevant website of the European Commission (‘Equivalence of third country accounting standards’):
http://ec.europa.eu/finance/accounting/third_countries/equivalence_reports_en.htm

RJ 217.214 (...) The legislative history shows that the standards of the IASB can be considered equivalent. Even if the consolidated financial statements have been prepared in accordance with legislation and regulations of a non-EU country, the equivalence requirement can be met. This requirement should not be seen as an equality requirement, but as a minimum requirement of equivalent quality of the legislation and/or regulations with regard to the financial reporting. It is the responsibility of the reporting legal entity to determine whether this is the case based on the contents of the consolidated financial statements.

RJ 217.215 As can be seen from paragraph 214, an intermediate holding company may use the exemption of consolidation pursuant to Section 408 Book 2 of the Dutch Civil Code if the parent company² applies IFRS in its consolidated financial statements (...).*

An interesting question is to what extent the consolidation exemption can still be applied in the future by Dutch intermediate holding companies with a parent company (parent company) based in the United Kingdom. Since the United Kingdom will then no longer formally be a member state, it must be ascertained whether the applicable reporting in the United Kingdom can be regarded as equivalent to the requirements of the European Directive on financial statements. If UK GAAP in the future has a similar content to current UK GAAP, the equivalence requirement is expected to be met.

2 IFRS* stands for IFRS as approved by the European Commission



Application of the language

Letter d: the consolidated financial statements together with the audit opinion and board report, insofar as not written or translated into Dutch, are drawn up or translated into French, German or English, and all in the same language;

Timely filing at the Commercial Register

Letter e: the documents or translations referred to in part d are filed each time within six months after the balance sheet date or within a month after a legitimate later disclosure to the commercial register.

The term that applies to the filing of the documents mentioned in letter d, including the board report of the parent company and its consolidated financial statements (including audit opinion), is important. This deadline cannot be extended: it is then no longer possible for the intermediate holding company to use the consolidation exemption. As a result, the intermediate holding company still has to draw up consolidated financial statements at the intermediate holding company level.

There is a variation in practice about the interpretation of these terms, partly because the legislation is not entirely clear. This will be further elaborated on using a few examples.

Example (4) filing period consolidated financial statements Dutch listed group head

The parent company [1] is a listed company based in the Netherlands (issuing institution). Based on Section 210(1), second sentence, Book 2 of the Dutch Civil Code, such a listed company must make its financial statements available within four months of the end of the financial year. This period cannot be extended. The issuing institution does not send its data to the Chamber of Commerce itself; instead, it sends the financial statements (and some other data) to the AFM within 5 days of their adoption. The AFM forwards these documents to the Chamber of Commerce within 3 days. On the basis of Section 394(8) Book 2 of the Dutch Civil Code, the parent company (the listed company) is deemed to have fulfilled its obligations to file.

In addition, the requirement in Section 408 that the parent company must have filed its financial statements with the Dutch Chamber of Commerce must also be complied with within six months. The intermediate holding company can therefore apply the consolidation exemption.

For the purposes of Section 408, it does not matter whether the parent company is located in the Netherlands, or outside it, as long as all the conditions of Section 408 are met. In the situation where there is a Dutch intermediate holding company with a foreign parent company, it is assumed that for the assessment of the terms as referred to in letter e) those of the Netherlands are taken into account, as also shown in example 5 below.

Example (5) filing period for consolidated financial statements foreign group head

The parent company [1] is a company based abroad. The parent company filed the consolidated financial statements in its own country on time. Filing the foreign group financial statements in the Netherlands takes place after 9 months (i.e. later than the 6-month period stated in the law but within the legal period of the intermediate holding company [2], which has used the possibility to extend the term for preparation of the financial statements, and with it the filing period).

- The intermediate holding company prepares its financial statements within the legal period and files them after 11 months (i.e. later than the consolidated financial statements of the parent company, and within the maximum legal period of 12 months): this is permissible, provided that the formal requirements of term extension are met. The starting point here is that the foreign parent company must comply with the time limits for filing applicable in the Netherlands.

- The intermediate holding company prepares its financial statements after 14 months and files them after 15 months (i.e. later than the consolidated financial statements of the group head, and in contravention of the 12-month legal period): in itself, late filing by the intermediate holding company does not impede application of Section 408, but otherwise - also due to other considerations such as possible liability on the part of the directors - this is an undesirable situation.

If the foreign parent company does not have a filing obligation, and therefore also no term within which this must be done, the same principle applies as indicated above: filing the consolidated financial statements of the foreign parent company must take place within one month (as an additional extension) after permitted later disclosure (latest legal term for the intermediate owner, being 12 months), i.e. within 13 months after the end of the financial year; and of course also before the Dutch intermediate holding company prepares and files its financial statements.

It is important that the financial statements of the Dutch intermediate holding company are prepared (and subsequently filed) after it has been established that the consolidated financial statements of the parent company have been filed in the Netherlands. After all, only then can it be established with certainty that the condition mentioned in letter e) is satisfied: timely filing. The fact that the foreign parent company only files in the Netherlands after 9 months does not prevent the application of Section 408 by the Dutch intermediate holding company, provided that this filing does take place before, or no later than simultaneously with the preparation and filing of the financial statements of the intermediate holding company. Information is then not withheld from the users of the financial statements (of the intermediate holding company).

If the consolidated financial statements of the parent company have not yet been filed at the time of preparation of the financial statements of the intermediate holding company, there is a risk that this will be done too late or not at all. That risk is real, especially among foreign parent companies, because they are not always aware of the conditions of Section 408. In that case, relevant information will not be available to the users of the financial statements of the intermediate holding company. In that case, it must be investigated whether there is an error as referred to in Section 362(6) Book 2 of the Dutch Civil Code in the financial statements of the intermediate holding company (which, after all, has only erroneously prepared separate financial statements).

RJ 217.214 The provision under e is not met if the consolidating legal entity publishes only a consolidated balance sheet with explanatory notes pursuant to applicable law. The legislative history shows that consolidated financial statements, i.e. a balance sheet and profit and loss account with explanatory notes, must be published.

The exemption from consolidation is granted only if the parent company [1] submits integral consolidated financial statements. If the parent company only needs to publish a consolidated balance sheet with explanatory notes according to its own law, the requirements for the exemption are not fulfilled by filing it.

Chamber of Commerce means the commercial register in the Netherlands (RJ 217.214). Filing the group's financial statements by posting them on the internet for example is not sufficient, which means that the condition under letter e) is not met.

*Section 19a(1) of the Commercial Register Act
By general administrative measure, for designated legal entities it is determined that for designated documents which must be filed at the commercial register as prescribed by or pursuant to the law that registration thereof is only done electronically and rules are made about how that filing must take place.*

At this time there is a transition ongoing with regard to filing. The (old-fashioned) filing by sending written documents to the Chamber of Commerce is being replaced step by step by electronic filing, for which the SBR (Standard Business Reporting) system must be used. This is laid down in Section 19a of the Commercial Register Act 2007 and the Decree on electronic filing for the Commercial Register. Pursuant to this Decree, the documents referred to in Section 394 of the Dutch Civil Code must be filed electronically.

This means the documents that must be filed on the basis of Section 408(1)(d)(e) of the Dutch Civil Code are not subject to the aforementioned Electronic Filing Decree. For foreign parent companies in a situation where Section 408 is applied, filing 'just' on paper can be continued in the future.

4. Concurrence with Section 403 Book 2 of the Dutch Civil Code group exemption

Another facility is dealt with in Section 403, 'exemption with regard to financial statements of a legal entity belonging to a group' (RJ 305.2) [hereinafter: group exemption]. The legal entity does not have to prepare financial statements in accordance with Title 9 of the Dutch Civil Code 2, and can also omit any mandatory audit. It is also possible to waive the filing of the financial statements. An important condition for this is that the financial data of that legal entity (which wants to apply the exemption of Section 403) will be consolidated by another legal entity. In addition, 'the other legal entity' must issue a liability (guarantee) for the debts of the legal entity that wishes to apply Section 403. This can lead to a concurrence of Sections 403 and 408. Below are some extracts from Dutch Civil Code 2 and from the RJ, with a further explanation and an example.

403 ↔ 408

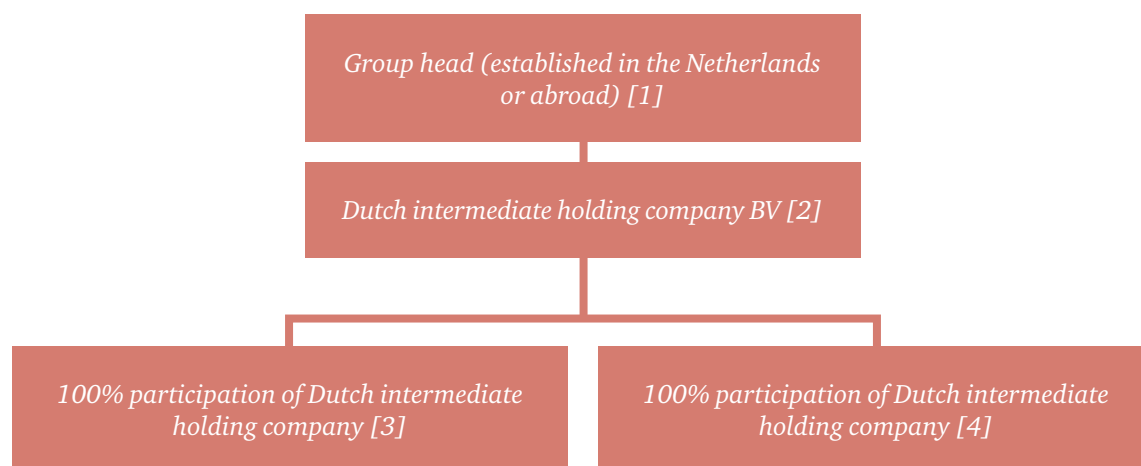
Section 403.1. (fragment) A legal entity belonging to a group need not prepare the financial statements in accordance with the provisions of this title, provided that: (...)

c. the financial data of the legal entity are consolidated by another legal entity (...) in consolidated financial statements (...);

f. the legal entity or company referred to under c has declared in writing that it is jointly and severally liable for the debts resulting from legal acts of the legal entity;

RJ 217.216 If the legal entity does not prepare consolidated financial statements under Section 408 Book 2 of the Dutch Civil Code, a legal entity belonging to its group for which the legal entity has issued a declaration as referred to in Section 403(1)(f) Book 2 of the Dutch Civil Code cannot use the provision of Section 403(1) Book 2 of the Dutch Civil Code that the financial statements do not have to be presented in accordance with the provisions of Title 9 Book 2 of the Dutch Civil Code.

Group exemption sections 403 and 408



Example (6) concurrence of Sections 403 and 408

A group has a parent company [1], intermediate holding company [2] and two group companies [3] and [4]. All entities have a 100% shareholder interest in the underlying company/companies. On the basis of the consolidation general rule, both the parent company [1] and the intermediate holding company [2] have a consolidation obligation. An exception to this can be made in [2] by applying the consolidation exemption of Section 408 Book 2 of the Dutch Civil Code.

In addition, the aim is to allow both group companies [3] and [4] to use the exemptions in Section 403 Book 2 of the Dutch Civil Code, making it possible for both companies to draw up simplified financial statements (and not to have to file them).

If the intermediate holding company [2] uses the exemption from consolidation, no consolidated financial statements are available at that level to facilitate the group exemption in [3] and [4]. The question then is whether the parent company [1] can facilitate the exemption in [3] and [4]. This is possible if the parent company meets all the conditions of Section 403. For example, that company must be subject to the law of the EU directive on financial statements or the EU-IFRS regulation. That consolidating company must also issue the liability statement. If the parent company [1] does not fall under EU law or under the EU-IFRS regulation, the parent company cannot facilitate the group exemption in [1] and [2].

N.B.: a condition not mentioned here for the application of Section 403 concerns its approval by the shareholders (in this case [2]).

If the Dutch intermediate holding company [2] uses the consolidation exemption, and also issues a declaration of liability for the benefit of legal entities [3] [4] belonging to its group, these two subsidiaries cannot use the exemptions under Section 403(1) Book 2 of the Dutch Civil Code (RJ 217.216). The legal entity that applies Section 408 Book 2 of the Dutch Civil Code [2] does not produce consolidated financial statements, one for the requirements for allowing subsidiaries [3] and [4] to use the exemptions from Section 403(1) Book 2 of the Dutch Civil Code. To use these exemptions, the declaration of liability referred to in Section 403(1)(f) Book 2 of the Dutch Civil Code must therefore be provided by the consolidating parent company [1].



5. Application size criteria and regime

Section 396

1. *Notwithstanding Section 395a, paragraphs 3 up to and including 9 [not stated here, editor] apply to a legal entity that on two consecutive balance sheet dates, subsequently without interruption on two consecutive balance sheet dates, has satisfied two or three of the following requirements:*
 - a. *the value of the assets according to the balance sheet and the explanatory notes does not exceed €6,000,000 on the basis of the acquisition and manufacturing price;*
 - b. *the net revenue for the financial year does not exceed €12,000,000;*
 - c. *the average number of employees for the financial year is less than 50.*
2. *For the purposes of paragraph 1, the value of the assets, the net revenue and the number of employees of group companies will be taken into account, which should be included in the consolidation if the legal entity were required to prepare consolidated financial statements. This does not apply if the legal entity applies Section 408.*

The legal entity that uses the exemption for consolidation (Section 408 Book 2 of the Dutch Civil Code), for determining whether it is large, medium or small, does not include the assets, the net revenue and the number of employees of the group companies that are not to be consolidated (Sections 396(2) and 397(2) Book 2 of the Dutch Civil Code). The individual data of the stand-alone entity are therefore decisive for the size, in which the value of the assets is determined on the basis of the acquisition price, even if they are actually valued differently. In respect of participations valued at net asset value, this implies that as value only the acquisition price needs to be taken into account (in which obviously the provisions of RJ 121, impairment of fixed assets, must be taken into account if necessary).

It should be noted that if there is a Dutch intermediate holding company that exclusively acts as a holding for the participations of a foreign top holding company, such participations can already be valued at the acquisition price (Section 389(9) Book 2 of the Dutch Civil Code and RJ 214.325).

In the case of intermediate holding companies, the income often consists of interest (on loans granted) and dividend; the question is whether this should be regarded as turnover. This is important because the size of the net revenue can be decisive for the question under which regime the intermediate holding company falls, see for a further elaboration RJ 270.201. This accounting standard stipulates that intermediate holding companies do not have to count dividend income, and often also interest income as revenue.

RJ 270.201

(...) Net revenue means the proceeds from the supply of goods and services from the legal entity's business, less discounts and such like and taxes levied on revenue (...).

If interest income arises from activities that are characteristic of the business of a legal entity, they form part of the net turnover.

Dividend income is part of net revenue if that is part of investment income, and investments are characteristic of the business of the legal entity. Examples are pension funds, insurance companies and investment entities (...). For (intermediate) holding companies, dividend income and interest income on receivables that are actually an extension of the net investment of the (intermediate) holding company in its participations are not classified as net revenue.



Example (7) application of the size regime

In the financial statements of the intermediate holding company, the participation [3] is valued at net asset value. The table below contains the relevant data to determine the size of this intermediate holding.

This intermediate holding company is regarded as small on the basis of the following facts:

- Balance sheet total (separate): €7,000,000, but on the basis of Section 396(1)(a) the acquisition price may be assumed for assessment of the size criteria; the difference between the net asset value (€2 million) and the acquisition price (€500,000) is deducted from the balance sheet total, so that ultimately in the separate financial statements €5,500,000 remains which

is less than the amount of €6,000,000 stated in the law; the (pro forma) consolidated balance sheet total is not relevant on the basis of the last sentence of Section 396(2);

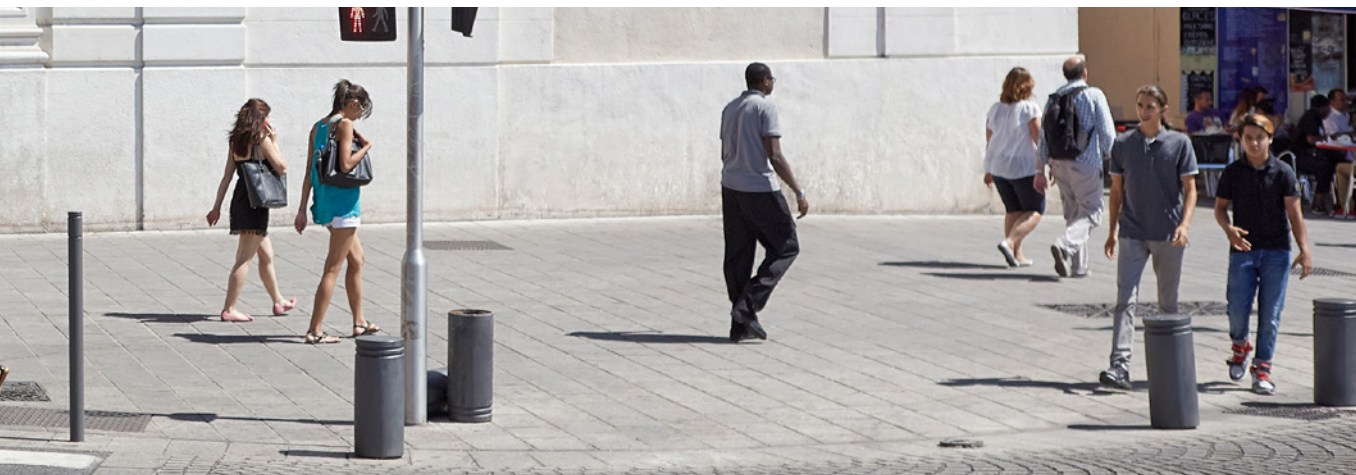
- Net revenue (separate): €11,000,000 (this is less than the amount of €12,000,000 mentioned in the law); the pro forma consolidated net turnover of €13,000,000 is irrelevant;
- Average number of employees (separate): 60 (this is more than 50, so this fulfils one requirement for medium-sized).

The conclusion is drawn by comparing the amounts and numbers of the last two columns (amount to be tested/number versus the size criteria in Section 396). The intermediate holding company only meets one of the three requirements and is therefore small.

Re.	Intermediary [2], applies Section 408	Participation [3]	Amount / number to be assessed	Size criterion in Section 396
Balance sheet total (including participation [3])		€4 m.	€5.5 m.	€6 m.
- net asset value	€7 m.			
- acquisition price	€5.5 m.			
Net revenue	€11 m.	€2 m.	€11 m.	€12 m.
Number of employees	60	2	60	50

The subsidiary is measured as follows:

- net asset value: €2.0 m.
- acquisition price/cost price: €0.5 m.



Another aspect here is the change of regime.

On first application of Section 408 Book 2 of the Dutch Civil Code, the company-only financial statements may be used for the assessment of the size criteria - both in the year of initial application of Section 408 Book 2 of the Dutch Civil Code as well as for the prior year. The reasoning for this is that the company in question is small in the first year, and that when applying the facility, the comparative figures would also lead to the small regime. This means that the company is small on two consecutive balance sheet dates and therefore falls under that regime.

If a company no longer uses the exemption under Section 408 Book 2 of the Dutch Civil Code, in our view there is no obligation to include comparative figures in the consolidated financial statements in the first year in which it prepares the consolidated financial statements. After all, otherwise the exemption from consolidation for the previous financial year would be reversed with retroactive effect.

Example (8) change of regime

BV Z qualifies as a large legal entity on the basis of its consolidated data and has prepared consolidated financial statements up to and including 20X8. With effect from 20X9, Section 408 Book 2 of the Dutch Civil Code is applied. On the basis of its separate data, BV Z qualifies as a small legal entity on 31 December 20X8 as well as on 31 December 20X9.

In this case BV Z may already apply the regime of the small legal entity in 20X9. According to the last sentence of Section 396(2) Book 2 of the Dutch Civil Code, the provision that the consolidated data must be assumed does not apply if Section 408 Book 2 of the Dutch Civil Code is applied. It follows that BV Z on both balance sheet dates (31 December 20X8 and 31 December 20X9) individually complies with the criteria for qualification as a small legal entity (Section 396(1) Book 2 of the Dutch Civil Code). This also applies incidentally to qualifying as a medium-sized legal entity in the above circumstances (Section 397(2) Book 2 of the Dutch Civil Code).

6. Measurement of participations according to Section 389 - general rule and exceptions



A legal entity that uses the consolidation exemption of Section 408 may limit itself to preparing separate financial statements. In these financial statements, the (majority) participations are included in the balance sheet. On the basis of the main rule of Section 389, these participations are valued at the net asset value, however, in the case of application of Section 408, the valuation of the participations at acquisition price is permitted. This is set out in RJ 214.325, in which the RJ has filled in the space offered by Section 389(9). Incidentally, it is customary in international relations that participations are valued at cost price. Application of this must be disclosed.

Section 389(1) The participations in companies in which the legal entity exercises significant influence on the business and financial policy are accounted for in accordance with paragraphs 2 and 3 (...).

– 2. The legal entity determines the net asset value of the participation by valuing the assets, provisions and debts of the company in which it participates and calculating its result on the same basis as its own assets, provisions, debts and result. (...).

– 9. Because of justified reasons stated in the explanatory notes, the application of paragraph 1 may be waived.

RJ 214.325

If there are sound reasons for not applying Section 389 Book 2 of the Dutch Civil Code in the separate financial statements, these must be disclosed in the explanatory notes. There may be reasons, such as international connection or application of Section 408 Book 2 of the Dutch Civil Code, on the grounds of which it is justified not to apply Section 389(1) Book 2 of the Dutch Civil Code in the separate financial statements, in addition to the view that the consolidated financial statements of the parent company give. This means that a legal entity that applies Section 408 Book 2 of the Dutch Civil Code can measure its participations at the acquisition price.

7. IFRS

There is an exemption in IFRS for consolidation that is comparable with the exemption provided for in Section 408 of the Dutch Civil Code. The relevant provision in IFRS10p4 reads as follows:

IFRS

An entity that is a parent shall present consolidated financial statements. This IFRS applies to all entities, except as follows:

- a. *a parent need not present consolidated financial statements if it meets all the following conditions:*
 - i. *it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;*
 - ii. *its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);*
 - iii. *it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and*
 - iv. *its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRSs.*
- b. (...)
- c. (...)

If an undertaking meets all conditions, it can suffice to prepare separate financial statements. Some differences with the conditions that apply to Dutch GAAP:

- 1.i: there is a duty to report to the shareholders, who can then object to the application of the consolidation exemption;

- 1.i: if there is an objection by the shareholders, no minimum quorum of 10% is required, in effect all shareholders must agree with the application of the exemption;
- 1.ii: if a company has debt or equity instruments that are traded on a public market³ the exemption cannot be applied; this is broader than the term 'regulated market' used in Section 408 of the Dutch Civil Code;
- 1.iii: if the company prepares for an initial public offering, the exemption cannot be applied; we do not have these conditions in Section 408;
- 1.iv: the group financial statements must be prepared on the basis of IFRS, while Section 408 and the RJ also consider systems of EU countries or equivalent schemes as acceptable as well as US GAAP for example;
- 1.iv: the group financial statements must be publicly available, it is not explicitly stated where this must be done and within what period; it is obvious to assume the requirements in the applicable local legislation.

In addition, IFRS10p4 does not prescribe that the filed group financial statements must be audited, nor that a boardreport from the parent company must be filed.

There are various relevant differences between IFRS and Dutch GAAP: sometimes the IFRS criteria are stricter, sometimes precisely less stringent.

If the intermediate holding company decides to apply (voluntary) IFRS in its separate financial statements, the exemptions from Section 396 (and Section 397) are not applicable (see Section 362(9) Book 2 of the Dutch Civil Code). The company is then large and therefore always subject to a mandatory audit.

³ The term 'public market' is defined in the standard IFRS for SMEs and includes: 'a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets'.

8. Want to know more?

Should you have any questions about this topic, feel free to get in touch with your contact person at PwC. It will be our pleasure to assist you with your needs.



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