NovioTax

Dutch legislative amendments per 1 January 2018 aim to strengthen tax climate whilst tackling tax avoidance

November 2017

The past few months have provided a clear view on what we can expect from the Netherlands in terms of its approach on tax. The old government announced formal legislative proposals on Dutch Budget Day that have effect from 1 January 2018. A few weeks later, nearly seven months after the elections in March 2017, a newly formed government released its coalition agreement which contained some interesting fiscal measures. These tax measures are aimed to take effect from 1 January 2019, subject to the parliamentary process. In this blog we will start with discussing the impact of the legislative amendments effective on 1 January 2018, which have been adopted by the upper house of the Dutch parliament on 19 December 2017.

Introduction

The legislative amendments are generally in line with earlier announcements, and are likely to benefit international structures involving Dutch entities, but may also adversely impact structures in which a Dutch holding cooperative is involved.

The new law (i) introduces a dividend withholding tax ("WHT") obligation for holding cooperatives; and (ii) broadens the general exemption from the WHT obligation. A holding cooperative is a cooperative whose activities for at least 70% consist of holding participations or financing (directly or indirectly) related entities or natural persons. Under the current legislation, such cooperatives, which are also used in international tax structures, are not subject to dividend WHT, except for certain "abusive" situation. Legislation is now proposed to align the dividend WHT treatment of cooperatives to entities with a capital divided into shares. Currently, for these companies a general exemption applies in domestic situations and to payments from EU/EEA countries. Hence dividend distributions by for instance BV's and NV's are in principle subject to 15% dividend WHT.

The legislation aims to eliminate the above-mentioned difference between holding cooperatives and public and limited liability companies by imposing the withholding obligation on such cooperatives and to broaden the general exemption from the withholding obligation for public (NV's) and limited (BV's) liability companies. With its law to fully eliminate dividend WHT at a domestic level, as a result of which in principle group companies do not have to rely on tax treaties, the Netherlands follows neighboring jurisdictions as Belgium, Denmark and the UK. However, to avoid artificial structures where the Netherlands is used as a "flow-through" jurisdiction, anti-avoidance measures have been put in place and in particular sufficient substance is required to ensure that the dividend exemption is only applicable in active/genuine situations.

New legislation broadening scope of dividend WHT exemption

The new law entails a full exemption of dividend WHT, to apply on dividends distributed to entities resident in the EU/EEA or in a state with which the Netherlands has concluded a tax treaty that includes a dividend article. As an additional requirement, the recipient entity must be able to apply the Dutch participation exemption or participation credit to the dividends if it would have been a resident of the Netherlands. The rationale behind this requirement is to ensure that the dividend WHT exemption will only be available for "active" businesses / holding companies.

The dividend WHT exemption will be subject to targeted anti-abuse rules, which are to be interpreted in accordance with the Principal Purpose Test ("PPT") of Action 6 of the OECD BEPS Project and also the Parent-Subsidiary Directive. Under these rules it should be assessed if the interest in the Dutch entity (e.g. Holding cooperative, BV or NV) is held with the main purpose, or one of the main purposes, to avoid dividend WHT abroad (subjective test), and if the structure should

be considered as an artificial arrangement (objective test). The latter test would be failed if the structure is not based on valid business reasons reflecting economic reality. In this respect it needs to be considered if the intermediate shareholder carries-on an active business itself, or accordingly meets the requirements for having relevant substance in relation to intermediate companies.

In the context of tackling tax avoidance, the existing Dutch substance requirements are expanded for intermediate companies to further prevent the use of so-called “letterbox companies”. The expanded requirements are as follows:

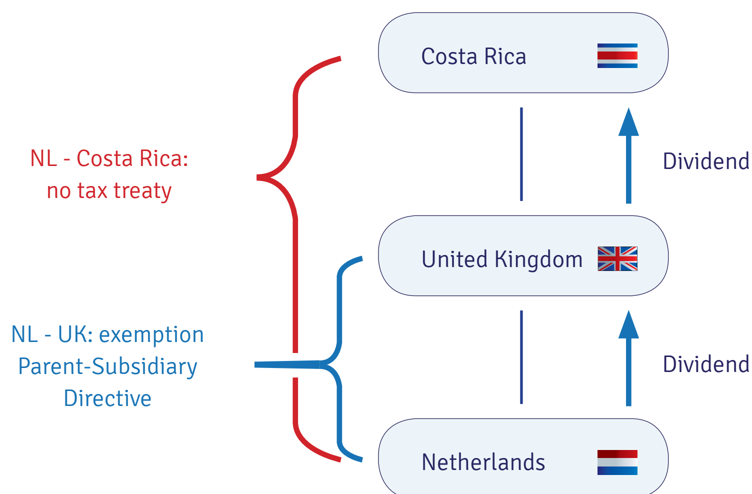
- the holding company incurs employment costs of at least EUR 100,000 in relation to its intermediary holding functions;
- the employees must have the professional knowledge and capacity to be able to properly perform their duties; and
- the holding company has office space at its disposal (for at least 24 months) from which the intermediary holding functions are being undertaken.

Based on the parliamentary proceedings, the amount of EUR 100,000 may deviate per country observing the domestic pricing level in the resident state of the intermediate company. In addition, it could be considered to allocate relevant labour expenses (this however needs careful consideration and needs to match with the day-to-day activities). An aspect worth pointing out is that the EUR 100,000 on employment costs (indexed per state) is not a guarantee for having substance; in parliamentary proceedings it has been clarified that there should be “relevant” substance. In this context, it has been confirmed that the EUR 100,000 also may be paid externally, which means that a company can also hire personnel externally (for instance from a trust) in order to satisfy the “relevant” substance test. As noted above, it remains critical that the remuneration of at least EUR 100,000 is paid in relation to activities for the intermediary holding company, and that the employees must have the professional knowledge and capacity to perform these activities. As a final remark to these expanded substance requirement, we note that the 24 month disposal requirement (i.e. real estate) may be satisfied retroactively following the dividend distribution.

The effect of this domestic anti-abuse rule can be best illustrated with three examples, which are derived from the consultation document released by the Dutch government.

Example 1: Costa Rica

In the first example an actual/active place of business takes place in a company in Costa Rica. There is no Double Tax Avoidance Agreement (“DTAA”) concluded between Costa Rica and the Netherlands. An intermediate holding company is established in the United Kingdom. As a result, it should be considered if the UK entity is put in place to avoid Dutch dividend WHT, since dividends from the Netherlands to the UK are exempt (and the UK does not have a domestic dividend WHT on outgoing distributions).



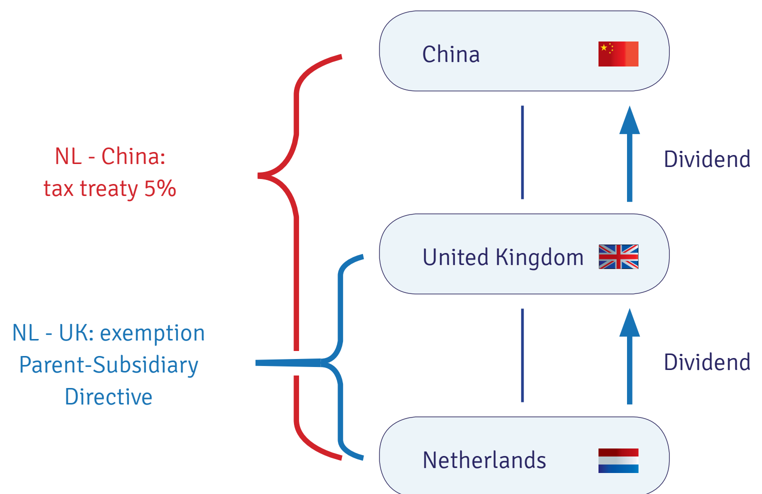
In case of a direct dividend distribution from the Netherlands to Costa Rica, dividend WHT would be due as the proposed dividend WHT exemption only applies to EU/EER countries and to states with which the Netherlands has concluded a DTAA that includes a dividend article. The intermediate holding company seems to be inserted in order to avoid dividend WHT – this means it can be assumed that the subjective test is fulfilled.

Subsequently, the objective test will need to be considered. The UK company should carry-on an active business itself, and / or should meet the requirements for having relative substance. For these purposes, among other elements, the extended Dutch substance requirements need to be considered in relation to the foreign intermediate holding company. In order to satisfy these, the UK company should incur employment costs of at least EUR 100,000 (or the relevant GBP amount taking into consideration the UK domestic pricing level) in relation to its intermediary holding functions, and the UK company should have (for at least 24 months) its own office space at its disposal used for carrying out the intermediary holding functions.

Example 2: China (observing the DTAA Netherlands - China 5% dividend WHT)

An active place of business is established in China through an active company incorporated in China. Between the Netherlands and China a DTAA is applicable which in principle provides for a reduced rate of 5% of dividend WHT (participating investments). However, the dividends flow through an intermediate holding company established in the UK.

In this example the subjective test is not fulfilled. In case of a direct dividend distribution from the Netherlands to China, the (proposed) dividend WHT exemption would have been applicable, since the DTAA between the Netherlands and China includes a dividend article, even though the DTAA does not provide for a full exemption. The objective test does not need to be assessed observing the level of substance at the level of the Chinese company.



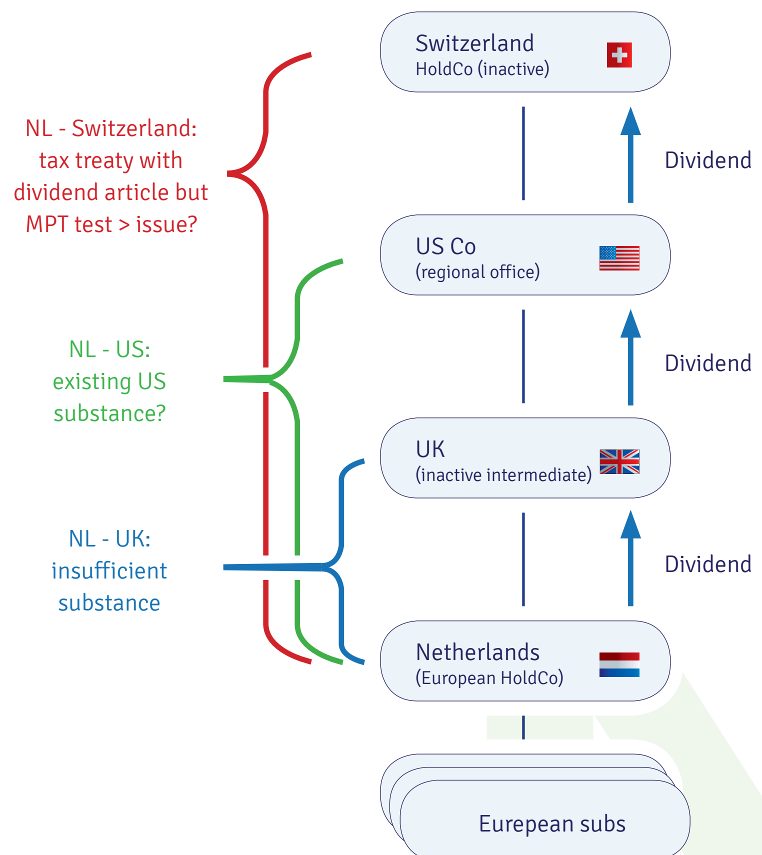
If the Chinese company would directly own the Netherlands company, the new domestic extended dividend WHT exemption should apply. Hence, interposing the UK should not adversely affect the Netherlands dividend WHT position. The same would be the case in respect of countries as Japan, Canada and Brazil, where the DTAA provides for a dividend article but not for a 0% rate (the DTAA NL-Japan provides for an exemption only in limited circumstances). In these cases it however should be safeguarded that the recipient in Japan, Canada and / or Brazil has sufficient substance to safeguard treaty entitlement (see also hereafter).

Example 3: US

In numerous structures a Dutch (intermediate) holding company is set up by a top holding group company for the holding of the European sub-group division.

In this example, an international operating group is parented by a Swiss holding company. The activities and substance in Switzerland is limited. In the US, regional head office functions are carried-out. Between the US company and the Dutch company, an inactive UK holding company is interposed.

In our view, it is questionable whether or not the subjective test in this example would be fulfilled. In case of an up streamed dividend distribution to Switzerland, it could be argued that the proposed dividend WHT exemption is applicable, on the basis that the DTAA NL-Switzerland provides for a dividend article. However, this dividend article includes a Main Purpose Test (“MPT”) which, in view of the limited substance/activities in Switzerland, would not be satisfied. It is therefore likely that the WHT exemption cannot be applied in relation to Switzerland.



A potential solution is to apply the tests on the basis of a direct dividend distribution from the Netherlands to the US. The DTAA NL-US contains a dividend article in which a Limitation on Benefits (LoB) test must be satisfied in order to qualify for the 0% rate. In this scenario, it might be possible to utilize the existing substance in the US to consider the US business as either an “active business” or as an active intermediate holding company. If managed properly, the dividend WHT exemption should be applicable on the basis of the existing substance in the US.

A possible alternative in case the US holding company would not exist in the structure, is to increase the substance in the UK in order to fail the objective test and thus to apply the dividend WHT exemption. As noted before, if the UK company would have office space at its own disposal, and employee(s) with a minimum salary of EUR 100,000, the UK company is likely to have sufficient substance and on that basis the dividend WHT exemption should be applicable, even if there would not be sufficient substance up the chain in the US and/or Switzerland.

Interaction with existing anti-abuse provisions

It should be noted that in the Dutch parliamentary proceedings, no clarification has been given in relation to the interaction between the broadened scope of the dividend WHT exemption (based on the PPT-test in the context of BEPS Action 6) and the existing anti-abuse provision. In this context we refer to the MPT-tests as seen in the DTAAs NL-Switzerland and Netherlands-UK as well as the Limitation on Benefits (“LOB”) provisions mentioned in for instance the DTAA NL-US and the tax regulation with Curaçao. Only reference has been given to the parliamentary proceedings to the Netherlands domestic fraus legis doctrine as well as the concept of beneficiary ownership. Both concepts may be applied in discussions regarding the application of the dividend WHT exemption. It should also be noted that the broadened scope of the dividend WHT exemption has been illustrated in Dutch parliamentary proceedings in three examples that explicitly mention the involvement of active companies. It would have been interesting to understand what would happen in cases where a DTAA is concluded between the recipient country and the Netherlands which contains a dividend provision but also a MPT-test or LOB provision (as illustrated in example 3 above).

Based on an educated guess, we expect that the extended substance provisions (salary requirement and office disposal requirement) might provide relief in respect to the MPT as noted in for instance the DTAA Netherlands-UK (Articles 10(3) and 20(4)), the EU Parent-Subsidiary Directive (i.e. general anti-abuse rule (GAAR) and the LOB provision in the DTAA NL-US. Please note that there is currently little guidance on how these tests (especially the MPT test) should be applied. To avoid unnecessary risks, it is generally recommended to secure that active management is performed at shareholder’s level (UK, in example 3). This could in theory match with the extended substance requirements (salary requirement and office disposal requirement) in the Netherlands.

In addition we note that foreign intermediate companies may be (pursuant to article 17, paragraph 3, under b of the Corporate Income Tax Act 1969 (“CIT”) Act), subject to CIT at a maximum rate of 25%, insofar Dutch income is realized (non-resident taxation). In day-to-day practice typically the position is taken that this provision should not apply if the non-Dutch resident entity conducts an enterprise to which its substantial interest in the Dutch resident entity is attributable or if it fulfils a strategic management function as top holding company of an active group. In this respect the extended substance requirements might also offer some relief. We also note that the strengthened substance requirements for intermediate companies may also affect the Multilateral Instrument (“MLI”) in relation to DTAAs concluded by the Netherlands. Based on provisional information we expect that the insertion of the PPT as a minimum standard aligns with the rationale of the broadened dividend WHT exemption.

These provisions however need careful consideration to avoid misunderstanding. We generally recommend companies to (i) secure that active management is performed and (ii) to make sure that ownership structures are put in place for valid commercial reasons which reflect economic reality.

Two practical observations

Based on parliamentary proceedings, we have two remarks that could be of significant importance in practice, the first one relating to the “strategic management function” which is part of the objective test, and the second one relating to the possible avoidance of dividend WHT, which is part of the subjective test.

As discussed, the objective test requires either that the direct shareholder or – via an intermediate holding company with “relevant” substance – the indirect shareholder carries on an active business. In parliamentary proceedings, it was explicitly clarified that the strategic management function of the intermediate holding company, relevant for meeting the conditions

of the objective test, does not necessarily require a 100% shareholding. On that basis, also joint ventures into a Netherlands (holding) company can benefit from the dividend WHT exemption, based on its strategic management function, provided all parties of the joint venture are all actively involved in the business of the group structure.

In some circumstances, it could be considered to repatriate funds from the Netherlands holding company by way of a buy-back of shares or as liquidation proceeds. By avoiding a dividend distribution, the repatriation is normally qualified as “capital gains” under most relevant DTAAs which therefore should result in taxation rights of the jurisdiction where the shareholder is resident (i.e. the foreign state). On that basis, it could be argued that there is no motive to avoid dividend WHT abroad (i.e. the “subjective test” as described above) – as the Netherlands was not entitled to levy dividend WHT on the basis of the relevant DTAA. As a result, the subjective test may not be met.

However, these scenarios should be treated with caution, as it should still be monitored if the structure is to be considered as an artificial arrangement (i.e. “objective test”). In particular, the combination of relatively high amounts involved and the absence of “relevant” substance, should result in dividend WHT or non-resident CIT even though the subjective test strictly may not be met.

Interaction with Court cases

On 12 December 2017, the The Hague Court published a decision involving the application of the non-resident taxation as adopted in article 17 of the Dutch CIT Act 1969. In paragraph 3 of this article, the provisions of non-resident taxation of holding a substantial interest in a Dutch resident company are clarified. In this respect:

I. the foreign company holds this interest with the (or one of the) main purpose(s) of avoiding Dutch personal income tax or dividend tax (the main purpose test); and
II. the substantial interest cannot be allocated to the business enterprise carried on by the foreign company (the enterprise test).

Without going into detail, the The Hague Court case related to a dividend distribution from a Netherlands entity to its Netherlands parent company that had migrated its effective place of management to Luxembourg. Hence, from a Netherlands perspective the parent company was recognized as a resident for tax purposes of Luxembourg. In this case, the The Hague Court decided that the parent company, which ultimately had limited substance (i.e. no personnel, no premises, limited expenses et al), was not able to satisfy the enterprise test. Consequently, the dividend at the level of the Luxembourg parent company was taxable at 2,5% CIT (based on the DTAA Netherlands – Luxembourg CIT).

Among other considerations, the The Hague Court considered that the managers of the parent company had limited involvement with the lower-tier subsidiaries. Hence, there was no functional attribution between the shares in (among others) the Netherlands company distributing the dividend and the parent company. If for instance the directors of the Luxembourg parent company were also involved elsewhere in the group, this could have been different. Following this case, it could be necessary (at least preferred) that directors of holding entities will be involved in the trading activities and the (strategic) management of the group elsewhere and that sufficient documentation exists to demonstrate this.

Substance requirements (minimum list)

We have collated a list of cumulative substance requirements applicable for intermediary companies in the Netherlands or holding a Netherlands company. Part of this “minimum list” of substance is mirrored from the conditions required by the Dutch tax authorities to give access to the tax ruling team and/or to issue certificates of tax residency, and has been clarified in the parliamentary proceedings:

- at least 50% of the statutory managers and managers authorized to take decisions are resident in the state of the intermediary holding;
- the managers must have the necessary professional knowledge to properly fulfil their tasks, including decision-making, based on their own responsibility for the intermediary and within the framework of the normal group practice, transactions of the intermediary and the responsibility to ensure proper settlement of the concluded transactions;
- the intermediary has qualified personnel for the proper execution and registration of transactions to be concluded by the intermediary;
- the intermediary’s board decisions are taken in the state in which the intermediary is located;
- the main bank accounts of the intermediary are held in the state in which the intermediary is located;

- the intermediary's accounting is conducted in the state in which the intermediary is located;
- the intermediate company incurs employment costs of at least EUR 100,000 in relation to its intermediary holding functions;
- the intermediate company has (for at least 24 months) own office space at its disposal used for carrying out the intermediary holding functions; and
- functional attribution / involvement of management in lower-tier subsidiaries (trading activities and strategic management of the group elsewhere).

What DTAAs could be affected?

Even though the Netherlands mostly succeeds in its policy to negotiate a full exemption of dividend WHT in active/genuine business situations, it is not always able to secure such an exemption. Examples of DTAAs concluded by the Netherlands without full dividend WHT are the DTAAs with Argentina, Australia, Brazil, Canada, China, India, New Zealand and South-Africa. In addition, there are various DTAAs in which the full dividend WHT only is available if a list of conditions is met, the most commonly seen DTAAs being with the US (80% participation and 1 year) and Japan (50% participation and six months).

Takeaways

- The new law introduces a dividend WHT obligation for holding cooperatives. Under the current legislation, such cooperatives, which are also used in international tax structures, are not subject to dividend WHT, except for certain "abusive" situation.

- The new legislation aims to eliminate the difference between holding cooperatives and public and limited liability companies by imposing the withholding obligation on such cooperatives and to broaden the general exemption from the withholding obligation for public (NV's) and limited (BV's) liability companies.

- Public and limited liability companies that currently face challenges in respect of satisfying a number of anti-abuse provisions such as MPTs (DTAA Netherlands – UK and Netherlands – Switzerland), LOB provisions (DTAA Netherlands – US and the Netherlands – Curaçao tax regulation) may consider to rationalize their ownership structures or to invest in key employees at intermediate companies to satisfy the broadened scope of the dividend WHT exemption.

- In addition, companies that are faced with 5-10% dividend WHT on participating investments (>10%+) in a Dutch company may check whether they are able to satisfy the new requirements (especially the extended substance requirements) and / or consider to await dividend distributions to January 1, 2018.

The additional substance requirements, which would apply from 1 April 2018, imply that existing advance tax rulings are no longer valid. Because new rulings can only be granted from 1 January 2018, intermediary holdings will have a grace period of 3 months to cope with the additional substance requirements.

ABOUT NOVIOTAX

NovioTax is a Dutch research-oriented tax consultancy firm with offices in Amsterdam and Nijmegen. Our employees are members of the Dutch Association of Tax Advisers (NOB) and the International Fiscal Association (IFA), have many years of experience and some are much sought-after guest speakers on tax policy and other topics that fall within their field of expertise. We typically serve midsized and large MNE clients, coordinate discussions with the DTA and closely cooperate with international law and tax law firms.

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