DE BRAUW BLACKSTONE WESTBROEK

Dutch Tax Bill 2019: what will change?

On 18 September 2018, the Dutch government presented a number of tax measures as part of the 2019 budget proposals. The key measures are:

- **Abolition of withholding tax on dividends as of 1 January 2020**
  Improves the position of the Netherlands as an attractive location for multinational headquarters
- **A 30% EBITDA interest limitation rule (ATAD1), with certain existing interest limitation rules eliminated**
  More stringent implementation than required
- **The CFC rule (ATAD1)**
  Model B is already part of Dutch law, a Model A "light" has been added
- **A phased reduction of the headline corporate income tax rate to 22.25% in 2021**
  In line with the worldwide trend of reducing corporate income tax rates

As of 1 January 2020, the Dutch government is also introducing an "anti-abuse" withholding tax on certain dividends and capital gains, where these have been directly or indirectly derived by certain non-resident corporate shareholders established in low tax jurisdictions from shares in Dutch resident companies. This measure shows the Dutch government's determination to end the practice of using Dutch companies as a go-between in structures that may involve aggressive tax planning. Although the anti-abuse withholding tax is intended as a deterrent rather than as a revenue raiser, it is full of "traps for the unwary" and contains strict enforcement provisions. Therefore, it is likely to cause trouble in many international structures that are not timely reorganised to deal with the new rules.

Q&A

Why is the DWT abolished?

With the abolition of the Dutch dividend withholding tax ("**DWT**"), the Dutch government intends to protect the position of the Netherlands as an attractive location for existing headquarters, as well as to attract new headquarters. Particularly in comparison to the UK, the Dutch government feels that the Netherlands is at a competitive disadvantage because shareholders of publicly-traded Dutch resident companies are subject to 15% DWT, whereas the UK does not impose a withholding tax on dividends paid by publicly-traded UK resident companies. The proposal to abolish DWT has sparked an intense public and political outcry since first announced in October 2017 as part of a coalition agreement for the newly-installed government. Opponents see it as a costly measure (estimates range from EUR 1.4 to EUR 1.9 billion) that mainly benefits foreign shareholders and treasuries and for which there is no evidence that it will serve its stated purpose. Despite this heavy

opposition, however, the Dutch government has gone forward with it.

What is the impact of the abolition of DWT on FIIs?

The abolition of DWT has two negative consequences for fiscal investment institutions ("**FII**") – a tax regime for pooled investments which provides a 0% corporate income tax rate – that the Dutch government has been unwilling to address. First, credits for foreign withholding tax on dividends and interest that were indirectly passed on to the benefit of Dutch retail investors through a mechanism in the DWT rules, will no longer be available due to the abolition of DWT. Second, FIIs will no longer be allowed to directly invest in Dutch real estate; this is to prevent non-resident shareholders of FIIs from being able to realise income from Dutch real estate without paying any Dutch tax.

How does the Netherlands implement the 30% EBITDA rule of ATAD1?

The Netherlands will implement the interest limitation rule prescribed by the EU Anti-Tax Avoidance Directive (Council Directive (EU) 2016/1164; ("**ATAD1**")) as per 1 January 2019 by providing that net borrowing costs – that is, excess of interest costs over interest revenue – are not deductible to the extent that they exceed 30% of the taxpayer's EBITDA. For the purpose of this rule, the term "interest" has a broad meaning and includes, for example, currency results, results on currency and interest hedging instruments, and related incurred costs. Furthermore, the Netherlands has opted for:

- the unlimited carry forward of interest being disallowed as a deduction;
- a EUR 1 million threshold (instead of a maximum of EUR 3 million);
- application of the rule to a fiscal unity as a whole (and not per individual fiscal unity member);
- no escape for a higher group debt-to-equity ratio or higher group interest/EBITDA ratio;
- not excluding banks and insurance companies

(Note: Interest deduction on debt instruments qualifying as tier-1 capital for banks and insurance companies will also be abolished as of 1 January 2019 and an additional thin capitalisation rule for the financial industry is envisioned for 2020);

- no exception for public-private infrastructure projects, except for grandfathering of existing projects;
- no grandfathering for loans entered into prior to 16 July 2016.

Most of these choices made by the Dutch government represent a more restrictive implementation of the 30% EBITDA interest limitation rule than required under ATAD1. The Dutch government justifies this approach by stating that it wants to align the tax treatment of interest expense on debt with remuneration on equity, which is non-deductible.

Two existing, specific interest limitation rules in the Dutch corporate income tax act 1969 ("**CITA**") have been abolished: article 13L (*excessive participation debt*) and article 15ad (*acquisition holding debt*). In addition, art. 20, paragraphs 4 to 6, CITA (*restrictions on loss compensation for holding and financing companies*) will be abolished.

How will the Netherlands implement the CFC rule of ATAD1?

The Netherlands will implement the controlled foreign company ("**CFC**") rules prescribed by ATAD1 as of 1 January 2019. It will do this by adopting Model B, which is already being

applied under the arm's length principle, as well as a "light" version of Model A. Under Model B, a CFC's income is allocated to a Dutch taxpayer if the functions, assets and risks associated with that income are carried out in the Netherlands. Under the Model A "light" rules, a Dutch taxpayer is deemed to have received certain categories of non-distributed passive income ("**CFC Income**") from controlled entities or permanent establishments ("**PEs**") in low-tax jurisdictions; that is, jurisdictions with a statutory rate of less than 7%, or jurisdictions on the EU blacklist of non-cooperative jurisdictions ("**CFC Jurisdictions**"). If the CFC rules apply, a Dutch taxpayer must include the CFC Income in its taxable base on a net basis, whereby the CFC Income is calculated according to Dutch CITA standards. If other EU member states also tax the income of the CFC, no relief from double taxation will be granted. Double taxation can also occur in multiple levels of indirect ownership of the CFC within the Netherlands.

CFC Jurisdictions will be exhaustively listed in a ministerial decree issued before the beginning of each calendar year. If an entity or PE is a CFC, two safe harbours apply. First, a substantial economic activity test applies, meaning that if the entity or PE has sufficient relevant substance the CFC rules will not apply. Second, if less than 30% of the total income of an entity or PE consists of the listed categories of passive income, it will not fall within the scope of the CFC rules. In addition, a specific exception applies for financial undertakings as defined in article 2, paragraph 5 ATAD1which derive more than 70% of the passive income from unrelated parties.

What is the purpose of the new anti-abuse WHT on dividends and capital gains?

Although DWT is in principle also due on distributions of dividends by Dutch resident companies to non-resident group companies, in practice, tax is rarely incurred in these situations as a result of the application of one of several exemptions. This is one of the reasons why Dutch companies are often used in international tax planning structures, including structures associated with aggressive tax planning. The Dutch government has clearly stated in a policy document issued in February 2018 that it wants this practice to end. To do this, the Dutch government is introducing the anti-abuse withholding tax ("**anti-abuse WHT**") as of 1 January 2020. The anti-abuse WHT is imposed on dividends and capital gains directly or indirectly derived by certain non-resident corporate shareholders established in low tax jurisdictions from shares in Dutch resident companies. The anti-abuse WHT is the first step in a two-step process. The second step is to extend the scope of this anti-abuse WHT to intra-group interest and royalties as of 1 January 2021. Rather than to raise revenue, the purpose of the anti-abuse WHT is to discourage taxpayers from using Dutch companies in international tax planning structures. The deterrent effect is reinforced by extensive reporting obligations, joint and several liability for unpaid tax, and penalties for noncompliance.

We expect many situations to occur from 2020 onwards in which taxpayers will inadvertently face liabilities under the anti-abuse WHT. This could happen, for example, when they have failed to reorganize their structure before 2020 or have simply not recognised the extra-territorial nature the tax has where it taxes indirect share transfers regardless of how far up in the chain of companies the transfer takes place. In the absence of grandfathering provisions and given the nature of the tax being a deterrent against the use of Dutch companies in aggressive tax planning structures, the Dutch tax authorities are unlikely to take a lenient approach in enforcement.

When does the anti-abuse WHT on dividends and capital gains apply?

The anti-abuse WHT is imposed on: dividends paid by a Dutch resident company to a related entity established in a jurisdiction with a statutory tax rate of less than 7%, a jurisdiction on the EU blacklist of non-cooperative jurisdictions, or reverse hybrid entities. The tax also applies if the related entity itself is not a resident of, but has a permanent establishment in of a low-tax or blacklisted jurisdiction to which the shares in the Dutch company are attributable. Annually, the Dutch Ministry of Finance will publish an exhaustive list of low-tax jurisdictions. The tax is imposed at a rate of 23.9% (the equivalent of the corporate income tax rate for 2020). An entity is related if it directly or indirectly holds an interest that entitles it to control the Dutch company; this is in any event the case if the shareholder directly or indirectly holds more than 50% of the voting power. The tax is also levied if the shares in the Dutch company are indirectly held through one or more entities not established in a low-taxed jurisdiction and there is an abusive situation. No abuse is deemed to exist if one of these intermediate entities meets certain substance requirements (including annual salary expenses of EUR 100,000 and office space, including the necessary equipment, at the disposal of the entity for a period of at least 24 months). EU/EEA intermediate entities may prove the absence of an abusive situation through other means as well. To prevent taxpayers from avoiding the anti-abuse WHT by realising the earnings of a Dutch company through a transfer of shares, rather than through a dividend payment, the scope of the tax has been extended to such transfers as well. In that case, tax is imposed on all of the Dutch company’s earnings (including goodwill and hidden reserves), regardless of whether the transferring shareholder realises a gain or not and of whether the transferee is related or unrelated.

The anti-abuse WHT does not contain any grandfathering provisions, so pre-2020 earnings are subject to the tax as well. Moreover, earnings of a non-Dutch resident company the shares of which have been contributed to a Dutch company in a share-for-share exchange, become subject to a claim under the new tax (this will probably also apply to pre-2020 share for share exchanges). Finally, the anti-abuse WHT cannot be credited against the non-resident Dutch corporate income tax liability, if any, of the foreign shareholder for dividends or capital gains derived from shares in a Dutch company.

How is the anti-abuse WHT enforced?

In order to ensure compliance with the anti-abuse WHT, both the non-resident shareholder and the Dutch distributing company have a duty to inform the Dutch tax authorities if they discover that withholding taxes are due, but have not been paid, whether in full or partially. The information must be provided within two weeks from the discovery. Failure to comply with the duty to inform is subject to a penalty of up to 100% of the tax due. Moreover, a joint and several liability for unpaid tax has been introduced for: the entity receiving the dividends, for the directors of that entity, and for the directors of the Dutch entity distributing the profits. In the case of tax due following a direct or indirect transfer of shares, the directors of the transferor have joint and several liability for the tax due.

What is the impact of tax treaties on the anti-abuse WHT?

Substantially all of the Dutch tax treaties are covered by the Multilateral Instrument – which is expected to be ratified by the Netherlands in 2019. As a result, an increasing number of Dutch tax treaties will contain a principal purpose test (“**PPT**). If such test is included, it is unlikely that treaty protection will be available to limit the application of the anti-abuse WHT. If the relevant treaty does not include a PPT, a reduced withholding tax rate on dividends and exclusive residence taxation on the transfer of shares of a Dutch resident

company under the tax treaty should be available. In respect of a tax treaty with a low-tax jurisdiction or with a jurisdiction included in the EU blacklist of non-cooperative jurisdictions, the anti-abuse WHT will not apply during the first three years that those jurisdictions are listed. During that period, the Dutch government intends to renegotiate the relevant tax treaty. An indirect shareholder that is not a resident of a treaty jurisdiction will not be able to claim protection from taxation for indirect transfers of shares in Dutch companies as of 2020. This is regardless of whether the intermediate company through which they hold their shares in the Dutch resident entity is a resident of a treaty jurisdiction.

Other changes?

The Dutch government's budget proposals also provide for the following changes to the Dutch corporate income tax base:

- the carry forward of tax losses will be limited to six years instead of nine years; grandfathering applies to losses incurred prior to 2019;
- the duration of the "30% regime" for incoming expats will be reduced from eight to five years, applying to both existing and new 30% regime rulings (this regime allows for a fixed 30% allowance for Dutch wage tax and income tax purposes and an effective base exemption from Dutch net wealth tax for investments held outside the Netherlands);
- The depreciation floor for real estate used for group operations will be increased from 50% to 100% of the real estate appraisal value ("WOZ" value).