Consultation launched on dividend withholding tax exemption and holding cooperatives

June 13, 2017

On 16 May 2017, the Dutch government published a draft bill for public consultation. The draft bill introduces a dividend withholding tax exemption for corporate shareholders with an interest of at least 5%, and who are resident in countries that have concluded a double taxation treaty with the Netherlands. The exemption is subject to an anti-abuse provision. In addition, the draft bill introduces an obligation for certain cooperatives to impose dividend withholding tax on distributions. The Dutch government is expected to submit a formal legislative proposal with an effective date of 1 January 2018 to the Dutch parliament after summer 2017. Corporate groups with Dutch holding and operating companies should review whether they will be able to qualify for the expanded dividend withholding tax exemption or, if they are currently enjoying an exemption, whether they can continue to do so in the future.

Dividend withholding tax exemption

Under current law (the provisions implementing the EU Parent-Subsidiary Directive), dividends distributed by Dutch companies to an EU corporate shareholder with an interest of 5% or greater are generally exempt from dividend withholding tax. Furthermore, certain Dutch tax treaties provide an exemption from dividend withholding tax subject to specific conditions. The exemption included in the draft bill will supplement these existing exemptions, and will apply to a corporate shareholder who:

1. is a resident for treaty purposes of a country that has concluded a double taxation treaty with the Netherlands (no other treaty-specific requirements, such as limitation on benefits provisions or holding periods, are taken into account),
2. is the beneficial owner of the dividend received, and
3. holds an interest of at least 5% in the Dutch company.

Anti-abuse provision

The dividend withholding tax exemption included in the draft bill, as well as the existing dividend withholding tax exemption implementing the EU Parent-Subsidiary Directive, will become subject to an anti-abuse provision. Under that provision, an exemption from dividend withholding tax is not available if one of the direct shareholder's main objectives is to avoid dividend withholding tax, *and* there is an artificial structure. The explanatory text to the draft bill suggests that the anti-abuse provision is not intended to apply if the direct shareholder of the Dutch company carries on a business enterprise to which the interest in the Dutch company is attributable. Furthermore, if the direct shareholder of the Dutch company is a holding company established in an EU jurisdiction or in a non-EU treaty jurisdiction, the anti-abuse provision is not intended to apply in one of the following circumstances:

a. the direct or indirect shareholder of the holding company would qualify for the dividend withholding tax exemption under the draft bill, under the EU Parent-Subsidiary Directive, or under a tax treaty, if it held the interest in the Dutch company directly (the substance of the holding company is irrelevant).
b. the Dutch company or its direct or indirect subsidiaries carry out a business enterprise that is in line with the business of the direct or indirect shareholder of the holding company, *and* the holding company has sufficient substance. For sufficient substance, the holding company has to incur at least EUR 100,000 per year in wages for staff engaged in the holding activities, have an office from which the holding activities are performed, and have at least half of its directors reside in the holding company's country of residence.

It could be concluded from the explanation to the draft bill that a shareholder in a passive investment structure can only benefit from a dividend withholding tax exemption if the requirement under a) above is met. However, it is unclear whether this application of the exemption is intended.

The dividend withholding tax exemption proposed in the draft bill, together with the existing withholding tax exemption implementing the EU Parent Subsidiary Directive and exemptions under tax treaties, will effectively reduce the scope of the Dutch dividend withholding tax to retail investors in Dutch listed entities. In practically all other situations, it should be possible to structure an investment without incurring Dutch dividend withholding tax, subject to the anti-abuse rule.

Questions arising from anti-abuse provision

The application of the anti-abuse provision raises many questions. One question is how to apply the rule in the case of multiple indirect shareholders of a holding company, some of which would be entitled to an exemption while others would not. Apart from these questions, some more general observations can be made with respect to the anti-abuse rule.

First, the use of substance requirements to draw a line between abusive and non-abusive situations is an issue which is regularly questioned in terms of its compatibility with EU law; this issue may be tested in court at some point. Second, current Dutch law contains a lighter version of the anti-abuse rule than the one proposed in the draft bill. The lighter version, which must currently be met to avoid the imposition of non-resident corporate tax on dividends and capital gains, does not have the requirements regarding wages and the availability of an office. Non-residents taxpayers that are currently relying on this less stringent substance rule would have to satisfy the increased substance requirements in the future to continue to be exempt from Dutch tax, including dividend withholding tax. Third, the Dutch government takes the position that the interpretation of the anti-abuse rule will also govern the application of the principal purpose test that will be included in Dutch tax treaties as a result of the Multilateral Convention (see our In context of 13 February

2017). In the future, therefore, claiming any benefits under Dutch tax treaties that contain a principal purpose test will become subject to the principles governing the draft bill's anti-abuse rule. This is a major departure from decades of practice. Fourth, the difference in treatment envisaged by the distinction between business enterprise structures and passive investment structures, each defined according to Dutch domestic tax law, raises questions. Will this, in all cases, comply with EU law, and how will it interact with the principal purpose test in the Multilateral Convention and the related OECD commentary (still to be formalised) and reports? Finally, it is expected that the increased substance requirements will also be applied to companies looking to obtain an advance tax ruling or advance pricing agreement in the Netherlands. Currently, only the lighter substance rules apply.

Dividend withholding tax obligation: holding cooperatives

In addition to the amended dividend withholding tax exemption, the draft bill also introduces a withholding tax obligation for holding cooperatives in respect of distributions to members holding an interest of 5% or more in holding cooperatives. Holding cooperatives are cooperatives that for 70% or more, measured by balance sheet total, activities performed by employees and other similar factors, hold participations in or grant loans to related parties (holding cooperatives). Distributions to treaty-based members which hold an interest of 5% or more in a holding cooperative can benefit from the dividend withholding tax exemption described above, subject to the anti-abuse rule.

Cooperatives have been widely used to avoid Dutch dividend withholding tax for non-treaty based investors, in particular private equity funds. If the draft bill becomes law, many of these structures will need to be reorganised to avoid Dutch dividend withholding tax liability in the future. Any such reorganisation will need to take into account an already existing dividend stripping provision, which generally seeks to prevent dividends on shares transferred intercompany from receiving more favourable dividend withholding tax treatment.