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Emergency legislation limits benefits of Dutch fiscal unity regime

The Dutch parliament has adopted emergency legislation on the Dutch fiscal unity regime in response to a 2018 judgment of the European Court of Justice. As a result of the emergency measures, several benefits of the fiscal unity regime are denied with retroactive effect from 1 January 2018. This is done by applying certain Dutch Corporate Income Tax Act (CITA) provisions as if no fiscal unity exists.

The emergency legislation is likely to lead to higher tax charges, which may be significant for some taxpayers, and may make it necessary to restructure intercompany relationships within existing fiscal unities. In addition, the emergency legislation is also expected to cause a significant increase in the administrative burden, as both future and past transactions within the fiscal unity will have to be traced, in order to assess whether the emergency legislation applies.

Background

The emergency legislation was adopted in response to a judgment in which the ECJ confirmed that the application of an interest deduction limitation to transactions that occur between a Dutch resident taxpayer and its EU subsidiary, is an unjustified breach of the freedom of establishment. This is because that limitation would not apply to the same transaction between two Dutch resident taxpayers that could form a fiscal unity. Therefore, the interest paid in relation to the transactions with EU subsidiaries should be deductible as well, according to the ECJ.

Content of the emergency legislation

Although the judgment itself was confined to the application of a single statutory interest deduction limitation (article 10a CITA) in a cross-border transaction, the emergency legislation has a wider scope. It seeks to deny benefits which were previously only available to fiscal unities that are deemed most vulnerable to challenges based on the freedom of establishment. Such benefits are derived from CITA provisions which, besides article 10a CITA, include: elements of the participation exemption (article 13 CITA), the interest deduction limitation for excessive participation debt (article 13L CITA), and anti-loss trafficking rules (article 20a CITA). Pursuant to the emergency legislation, the benefits of forming a fiscal unity regime with respect to those provisions are denied (with retroactive effect to 1 January 2018) by requiring members of a fiscal unity to apply these provisions, as if no fiscal unity exists. This goes as far as making intra-fiscal unity loans visible and applying statutory interest deduction limitations on that basis. To the extent that the interest deduction is denied, this will result in additional taxable profits at the level of the fiscal unity.

It is, in our view, interesting to note that despite the 2018 judgment and its implications, the Dutch government apparently does not consider the new earnings stripping limitation vulnerable to challenges based on the freedom of establishment. This provision limits the deduction of net interest expenses to 30% of the adjusted EBITDA. Taxpayers forming a fiscal unity will be able to apply this interest deduction limitation on a consolidated basis for the entire fiscal unity. This will generally be beneficial because excess EBITDA capacity of individual entities can be effectively shared with members of the fiscal unity which have excess interest expenses on a stand-alone basis. This new limitation seeks to implement the EU Anti-Tax Avoidance Directive, which specifically allows this consolidated approach. It became effective as of 1 January 2019.

Going forward

Although the emergency legislation is aimed at closing the most likely gaps in the current fiscal unity regime, the Dutch State Secretary of Finance has indicated that other elements may also be contrary to the freedom of establishment. He has therefore announced that a future-proof group taxation regime will be designed to replace the current fiscal unity regime. This process is expected to take several years. In the meantime, the emergency legislation applies.