WITHHOLDING TAXES AND ANTI-ABUSE PROVISIONS IN THE NETHERLANDS

In this newsletter we discuss the new Dutch conditional withholding tax on interest and royalties and its impact on current anti-abuse provisions in the Dutch Corporate Income Tax Act and the Dutch Dividend Withholding Tax Act.

INTRODUCTION

On 17 September 2019, the Dutch 2020 Budget and accompanying legislative proposals were presented by the Dutch Minister of Finance. One of the proposals is a bill to introduce a conditional withholding tax on interest and royalties ("CWHT") which will apply to payments of interest and royalties to related entities situated in low-tax jurisdictions, as well as in abusive situations. In this newsletter we will describe the most important aspects of the bill, which should enter into force with effect from 1 January 2021. Furthermore, we will describe how the bill will impact the current anti-abuse provisions in the Dutch Corporate Income Tax Act and the Dutch Dividend Withholding Tax Act. Also, we will give a brief recap on the Dutch dividend withholding tax developments of the last years. Please note that the bill still needs to be approved by Dutch Parliament and may therefore be subject to change.

2020 BUDGET - CONDITIONAL WITHHOLDING TAX ON INTEREST AND ROYALTIES

The CWHT is due on gross interest and royalty payments made by Dutch resident corporate entities. The CWHT will only be due if the recipient of the interest/royalty payments is:

- A corporate entity that is a related entity to the Dutch company; and
- Residing in a low-tax jurisdiction.

The applicable tax rate will be equal to the top corporate income tax rate, which, for 2021 will expectedly be 21.7%.

Please note that the CWHT cannot be credited against Dutch corporate income tax payable by non-resident Dutch corporate income taxpayers being subject to Dutch corporate income tax on account of income from a substantial interest in a Netherlands-resident entity.

Related entities

The CWHT only applies to interest and royalty payments between related entities. An entity is deemed to be related if:

- the recipient entity has a direct or indirect qualifying interest (*e.g.* more than 50% of the capital or statutory voting rights) in the paying entity;
- the paying company has a direct or indirect qualifying interest (*e.g.* more than 50% of the capital or statutory voting rights) in the recipient entity;
- a third entity holds a direct or indirect qualifying interest (*e.g.* more than 50% of the capital or statutory voting rights) in both the recipient entity as well as in the paying company;
- the receiving entity holds a direct or indirect interest in the paying entity and together with other entities of a cooperating group that entity owns a direct or indirect qualifying interest (*e.g.* more than 50% of the capital or statutory voting rights) in the paying entity; or
- the paying entity holds a direct or indirect interest in the receiving entity and together with other entities of a cooperating group that entity owns a direct or indirect qualifying interest (*e.g.* more than 50% of the capital or statutory voting rights) in the receiving entity.

The definition of a 'cooperating group' is deliberately wide. This means that especially many joint-ventures or PE/VC-held entities can be impacted by the new Dutch CWHT, where one of their shareholders is debt-funding the joint venture or entity from a low-tax or non-cooperating jurisdiction.

Low-tax jurisdiction

The definition of a low-tax jurisdiction is consistent with the definition included in the Dutch Controlled Foreign Company (CFC) legislation which applies from 1 January 2019. This means that the CWHT applies (i) to payments of receiving entities established in countries which have a statutory corporate income tax rate of less than 9% and (ii) to payments to countries which are on the European Union's list of non-cooperative jurisdictions.

If the Netherlands has concluded a tax treaty with a low-tax jurisdiction, the CWHT will only kick-in once three years have passed following the qualification of that jurisdiction as a low-tax jurisdiction. During this 3-year period the Netherlands intends to renegotiate the tax treaty in order to be able to effectively levy the CWHT.

Abuse

When the interest or royalty is not paid into a low-tax or non-cooperative jurisdiction, the CWHT is also due in cases of abuse. Abuse is defined as artificial constructions aimed at avoiding the CWHT.
Under proposed anti-abuse rules, CWHT will be levied if the following two conditions are met:

- The recipient entity is held with the main purpose, or one of the main purposes, to avoid the CWHT (subjective test); and
- The arrangement is considered to be artificial (objective test). The objective test should be assessed based on the substance of and business reasons behind the arrangement. An example of such an artificial arrangement is having the interest or royalty flow-through an entity located in a country which is not regarded as a low-tax or non-cooperative jurisdiction without having any valid business reasons.

The objective test should - as a main rule - not be met (and the CWHT does not apply) if the intermediate entity meets certain minimum substance requirements (such as annual salary costs of at least EUR 100.000 and an office space in the Netherlands for at least 24 months). However, pursuant to the decision of the Court of Justice of the European Union ("CJEU") in the so-called Danish withholding tax cases (*see our newsletter of 5 March 2019*) the substance requirements will no longer function as a 'safe-harbour'. This means that even if the minimum substance requirements are met, the Dutch tax authorities can still prove the structure is abusive. Vice versa, if the intermediate entity does not meet the substance requirements, it may still demonstrate that the arrangement is not abusive. The minimum substance requirements will thus henceforth only play a role in the allocation of the burden of proof between the taxpayer and the Dutch tax administration.

Tax collection and information obligations

The CWHT must be withheld by the Dutch paying entity. Within 1 month after the ending of the calendar year, a tax return should be filed and the CWHT should be remitted to the Dutch tax authorities.

The managers of the paying and receiving entities may be severally liable for the CWHT.

AMENDMENTS TO ANTI-ABUSE PROVISIONS IN THE CORPORATE INCOME TAX ACT AND DIVIDEND WITHHOLDING TAX ACT

Following the decision of the CJEU in the Danish withholding tax cases, the bill also announces some important measures that will impact the current anti-abuse provisions in the Corporate Income Tax Act and Dutch Dividend Withholding Tax Act. Although the Dutch government considers that the existing Dutch anti-abuse provisions are broadly in line with the CJEU case law, it shall amend the following provisions in order to avoid any possible incompatibility with EU law:

1. The substantial interest rule in the Corporate Income Tax Act,

2. The anti-abuse provision in the Dividend Withholding Tax Act; and

3. The safe-harbour clause of the Controlled Foreign Company ("CFC") measure in the Corporate Income Tax Act.

The role of the substance requirements in these provisions will be amended in line with the substance requirements in the CWHT:

1. The substantial interest rule in the Corporate Income Tax Act applies if non-resident individuals indirectly (via a foreign entity) hold at least 5% of the shares in a Dutch entity. The foreign entity will become a non-resident taxpayer, meaning that dividends and capital gains derived by that entity from that substantial interest are subject to non-resident Dutch corporate income tax if the substantial interest is considered to be abusive. Under current legislation the substantial interest is deemed not to be abusive if the foreign entity is an intermediary holding company which fulfills a linking function between operational activities of its own (indirect) parent entity and operational activities of its (sub)subsidiaries while that foreign entity meets the minimum substance requirements. Under the proposed amendments, the substance requirements will only play a role in the allocation of the burden of proof between the taxpayer and the Dutch tax administration, while the linking function is no longer required.

2. For purpose of the current Dutch dividend withholding tax, there is no abuse considered if the recipient of the dividend is an intermediary holding company having the above linking function (which is often the case in private equity investment structures) while it meets the relevant minimum substance requirements. Under the proposed amendments, the linking function of the intermediary holding company is no longer a requirement for the structure not to be considered abusive and the substance requirements again only play a role in the allocation of the burden of proof.

3. Currently, if a foreign CFC meets the relevant Dutch minimum substance requirements, it is considered that it carries out substantial economic activities. As a result, the Dutch CFC rules do not apply. The substance requirements currently apply as a safe-harbour. As a result of the proposed amendment, the substance requirements no longer function as a safe-harbour. Vice versa, even if the CFC does not meet the minimum substance requirements, the taxpayer can still demonstrate that it carries out substantial economic activities.

We emphasize that under the new Dutch tax ruling practice in force since 1 July of this year, (potential) taxpayers can in principle still qualify for an Advance Tax Ruling from the Dutch tax authorities on whether or not a situation shall be considered abusive.

RECAP DIVIDEND WITHHOLDING TAX

Currently, the Netherlands levies withholding tax on dividend and profit distributions by Dutch entities or by other Netherlands-resident entities at a rate of 15%.

On 18 September 2018 the Dutch government presented the 2019 Budget which included the proposal to abolish the Dutch dividend withholding tax. This proposal was heavily debated in Dutch Parliament and ultimately government withdrew the proposal.

However, since April 2018 the Dutch Dividend Withholding Tax Act contains an expanded dividend withholding tax exemption for dividends distributed by Dutch entities to foreign entities if the following conditions have been met:

1. The recipient of the dividend is a resident of:

   - a Member State of the EU;
   - a Member State of the European Economic Area; or
   - a country that has concluded a tax treaty with the Netherlands which includes a provision on dividends;

2. The recipient would have been entitled to the participation exemption had it been a resident of the Netherlands (generally this means that the recipient or one of its related entities holds 5% or more of the nominal paid-up share capital of the dividend-paying Dutch entity);

3. The activities of the recipient are not similar to those of an Exempt Investment Institution;

4. The interest in the dividend-paying entity is not held with the main purpose, or one of the main purposes, to avoid Dutch dividend withholding tax (subjective test) or the arrangement is not considered to be artificial (objective test).

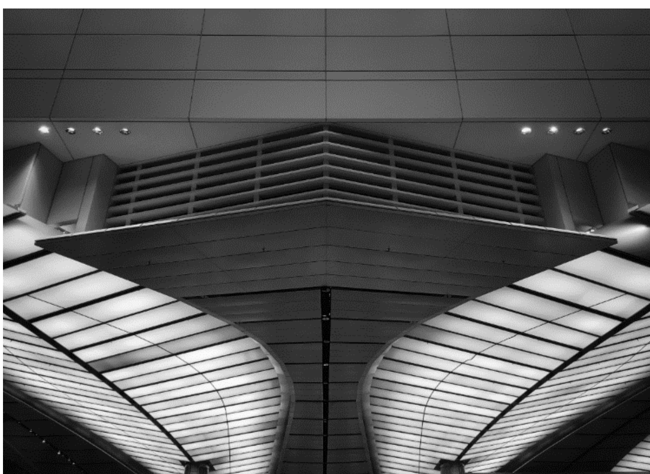
The objective test should be assessed based on the substance of the recipient of the dividend (i.e., if the minimum substance requirements are met). Please note that, in line with the proposed CWHT, these substance requirements no longer will function as a safe-harbour and the tax authorities can thus still demonstrate the structure is abusive. Vice versa, if the recipient of the dividend does not meet the substance requirements, both the payer and the recipient of the dividend may still demonstrate that there is no tax abuse by demonstrating that either the subjective or the objective test is not met. Furthermore, as a result of the aforementioned amendments in the anti-abuse provision in the Dutch Dividend Withholding Tax Act, the linking function of intermediary holding companies is no longer required for a structure not to be considered abusive. This means that also if there is no linking function, the taxpayer can still demonstrate the structure is not abusive and the dividend withholding tax exemption is applicable;

and

5. The recipient of the dividend has to be the beneficial owner of the dividend.

The purpose of the anti-abuse rule of condition 4 is to make a distinction between so-called (operational) business structures, that should qualify for the dividend withholding tax exemption and so called (passive) investment structures, that should not qualify for the dividend withholding tax exemption.

Important to note is that existing ATRs confirming the application of the dividend withholding tax exemption will not be cancelled. However, the Dutch tax authorities could review the ATR and cancel the ATR in the event the authorities are of the view that there is abuse. The ATR will remain valid until expressly cancelled.



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