

TAX NEWS BULLETIN

A COMPILATION OF RECENT DEVELOPMENTS IN DUTCH INTERNATIONAL TAXATION AND EU TAXATION

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1. NEW EXPLANATORY DECREE ON THE APPLICABILITY OF THE DUTCH PARTICIPATION EXEMPTION

1.1. Introduction

Until 1 January 2010, the Dutch participation exemption applied to dividends derived from - and capital gains on the sale of - all qualifying participations in Dutch or foreign companies, unless that company is a so called “low taxed passive investment company” (“LTPIC”). A qualifying participation is a participation of at least 5% in the nominal issued and paid-up capital of a Dutch or foreign company with a capital divided into shares. A participation was considered not to be an LTPIC is either it could meet the asset test or the subject to tax test. The concept of an “LTPIC” has proven to raise difficulties for taxpayers trying to support their position that the participation exemption applies. In addition, the volatility of both the value and composition of assets can lead to inconsistent conclusions being drawn from the asset test from year to year, resulting in uncertainty for the taxpayer.

In order to provide a clearer and more consistent approach than the LTPIC concept, as per 1 January 2010 the participation exemption applies if a qualifying participation is “not held as a passive investment by the tax payer”. A qualifying participation is held as a passive investment if it is held for the purpose of earning a return on investment which can be expected from ordinary asset management. Only if this “motive test” can not be met, the taxpayer should support its position that a qualifying participation is not an LTPIC (i.e. that either the asset test or the subject-to-tax test is met).

The asset test is met when the aggregated assets of the participation do not consist, for more than 50%, of *low taxed* free passive assets. The following assets are deemed not to be low taxed passive assets:

- Assets the income of which is subject to levy of profits tax which is considered “real” by Dutch standards (reference is made to the subject to tax test).
- Real estate (including rights which relate directly or indirectly to real estate).
- Low taxed passive assets which do not form more than 30% of the total assets of the participation owning the low taxed passive assets.
- Group receivables or receivables from providing assets intragroup, provided that the participation owning such receivables meets the strict conditions for “active group financing companies” or if such receivables have been externally financed (legally and in substance) for at least 90%.

The subject to tax test effectively requires a general comparison of the profits tax regime of the country where the participation is established with the Dutch corporate income tax regime.

The subject to tax test is met if:

- The statutory rate of the profits tax is at least 10% and there are no “significant differences” in tax base, or
- The statutory rate of the profits tax is at least 10% and although there are “significant differences” in tax base these do not result in an effective tax burden of less than 10%, or
- The statutory rate of the profits tax is less than 10% but it is probable that the effective tax burden is at least 10%.

Differences in e.g. asset depreciation, investment incentives or loss compensation, should not be considered significant differences. Neither should, in principle, differences in tax grouping regimes be considered significant differences. However, tax holidays, substantial deemed deductions or exemptions, or too generous participation exemptions will be considered significant differences.

1.2. *New Decree*

On 26 February 2008, an important decree was issued by the State Secretary of Finance, in which he provided technical explanations to the applicability of the participation exemption, and not in the last place on the interpretation of the asset test and subject-to-tax test. On 12 July 2010, the State Secretary of Finance issued a new decree, based on the amendments to the participation exemption effective 1 January 2010. In many respects, the new decree is an update of the 26 February 2008 decree. However, a small number of aspects are new or have been amended, as follows:

1.2.1. *Subject to tax test*

The applicability of a local group relief or tax consolidation regimes to which the foreign participation is subject is not prohibitive for purposes of the subject-to-tax test, unless the resulting low effective tax rate is caused by a “significant differences” in tax base. Example: participation A is a passive investment company but is subject to more than 10% tax without significant differences in tax base. Participation B is in a loss position which loss is caused by a significant difference in tax base. If B transfers its loss to A as a result of which A becomes effectively subject to tax at less than 10%, A is considered an LTPIC. If the loss of B had not been caused by significant differences in tax base, A would not have been considered an LTPIC, before or after the transfer of the loss.

The new Decree emphasizes that, if the foreign participation has a permanent establishment (p.e.) in a third State, the provisions for avoidance of double taxation of the residence country of the participation are relevant in relation to the subject-to-tax test. The combined tax burden of participation and p.e. should be taken into account for purposes of the subject-to-tax test. Under the pre-2010 regime, the general rule was that foreign provisions for avoidance of double taxation were disregarded. Tax credits at the level of the participation for foreign withholding tax on dividends, interest or royalties received by the participation are not prohibitive, so long as the effective tax burden before crediting was at least 10%.

Tax sparing credits are prohibitive only if and to the extent, under the same circumstances, the Netherlands would not have allowed for a tax sparing credit or would have allowed only for a lower tax sparing credit.

If the Netherlands treats the participation as a separate taxable entity (non-transparent) and the residence country of the participation treats the participation as transparent (i.e. a hybrid entity), the participation will be considered to meet the subject-to-tax test if the (Dutch) participants are sufficiently subject to a profits tax in the residence country of the participations. In case of a “reverse hybrid entity” (i.e. transparent from a Dutch perspective, non-transparent from a participation residence country perspective), the subject-to-tax test may not be met, e.g. in the following situation: a Dutch taxpayer holds a direct foreign participation which in turn holds a foreign passive investment company. The foreign passive investment company is in principle not low taxed, i.e. subject to a profits tax of more than 10% and no significant differences in tax base. The direct participation is transparent from a Dutch perspective, and not sufficiently subject to tax due to significant differences in tax base, for example a fictitious deduction. The direct participation and foreign passive investment company are part of a tax consolidation regime. As a result of the consolidation, the passive investment company will be considered an LTPIC (i.e. insufficiently taxed). In these type of situations, requests may be submitted with the ATR/APA team of the tax authorities for approval that the subject-to-tax test should be considered to be met.

1.2.2. Associations and mutual insurance companies

Under certain conditions, the participation exemption may be applied to associations (society clubs, in Dutch “verenigingen”) which are fully subject to tax, and to mutual insurance companies (in Dutch “onderlinge waarborgmaatschappijen”).

1.2.3. 5% threshold and constructive ownership

Based on the so-called “Falcons case law” of the Dutch supreme court, results on call options on shares which upon exercise would form a qualifying participation eligible for participation exemption, also fall under the participation exemption. Pursuant to later case law, this doctrine has been extended to warrants, convertible bonds and other rights to acquire qualifying participations.

Under the constructive ownership provisions, shares (<5%) of a company held by the taxpayer fall under the scope of the participation exemption if a company related to the taxpayer holds a qualifying participation in the same company. Based on this decree, the result on call options on shares (<5%) of a company held by a taxpayer also fall under the scope of the participation exemption if a company related to the taxpayer holds a qualifying participation in the same company.

If the taxpayer holds shares (<5%) of a company, and a company related to the taxpayer owns call options on shares which upon exercise would form a qualifying participation, the participation exemption does not apply to the shares held by the taxpayer, even though the participation exemption applies with the related company in relation to the results on the call option under the Falcons case law. Furthermore, if a taxpayer holds call options on shares of a company which upon exercise would form a qualifying participation and in addition owns <5% of the shares of the same company, the participation exemption applies only to the results on the call options.



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2. EC ATTACKS CORPORATE EXIT TAXES OF MEMBER STATES, INCLUDING THE NETHERLANDS

Based on the Dutch corporate income tax act, all profits and unrealized gains in assets or liabilities and fiscal reserves are taxed upon transfer of the tax residence (fiscal emigration) of the company to another country (so called "exit tax"). On 18 March 2010, the EC has challenged the legality of the exit tax in view of the freedom of establishment. The EC has advised the Dutch legislator to amend its exit taxes such that the collection of taxes due on exit tax assessments is postponed until the moment the gains are actually realized. The EC has given the Dutch government 2 months to act in accordance with this advice. Failure to do so may cause the EC to submit the case with the ECJ. The Dutch government has not yet acted in accordance with the advice from the EC. It is not clear where the EC stands now (i.e. whether the case has been presented before the ECJ). Belgium and Denmark have been given similar advice. Portugal and Spain have already been taken to the ECJ by the EC. A case against Sweden has been ceased upon Sweden's compliance with the advice from the EC. On 15 July 2010, a Dutch tax court of appeals asked the ECJ to answer the prejudicial question whether the exit tax is a violation of the freedom of establishment.

3. ECJ HOLDS NOT EXTENDING DUTCH FISCAL UNITY REGIME TO EU RESIDENT GROUP COMPANIES TO BE IN ACCORDANCE WITH EU LAW

The Dutch fiscal unity regime allows Dutch resident corporate taxpayers (including Dutch permanent establishments of certain qualifying foreign tax payers) to file a consolidated tax return as a single tax payer. Among other things, profits and losses of fiscal unity participants are pooled, and assets and liabilities can be transferred internally without triggering corporate income tax on unrealized gains, subject to certain conditions. On 25 February 2010, the ECJ confirmed that an extension of the fiscal unity regime to EU resident group companies can not be forced on the basis EU law. Given the general wording used by the ECJ, it is expected that the ruling applies in respect of all aspects of a fiscal unity, not just the pooling of profits and losses and the transfer of assets and liabilities.



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4. DUTCH SUPREME COURT HOLDS DUTCH DIVIDEND WITHHOLDING TAX TO NETHERLANDS ANTILLES PARENT COMPANY NOT TO BE A VIOLATION OF EU LAW

On 10 April 2010, the Dutch Supreme Court ruled that the Dutch dividend withholding tax on dividends to a Netherlands parent company (which is reduced to 8.3% under the treaty with the Netherlands Antilles) is neither a violation of EU law, nor a discrimination within the meaning of the international treaty for civil and political rights, the European treaty for human rights, or the treaty with the Netherlands Antilles. The situation concerned one of 70% share ownership. Based on existing ECJ case law, generic provisions (i.e. provisions which are not specifically aimed at situations of majority or minority interests) can be governed by either the freedom of establishment or the freedom of capital. If the factual situation is one of a majority interest, the freedom of establishment applies, whereas if the factual situation is one of a minority interest, the freedom of capital applies. The freedom of capital has effect towards third countries (such as the Netherlands Antilles), whereas the application freedom of establishment is restricted to EU member states. Given the fact that the situation at hand concerned one of 70% share ownership, applicability of the freedom of capital was not tested by the Supreme Court

On 16 April 2010, the Dutch Supreme Court confirmed an earlier decision from the lower tax court of The Hague regarding a comparable situation, where the lower tax court ruled that even if the freedom of capital were to apply, the dividend withholding tax is still allowable under the "stand still provision". The stand still provision holds that all restrictions which are in principle a violation of the freedom of capital are allowable if such restriction was already present in the domestic law of a member state on or before 31 December 1993 and has not been amended significantly after that date.



5. STATUS OF BILATERAL INCOME TAX TREATY (RE)NEGOTIATIONS

The Netherlands has started first-time treaty negotiations or announced to start first-time treaty negotiations with: Algeria, Angola, Colombia, Costa Rica, Cyprus, Cuba, Iran, Kenya, Libya, Isle of Man, Panama, Peru, and Tanzania. The Netherlands has signed a new treaty with Saudi Arabia, the date of entry into force is yet unknown.

The Netherlands has negotiations pending, or has announced negotiations for new treaties or protocols, replacing or amending existing treaties or protocols, with the following countries: Australia, Belgium, Brazil, Canada, Chile, China, Germany, France, India, Indonesia, Japan, Kyrgyzstan, New Zealand, Poland, Singapore, Slovak Republic, South Korea, Turkmenistan, and Turkey.

According to a press release the new treaty with Japan will include: 10% (currently 15%) generally on dividends, but 0% (currently 5%) if the company receiving the dividends owns a participation of at least 50% in the company distributing the dividends, and 5% if the receiving company owns a participation of at least 10% in the company paying the dividends; 10% on interest, but 0%, amongst others, for financial institutions; and 0% (currently 10%) on royalties.

Pursuant to pending Dutch Kingdom state reform, the Dutch Antilles (currently consisting of Curacao, Bonaire, Saba, Saint Eustatius, and Saint Martin) will be dissolved as an independent country on 10 October 2010. Curacao and Saint Martin will each become independent countries within the Kingdom of the Netherlands. Bonaire, Saint Eustatius, and Saba (the "BES Islands") will become extraordinary municipalities of the Netherlands. Aruba has been a country within the Kingdom of the Netherlands since 1986. In view of the Dutch Kingdom state reform, the Netherlands will also have to rearrange its arrangements for the avoidance of double taxation with the abovementioned territories. To date, the avoidance of double taxation was laid down in the so-called Tax Arrangement of the Kingdom ("TAK"; Belastingregeling voor het Koninkrijk, "BRK"), a state law with a status similar to that of a treaty. The TAK is applicable to the current Dutch Antilles and Aruba. The introduction of a new Unilateral Decree for the avoidance of double taxation has been announced in relation to the BES Islands. No draft text is yet available. Furthermore, it is expected that the TAK will be replaced by new bilateral agreements between the Netherlands and each of Curacao, Saint Martin and Aruba respectively. As yet it is unclear when such new treaties can be expected. Until such time the BRK will continue to be effective in relation to all territories mentioned above. In principle, all future tax treaties with third countries negotiated by the Netherlands will also apply to the BES Islands, unless the treaty partner disagrees. After the Dutch Kingdom state reform, tax treaties concluded by the current Dutch Antilles (tax information exchange agreements) will continue to apply to Curacao and Saint Martin, as well as to the BES Islands.

Finally, the Netherlands has recently concluded or amended tax treaties or protocols with the following countries.

Amended or new income tax treaties / protocols			
Country	Treaty or protocol	Entry into force	Remarks
Azerbaijan	Treaty	18 December 2009	5% on dividends from $\geq 25\%$ participation and $\geq \text{€}200,000$ investment, 10% on interest, 5/10% on royalties, all reductions subject to mutual agreement. Capital gains on sale of $\geq 50\%$ shares or voting power of a company the assets of which consist mainly of real estate are taxable in the source state, unless the real estate is used in the business of the taxpayer.
Bahrain	Treaty	24 December 2009	0% withholding tax on dividends from $\geq 10\%$ participations, subject to mutual agreement procedure. 0% withholding tax on interest, 5% withholding tax on royalties. Capital gains tax (including on shares of a real estate company) allocated to residence state of the seller, except for capital gains on sale of real estate.
Hong Kong	New treaty signed	1 January 2011 for NL, 1 April 2011 for Hong Kong	0% withholding tax on dividends from $\geq 10\%$ participations, subject to stock exchange test or head office test (limited LOB provision).
Japan	New treaty scheduled to be signed in 2010		New treaty will include: 10% (currently 15%) generally on dividends, but 0% (currently 5%) if the company receiving the dividends owns a participation of at least 50% in the company distributing the dividends and 5% if the receiving company owns a participation of at least 10% in the company paying the dividends; 10% on interest, but 0%, amongst others, for financial institutions; and 0% (currently 10%) on royalties.
Mexico	New protocol signed	31 December 2009	Withholding tax rate on interest reduced from 15% to 10%; Anti abuse in capital gains article (to counter sham corporate reorganizations); No LOB clause;
Qatar	Treaty	25 December 2009	0% withholding tax on dividends from $\geq 7.5\%$ participations, subject to mutual agreement procedure. 0% withholding tax on interest, 5% withholding tax on royalties subject to mutual agreement procedure. Capital gains tax (including on shares of a real estate company) allocated to residence state of the seller, except for capital gains on sale of real estate.
United Arab Emirates	Treaty	2 June 2010	5% withholding tax on dividends from $\geq 10\%$ participations. 0% on interest and royalties. Capital gains tax (including on shares of a real estate company) allocated to residence state of the seller, except for capital gains on sale of real estate.
UK	New treaty signed	1 January 2011 for NL, 6 April 2011 for UK	Mutual agreement in stead of place-of-effective-management test for dual resident companies.
Switzerland	New treaty signed	unknown	Pursuant to the new treaty, interest is exempt from withholding tax. The new treaty includes: <ul style="list-style-type: none"> – an exchange of information provision in Art. 26 of the OECD Model. This provision cannot be invoked as a ground for refusing to exchange the information expressly required to be exchanged (e.g. bank information); and – an arbitration clause, within the mutual agreement procedure provision.



6. EU REGULATION 883/2004 (SOCIAL SECURITY) ENTERS INTO EFFECT MAY 2010

On 1 May, 2010 the EU Regulation 883/2004 entered into effect. The Regulation seeks to harmonize the social security legislation of member states, so as to improve mobility of individuals within the EU. The Regulation was built on four pillars:

- 1) Equal treatment of EU citizens;
- 2) Providing a tie-breaker as to the applicable domestic social security laws of member states involved;
- 3) An adding of periods during which social security benefits were built up in different member states;
- 4) An export of existing social security benefits to other member states.

Allocation rules are based on the principle that only the domestic social security law of one member state can be applicable. As a result, double payment of contributions as well as uninsured situations are avoided.

Main rule:

a person who lives in a member state, but works in another member state, will be insured in accordance with the law of that other member state (the "work state"), irrespective of whether the employer is also established in that other member state.

Exceptions:

- (1) In cases of international secondment (24 months or less), the social security law of the country of origin of the employee continues to apply.
- (2) If an employee works in two or more member states, the social security law of the residence state of the employee applies if:
 - a) one of the member states is his residence state, and a substantial part (25% or more) of the work is carried out in the residence state for the same employer, or
 - b) if the employee works for several employers which have their seat or domicile in several member states.
- (3) If an employee works in two or more member states, the social security law of the member state where the employer for whom the employee works primarily has its seat or domicile, if a substantial part of the work is not carried out in the residence state of the employee.
- (4) If a person works other than as a paid employment in two or more member states:
 - a) the social security law of the residence state of the employee applies if a substantial part of the work is carried out in the residence state, or
 - b) the social security law of the member state where the center of interests of his work is located applies, if he does not live in one of the member states where he carries out a substantial part of his work.

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- (5) If a person works in several member states as a paid employee as well as other than a paid employee, the social security law of the member state where he works as a paid employee applies or, if he carries out paid employment in two or more member states, the social security law applies as determined under 2.
- (6) Persons who work as a civil servant with a government body in a member state and who, as a paid employee or otherwise, carries out work in one or more other member states, the social security law of the member state where the government body is located applies.

For purposes of the social security law which is treated as the applicable law under this Regulation, the persons mentioned above are deemed to carry out all of their work and earn all of their income in the member state whose social security law is the applicable law.

7. DECREE FROM THE STATE SECRETARY OF FINANCE REGARDING INTRAGROUP SECONDMENT OF EMPLOYEES

On 12 January 2010 the Dutch State Secretary of Finance issued a decree in which, a.o., he stated that foreign employees who are temporarily seconded to a Dutch company or permanent establishment belonging to the same group of the foreign employer, will not be taxed in the Netherlands on their wage attributable to the days worked in the Netherlands, if the number of working days (sick days included) does not exceed 60 in any 12 month period. In cases where this approach would result in double exemption, a discussion procedure may be started with the competent authorities of the other state.

In the reverse situation (Dutch employee seconded abroad), there will in principle be no exemption from Dutch wage tax (for purposes of the so called 183-days rule). In cases of (potential) double taxation, the State Secretary of Finance will evaluate whether a discussion with the competent authorities of the other state is required.

If under the relevant tax treaty, the Netherlands has the right to tax in cases of international secondment of employees, the question arises who will be required to withhold the tax (and meet the withholding tax compliance requirements). Based on the decree, if the Dutch "borrower" of personnel is the employer for purposes of the relevant treaty, without the relationship between the Dutch borrower and foreign employee qualifying as an employment for purposes of the Dutch wage tax act, the "lending" foreign employer will be liable to withhold the Dutch wage tax. If the Netherlands has the right to levy tax under the relevant treaty, the foreign "lender" of personnel is liable to withhold the Dutch wage tax. In order to avoid an increase of the administrative burden for multinational companies, the State Secretary of Finance approves that in cases of international secondment of foreign personnel to a Dutch part of the multinational group, such Dutch part of the multinational group may be considered the person who is liable to withhold and pay Dutch wage tax.



8. TONNAGE TAX REGIME

Based on the (optional) Dutch tonnage tax regime, for tax purposes the profit earned with sea vessels from transport of goods or persons is calculated by reference to tonnage capacity of the vessels. If elected the regime applies for a period of ten years. This regime intends to be a tax incentive to maritime enterprises and to facilitate the establishment of the head offices of maritime enterprises in the Netherlands.

As per 1 January 2010, the Dutch tonnage tax regime has been extended to income from *shipping* services performed by cable and pipe laying vessels, research vessels and crane vessels. As a result of this extension, an application of the tonnage tax regime to these vessels would in principle trigger corporate income tax on unrealized capital gains and fiscal reserves relating to these types of vessels and other connected assets. A new Decree was issued on 8 July 2010, which makes it clear that such unrealized capital gains and fiscal reserves can be offset against carried forward net operating losses. To the extent the unrealized capital gains and fiscal reserves exceed the losses, they will be exempt from taxation. In case of opting out of the regime before the end of the ten year term, the corporate income tax liability will become due. If not, the corporate income tax claim will be waived after the ten year period.

9. AMENDMENT OF THE EU MERGER DIRECTIVE

The amended EU Merger Directive entered into effect on 15 December 2009. The amended version does not contain new aspects, it is a codification of four prior amendments since the first version of 1990. The EU Merger Directive seeks to avoid immediate taxation, in the member state where the disappearing or contributing company is resident, on any unrealized gains or losses in assets upon a merger, demerger, contribution of assets and share-for-share exchanges, provided that these assets remain attributable to a permanent establishment in that member state.

The most important amendments to the Directive which have now been codified are those from 2005:

- A. Extending the Directive benefits to “European Companies” (“Societas Europea”, or “SE”) and European Cooperative Associations (“SCE”);
- B. Specific provisions for hybrid entities: where a disappearing entity in a merger - or other transaction covered by the Directive - is treated as a non-transparent by the member state where the entity resides, but is treated as transparent by the member state where participants in the disappearing entity reside, the latter member state may not include in its taxable basis gains or losses from the merger or other transaction;
- C. Extending the Directive benefits to split offs (no longer restricting the Directive to “pure” split ups or “pure” demergers);
- D. Clarification that a conversion of a permanent establishment into a company also qualifies for the Directive benefits;
- E. Adding specific provisions enabling SE’s and SCE’s to transfer their statutory seats from one member state to the other in a tax neutral manner.



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10. PENALTIES FOR LATE FILING OR FAILURE TO FILE TAX RETURNS, AND LATE PAYMENT OR FAILURE TO PAY TAX INCREASED

From 1 January 2010, the maximum amount for penalties for late filing or failure to file tax returns, and late payment or failure to pay tax has been increased from € 1134 to € 4920. In general, penalties of 50% of the maximum amounts will be imposed. In case of repetitive offense the amount of the penalties may be increased up to the maximum.



Should you have any questions or require further information, please do not hesitate to contact one of the Tax Advisers mentioned below.

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