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TAX NEWS BULLETIN

Topics in this Tax News Bulletin:

- **Budget proposals for 2009**
On Tuesday 16 September 2008 the Government presented its Budget for 2009, including the following tax measures and considerations.

- **Proposals for improvement of the Dutch Environment for new business**
Being challenged by Parliament, on 28 August 2008 three Dutch tax professors have launched proposals aimed at improving the Dutch tax regime, which received a warm welcome in the business community.

- **New Netherlands-UK tax treaty signed on 26 September 2008**
On 26 September 2008, the UK and the Netherlands signed a new tax treaty, which is intended to replace the existing tax treaty as from 2009.

- **Proposals for taxation of excessive remunerations**
On 9 September 2008, the Second Chamber of Parliament adopted proposals dealing with excessive remunerations.

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Budget proposals for 2009

On Tuesday 16 September 2008 the Government presented its Budget for 2009, including the following tax measures and considerations:

➤ *Optional interest box/reduced CIT rate 2008*

Upon introduction of the optional interest box rules in 2007, a request was filed with the Commission of the EU to confirm that the optional interest box regime shall be considered to be compatible with the common market. This request is still pending and discussions with the Commission are ongoing. As one of the reservations of the Commission is the optional nature of the regulations, the Government contemplates rules whereby the interest box will not be optional (we also refer to the proposals to improve the Dutch fiscal climate below). Since approval by the Commission is not expected in 2008, the Government proposes to apply the funds reserved for 2008 for a one-time reduction of the 2008 corporate income tax (CIT) rates: 20% will apply to the first €250.000 annual taxable profits and 25.5% of the amount in excess thereof.

➤ *Research & development tax incentives (as from 2009)*

It is proposed to extend the scope of research & development tax incentives to the development of new technical software using existing components with effect from 2009. After monitoring of the effect of this measure in 2009 it may be further extended in 2011.

➤ *Investment funds qualifying for a 0% CIT rate (as from 2009)*

This type of investment fund can invest into commercial and other real estate investments (direct real estate). In recent years a trend has occurred whereby such investments were structured via subsidiaries (indirect real estate), and now it is proposed to treat shareholdings in subsidiaries, the assets of which consist for 90% or more out of real estate, in the same way as direct real estate investments. Also the investment fund will be permitted to grant loans to real estate subsidiaries and to issue guarantees on their behalf.

➤ *Tonnage tax regime (as from 2009, subject to approval Commission EU)*

The tonnage tax regime is regarded as an instrument stimulating shipowners to keep their business in the Netherlands. The Government proposes two measures to maintain a level playing field compared to tonnage tax regimes in other EU Member States. First, the current digressive scale stops where the net tonnage of a vessel is 25.000 net ton or more. To remain competitive, an extra scale is introduced: as from a tonnage of 50.000 net ton, a lower rate of 0.50% per net ton shall apply. This should stimulate shipowners to manage such large vessels from the Netherlands.

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Second, since 2006 the tonnage tax regime also applies to shipmanagement enterprises. It has become clear that the tonnage result is often fairly high compared to their actual profits. Against this background it is proposed to reduce the tonnage base by 75%.

➤ *Administrative burden for employers and employees (as from 2009)*

The Government intends to reduce the administrative burden for employers. Currently, an employer must file a First Day Notice (FDN) before a new employee starts to work for him. This anti-abuse rule turned out to be disproportional. The general requirement to file FDN's is abolished, but the Tax Inspector may oblige employers where special risks of illegal labour or fraud occur to file FDN's. Furthermore, it is contemplated to replace wage tax and social security by one wage tax. Social security premiums for unemployment benefits will not be withheld on the employee's salary any longer.

➤ *Employees working in non-tax treaty jurisdictions (as from 2009)*

Currently, the employment income of employees who are resident in the Netherlands of a Dutch resident employer, but who work in a non-tax treaty jurisdiction, are exempt from wage and income tax if they have worked there at least an uninterrupted period of three months. As this should be a violation of EU law, the measure is extended to foreign employers who are resident in an EU Member State.



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Proposals for improvement of the Dutch environment for new business

Being challenged by Parliament, on 28 August 2008 three Dutch tax professors have launched proposals aimed at improving the Dutch tax regime and thus the Dutch environment for new business investment. Thorough reflection and an entry into force in 2010 were recommended. Although not an incentive of Parliament or Government (yet) we believe they are worth mentioning. They received a warm welcome in the Dutch business and tax professionals community, which raises expectations that these proposals will be embraced by the Government too. The Ministry of Finance is currently studying the proposals, which in headlines contain the following measures:

1. The CIT rate will be reduced to 20%.
2. The dividend withholding tax (DWT) will be abolished completely.
3. Interest received from and paid to a group company will be excluded from the taxable profit. A group company will be defined as a shareholding in a subsidiary of more than 50%. Therefore, this would effectively replace the contemplated interest box and stimulate strengthening the equity of Dutch (holding) companies.
4. Interest on financings of the acquisition of group companies (i.e. subsidiaries > 50%) is not deductible if the company's equity is insufficient, irrespective whether interest is owed to group companies or to third parties. The non-deductibility of interest is limited to the interest that corresponds materially with insufficient equity. Insufficient equity is defined as the amount by which the investment in the participation (of more than 50%) exceeds the equity of the company. Non-deductible interest can be carried forward and deducted in later years when an equity surplus occurs (i.e. the opposite of insufficient equity).
5. All present regulations regarding limitations of interest deduction in the CIT Act are abolished (article 10a for abusive transactions, article 10b for loans with a duration of more than 10 years and an interest rate below at arm's length level, article 10d regarding thin capitalization, article 20, paragraphs 4, 5 and 6 regarding holding results, as well as a number of more detailed rules).
6. The scope of the participation exemption is broadened. As a result the exception for low taxed passive port folio participations is abolished. Where the company participates in a passive port folio investment subsidiary, that subsidiary must be subject to tax whereby, like before 2007, no minimum tax rate is required. However, participations of which the assets consist 50% or more of receivables on group companies, short term investments and real estate to be exempt under tax treaty are excluded from the definition of passive port folio investments.



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New Netherlands-UK tax treaty signed on 26 September 2008

On 26 September 2008, the UK and the Netherlands signed a new tax treaty, which will replace the tax treaty of 7 November 1980 once both countries will have ratified it. Given the importance of relations between the UK and the Netherlands, but also because the treaty shows some new trends, we have prepared the following analysis of the major changes:

- If a company or legal person is a resident of both the Netherlands and the UK under their respective national legislations, currently the place of effective management is decisive. Under the new treaty, the competent authorities will decide by mutual agreement of which State the company is a resident; in the absence of a mutual agreement, broadly the company will not be resident of either State for the purposes of claiming most benefits provided by the tax treaty.
- Companies participating in *dual listed company arrangements* will be deemed to be resident in their State of incorporation, provided it has its primary stock exchange listing in that State.
- An exemption from dividend withholding tax (DWT) for dividends paid to a parent company holding at least 10% of the voting power of the distributing company. The DWT rate is 15% if the distributing entity is a real estate investment company. Also, an exemption from DWT will apply for dividends paid to a *pension scheme* and to organisations established and operated exclusively for religious, charitable, scientific, cultural, or educational purposes which are exempt from tax in their State of residence. The DWT rate for portfolio dividends is reduced to 10% (currently 15%). Income from purchase of own shares or liquidation are treated as dividends for Dutch tax purposes.
- New anti-abuses clause are included in the dividend article and in the other income article. Rather than a possibly inaccurate description we prefer to quote the text of article 10 § 3: "No relief shall be available under this Article if it was the main purpose or one of the main purposes of any person concerned with an assignment of the dividends, or with the creation or assignment of the shares or other rights in respect of which the dividend is paid, or with the establishment, acquisition or maintenance of the company that is the beneficial owner of the dividends and the conduct of its operations, to take advantage of this Article."

In any case where a Contracting State intends to apply this paragraph, its competent authority shall in advance consult with the competent authority of the other Contracting State."

Explanatory notes may explain the scope of this provision.

Indirectly, this anti-abuse clause should also apply to the implementation of the EU Parent Subsidiary Directive in the relation between the Netherlands and the UK.

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- Under a mutual agreement procedure, special arrangements can be achieved for the representatives of investment funds deriving cross border dividends or interest.
- In certain triangular cases the UK does not have to grant treaty benefits with respect to taxes on UK source interest and royalties paid to a Dutch company, if that interest or those royalties are attributable to a permanent establishment of the Dutch company located in a third state with whom the Netherlands has a tax treaty.
- Capital gains relating to unquoted real estate investment company shares, the value of which is determined for at least 75% out of real estate located in the Source State, may be taxed in the Source State. Exceptions apply for restructurings and capital gains realised by pension funds.
- No major changes are made to the rules for employment income and directors' remunerations. Exploitation of ferries no longer falls within the scope of international traffic, resulting in other allocation rules for business profits and employment income of staff (for them transitional rules will apply).
- The allocation of the right to tax pensions and annuities is structured in line with the recent Dutch model (more often resulting in taxation in the Source State). Transitional rules shall apply. The separate treaty provision for government service pensions is abolished, so that private and government service pensions will be covered by one and the same rule.
- Confirmation of the treatment of income regarding pipelines between the Netherlands and the UK.
- Confirmation of the treatment of partnerships and transparent entities.



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Proposals for taxation of excessive remunerations

On 9 September 2008, the Second Chamber of Parliament adopted proposals dealing with excessive remunerations. The proposals are a reaction to perceived excessive carried interest remunerations of private equity managers and severance payments and pension entitlements for managers. It contains provisions regarding the personal income tax (PIT) on carried interest and similar remunerations and two wage tax measures for employers with consequences for costs of severance payments and of pensions granted to employees receiving annual salaries exceeding €500,000. The First Chamber (Senate) will now deal with the proposals, whereby amendments within this draft bill are no longer possible.

- *PIT on carried interest remunerations (intended to be in force as from 1 January 2009)*

Currently, carried interest and similar remunerations at first sight often appear as capital gains and not employment income and may receive the corresponding tax treatment.

Under the proposals, they are covered by the definition of *lucrative interests* (profitable participations), which includes shares, debt claims and other comparable rights (taken broadly) granted under such conditions that they have features of a remuneration for work carried out, whereby a yield can be realized which – according to the Dutch Government - is in no relationship to the capital invested. It is proposed to tax the actual benefit from such lucrative interests in Box 1 at the progressive rates up to 52% like other employment income. Lucrative interests *held indirectly*, i.e. via an interposed substantial interest company, are also taxed in the hands of the shareholder at progressive rates, unless the actual benefit from lucrative interest is passed on immediately by the interposed company to its shareholder. In such a case a 25% substantial interest taxation (Box 2) is levied instead of the progressive rates for Box 1-income. Due to the nature of these rules, retroactive effects may occur.

- *30% employer's levy on excessive severance payments over € 500,000 (intended to be in force as from 1 January 2009)*

Where an employee's annual salary is €500,000 or more, besides the regular taxation in Box 1 at rates up to 52%, a severance payment may also be taxed in the hands of the employer at a flat rate of 30%, if and to the extent that the severance payment exceeds the annual salary.

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- *15% employer's levy on final pay backservice pension premiums for salaries over € 500,000 (intended to be in force as from 1 January 2010)*

An additional wage tax is introduced, levied from the employer, of 15% of a forfeited calculated backservice premium paid for a pension build-up under a final pay system on a salary of € 500,000 or more. This tax will replace the limitation to a maximum of € 185,000 of the fiscal support for pension accrual, which was included in the 2008 Budget proposals.



Should you have any questions or require further information, please do not hesitate to call your regular contact person within our firm (+31 10 436 50 44).

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