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by Eric van der Stoel

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by Eric van der Stoel

The Dutch Ministry of Finance on May 11 issued a statement of practice (CPP2007/983M) that aims to discourage share buy-back schemes. It is argued that the only purpose of these schemes is to reduce the dividend withholding tax burden regarding the buyback of shares.

The Dutch newspaper *Het Financieele Dagblad* on May 3 had reported that the Dutch tax authorities may want to challenge the outcome of some buyback schemes arranged by Dutch banks for listed Dutch resident companies.

The Law

In the Netherlands, profit distributions made by Dutch resident companies are subject to a 15 percent dividend withholding tax. (It should be noted that before January 1, 2007, the rate was 25 percent. Transactions conducted before this date may therefore be subject to higher claims.)

Distributions subject to dividend withholding tax include the purchase price paid for a buyback of own shares to the extent the price exceeds the average paid-up capital of the shares concerned (article 3 (1)(a), Dividend Withholding Tax Act (DWTA). An exception applies for shares that are bought back for temporary portfolio investment purposes. This amount is subject to the ordinary dividend withholding tax rate of 15 percent, unless an exemption or reduction applies. Dutch residents can generally credit the withholding tax with their own corporate income tax liability or receive a refund in case of an excess credit (article 25(1) of the Corporate Income Tax Act (CITA) and article 10(3) of the DWTA). The credit and refund apply only if the recipient is considered to be the ultimate beneficial owner of the revenue concerned (CITA article 25(2) and DWTA article 10(3)).

In the situation of a buyback of listed shares, the shareholder of the shares concerned is generally not known. As a result, the company itself has to bear the dividend withholding tax. For these purposes, the law requires that the amount subject to dividend withholding tax is grossed up by multiplying the amount with the factor 100/85 (DWTA article 6 (1)).

The law does include a special facility for listed companies that provides for an exemption of dividend withholding tax (DWTA article 4 (c)). However, some conditions and limits apply.

Reducing the Tax Burden

Because of the pressure exercised by hedge and private equity funds, several Dutch listed companies are involved in substantial share buyback programs. For companies that have already exceeded the limits set by law for exempt buyback transactions, Dutch banks have created certain schemes. The schemes include the forward purchase agreement (FPA) and the second trading line (STL). The schemes may involve the acquisition of shares from the public by those banks, in which the shares are later bought back from the bank by the listed companies concerned. These transactions would avoid the application of the gross-up mechanism and allow the bank to benefit from the possibility of crediting the withholding tax. The bank is left with a profit (usually some basis points of the stock market price). The Dutch Ministry of Finance is now challenging these schemes.

Forward Purchase Agreement

An FPA is an agreement between the listed company and the bank that provides that the bank will acquire shares on the stock exchange and deliver the shares to the listed company. The contract generally

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includes the agreements on the number of shares, the timing, and the price to be paid for the buyback.

The Ministry of Finance believes the FPA should be treated as a kind of service agreement. The listed company should still be viewed as the party that indirectly buys back the shares from an unknown shareholder. The bank that has been interposed should be viewed as a service provider and not as the (ultimate) beneficial owner of the proceeds of the share buyback transaction. Accordingly, that bank is not entitled to a credit or refund of the dividend withholding tax. The listed company will be faced with the gross-up mechanism.

Second Trading Line

The STL comprises for the same kind of shares a second listing with the stock exchange in Amsterdam (Euronext). This is in addition to the regular trade at this stock exchange of shares of the company concerned. The STL makes it possible that shareholders who make themselves known offer their shares to the company for a buyback.

The MOF accepts this buyback (that is, no gross-up and possibility to apply for a credit) if the shareholder already owned the shares in the company at the start of the buyback program and has not acquired the shares since the buyback. (The (former) shareholder may acquire new shares to rebuild his former position provided the newly acquired shares are not offered again to the company via the STL.) However, the buyback will be challenged if a third party (for example, the bank) purchases the shares at the stock exchange with the aim to offer the shares to the company via the STL. In this latter situation, the Dutch tax authorities will apply the same consequences as under the FPA (that is, a gross-up and the third party is not considered to be the beneficial owner).

Discussion

An important question is whether the bank can be considered to be the ultimate beneficial owner of the amount paid by the listed company for the buyback of its shares. The requirement of beneficial ownership in order to be entitled to a credit or a refund was introduced in Dutch domestic law in 2001. The background was to counteract dividend-stripping transactions that were accepted by the Dutch Supreme Court.[1] The Supreme Court had applied a rather formal interpretation of the term "beneficial owner" — that is, the recipient should be able to freely dispose over the proceeds, therewith not acting as an agent.

In the law, no positive definition is given of the term "ultimate beneficial owner"; there is only a negative definition describing who is not considered to be the ultimate beneficial owner. This latter definition deals with dividend-stripping transactions whereby the transferring person who was initially entitled to the distribution maintains an interest in the shares. In this latter situation, the acquiring person may not be considered to be the ultimate beneficial owner of the proceeds received with the shares concerned.

The question is whether the introduction of the term "ultimate beneficial owner" in the law (except for the negative definition mentioned above) has changed the former (formal) interpretation given by the Supreme Court into a more economic interpretation. This was the intention of Dutch government, but it was not explicitly included in the law by means of a (positive) definition of the term. Moreover, the exact terms of the agreements made between the listed companies and the banks will be relevant. This is in order to determine whether the banks fall within the economic interpretation or, if this latter interpretation does not apply, within the former (formal) Supreme Court definition.

It may take several years before the Supreme Court will render a decision in a share buyback case challenged by the Dutch tax authorities. The recently issued statement of practice will most likely reduce the appetite of parties to participate in a FPA or STL, which may have been the background of the publication of this statement. ◆

♦ *Eric van der Stoel, Otterspeer, Haasnoot & Partners, Rotterdam*

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[1]See, for example, Hoge Raad, Apr. 6, 1994, no. 28638 (published in BNB 1994/217) and Hoge Raad, Feb. 21, 2001, no. 35415 (published in BNB 2001/196).