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NOTE ON WITHHOLDING TAX ACT 2021 AND DIRECTOR'S LIABILITY

1. Introduction

The Withholding Tax Act 2021 introduces a (25%) conditional withholding tax (also referred to as "WHT" , a "WHT"or "the WHT") on interest and royalty payments to affiliated entities in designated low-tax and non-cooperative jurisdictions (hereafter: tainted jurisdictions, see 2.2) and in abusive situations, for example where payments are artificially diverted to entities in tainted jurisdictions via companies in normal tax jurisdictions.
The 2021 Withholding Tax Act enters into force on 1 January 2021, but for example also covers interest and royalties that accrued in 2020 and become payable on 1 January 2021.
Moreover, the Withholding Tax Act 2021 introduces a significant extension of the director liability regime, applying to both the director(s) of the paying company and of the receiving foreign company, when the WHT payment is not made correctly.
A brief overview of the Withholding Tax Act 2021, the extended director liability in the context of the Withholding Tax Act 2021, and their ramifications, is discussed in greater detail below.

2. Withholding Tax Act 2021

2.1 Scope, system

The intention of this new tax is that – as from 1 January 2021 - a WHT will apply, at a rate equal to the high CIT rate (25%), on intra-group interest and royalties flows to a related entities in a low tax or non-cooperative jurisdiction. Key definitions of the Act are, on the one hand, *taxpayer* and *beneficiary* of the interest and royalties, and on the other hand the *associated debtor company*.
In those cases where the taxpayer is already subject to Dutch corporate income tax (CIT) for the same interest or royalties, the new withholding tax constitutes double taxation. The Government accepts such double taxation, arguing that taxpayers should avoid situations in which the WHT arises in the first place.

2.2 Low-tax jurisdiction or EU list of non-cooperative jurisdictions

Broadly, the Withholding Tax Act 2021 targets taxpayers, or their permanent establishments situated in a tainted jurisdiction, i.e. in the following cases:

a) the related entity is resident in a jurisdiction with a statutory tax rate lower than 9%;
b) the related entity is resident in a jurisdiction that is included on the European Union (EU) list of non-cooperative jurisdictions.

At the end of each year, the Dutch Government publishes a list of jurisdictions that qualify as low-tax jurisdictions or are included on the EU List at that time. Only jurisdictions that are

included on that list that year are in scope of the WHT for the following calendar year (see appendix 1).

2.3 Taxable events and the counter-evidence facility

The Withholding Tax Act 2021 describes taxable events as payments of interest and royalties to a taxpayer, being a company, which meets *any of the following* criteria (some of which have a counter-evidence facility):

1. The company receiving the interest and/or royalties is, based on the relevant circumstances – determined on the Dutch criteria –resident in a tainted jurisdiction or the company is established in a tainted jurisdiction under the local tax or other legal regulations of that jurisdiction.

   A counter-evidence facility applies, comprising that if it is plausible that the company receiving the interest is also resident in a "normal tax" jurisdiction, where it is also treated as the beneficiary of the interest and/ or royalty income, while it is not resident in another state for purposes of a double tax treaty.

2. The company is resident in a "normal tax" jurisdiction, but the company has a permanent establishment in a tainted jurisdiction and the interest and/ or royalty income must be allocated to that tainted jurisdiction.

   No counter-evidence facility applies.

3. Although under the laws of a "normal tax" jurisdiction, the company is treated as beneficiary to the interest and/ royalty income, this company is also part of an artificial arrangement to avoid taxation (for example the company on-pays the interest and/ or royalty income to a party in a tainted jurisdiction).

   A counter-evidence facility applies, comprising that the structure is not considered abusive if the company in the "normal tax" jurisdiction meets the substance requirements (see Appendix 2), *unless the Tax Inspector proves the contrary*.

4. For Dutch tax purposes, the legal creditor company is transparent and the participants in the creditor company should be taxed for the interest and/ or royalty income. But for local purposes the legal creditor company is treated as the beneficiary to the interest and/ or royalty income.

   A counter-evidence facility applies.

5. For Dutch tax purposes, the legal creditor company should be taxed as a company and as the beneficiary to the interest and/ or royalty income. But for local tax purposes the legal creditor company is transparent, and the participants should be taxed for the interest and/ or royalty income.

   A counter-evidence facility applies.

To summarize: the Withholding Tax Act 2021 is meant for the situations described in 1. and 2. The third taxable event is meant for abusive situations where payments are routed via companies in a normal tax jurisdiction. The fourth and fifth taxable events target situations involving hybrid companies (i.e. entities taxed as a company in one state and treated as being transparent in another state, which then taxes the participants).

2.4 Grandfathering for tax treaty jurisdictions

With respect to low-tax jurisdictions or jurisdictions that are on the EU List with which the Netherlands has concluded a tax treaty (Panama, United Arab Emirates), a three-year grandfathering period applies during which the WHT will not apply. The Dutch Government will approach the relevant treaty partner to renegotiate and amend the respective treaty.

2.5 Date when the tax liability arises

The starting point is that the WHT is due not only when interest and royalties considerations are paid or offset, but also when the considerations are at the disposal of the Taxpayer (“ter beschikking gesteld”) or can be collected immediately (“vorderbaar en inbaar”).
To avoid abuse by way of deferrals, the WHT also applies to interest and royalties which have accrued during a tax period but are not yet payable. Here the taxable event will be dated 31 December of the tax period. A decree will be published confirming that the tax period will be equal to the calendar year. In other words, interest and royalties accrued during a calendar year – but not yet paid or collectable as meant above – must be taken into account on 31st December. This anti-abuse provision does not apply if payment was not possible because of liquidity problems of the debtor. Once WHT has been paid over the accrual, the actual payment is not taxed, to avoid double taxation.
Upward corrections if the interest or royalty payment is not at arm’s length (e.g., imputed interest), are also in scope of the WHT.

2.6 Levy of the WHT

The WHT Act targets the taxpayer, being the beneficiary of the interest or royalties, but is in principle levied from the associated company, paying the interest or royalty; that company must withhold the WHT (“further referred to as the Payor”). However, if the WHT has not been applied correctly and fully paid, the tax inspector may choose to issue an additional tax assessment to the Payor, or to the foreign company receiving the interest or royalty payment (“further referred to as the Recipient”).

2.7 Director’s liability

The new extended director liability included in the WHT Act 2021 entails a significant extension of the existing director liability regime. Under the normal legal framework governing constitution of a liability for director(s) it is required that the tax authorities prove mismanagement on account of the director(s). Mismanagement on account of the director(s) is assumed to materialize when:

1. the director(s) are rendering the notification of inability to pay too late; or,
2. given the circumstance no reasonably thinking director would have acted in the way the relevant director acted.

In contrast, under the WHT Act 2021, to ensure that the correct amount of WHT is paid, the current director(s) of the Payor, but also the current director(s) of the foreign Recipient will collectively be held jointly and personally liable for the (timely) payment of the correct amount of withholding tax. Moreover, the (foreign) director(s) will not be discharged from said WHT liability, arising under the WHT Act 2021, upon retirement or by stepping down as director. The (foreign) director(s) can exculpate themselves from the afore-mentioned WHT liability, if they can proof that they are imputable for not or not fully paying the correct amount of WHT.

In the explanatory notes to the WHT Act 2021 the legislator stipulates that the (foreign) director(s) can exculpate themselves when they have obtained timely a properly rendered tax opinion (should level) from an knowledgeable tax advisor, who is in the possession of all facts and circumstances relevant to the case. When the tax opinion concludes that a degree of risk exists that WHT is due, the tax opinion should probably also include an assessment to the arms' length character of the interest or royalty payment(s)

3. Conclusions

Legal entity structures engaged in financing and/or licensing activities, involving activities in listed jurisdictions as referred to under paragraph 2.2 are subject to a conditional WHT of 25%. Legal entity structures engaged in financing and/or licensing activities, involving activities in non-listed jurisdictions, claiming benefits from a tax treaty or EU directive should be carefully reviewed to determine, if in the context of the Withholding Tax Act 2021, the structure can potentially be qualified as abusive, to avoid adverse WHT consequences.

Moreover, legal entity structures engaged in financing and/or licensing activities need to be reviewed, in the context of the potential severe director liability issues, potentially arising from structures, not being compliant with the Withholding Tax Act 2021 for (foreign) director(s) when WHT is not or not fully paid.

Rotterdam, November 2020

Appendix 1: The List

As of 1 January 2020, the following jurisdictions are included on the list: American Samoa, Anguilla, Bahamas, Bahrain, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Fiji, Guam, Guernsey, Isle of Man, Jersey, Oman, Samoa, Trinidad and Tobago, Turkmenistan, Turks and Caicos Islands, United Arab Emirates, Vanuatu, and the US Virgin Islands.

Appendix 2: Substance requirements

1. At least half of the statutory (and decision making) board members of the taxpayer are a resident or should be factually located in the Netherlands.
2. The board members resident in the Netherlands have the required professional knowledge to perform their duties satisfactorily, which duties in any case include decision making, based on the own responsibility of the tax payer and within the context of normal group involvement, with respect to the transactions to be concluded, as well as taking care of a proper execution of the transactions to be entered into.
3. The taxpayer has qualified personnel at its disposal to properly execute and register the transactions entered.
4. The Dutch company should have an office space available (leasing or holding in property) for a period of at least 24 months. This office space should not only be rented (or held) but also be used in the Dutch company's operations and should be appropriate for its business activities.
5. The annual salary cost relating to the financing and/or licensing activities of the Dutch company should be at least €100K.
6. Board decisions are taken in the Netherlands.
7. The main bank accounts are managed and kept from the Netherlands.
8. Bookkeeping takes place in the Netherlands.
9. The taxpayer's business address is in the Netherlands.
10. The taxpayer is (to the best of its knowledge) not treated as a tax resident of another state.

Currently, Dutch companies predominantly (at least 70%) engaged in financing and/or licensing activities that can claim the benefits of a tax treaty or EU Directive must declare in their annual Dutch corporate income tax return whether a defined set of substance requirements is met. If one or more of these substance requirements are not met, detailed information on the intra-group financing and/or licensing activities must be provided to the Dutch tax authorities. The Dutch tax authorities may then spontaneously exchange this information with the relevant foreign tax authorities.

Under the Withholding Tax Act 2021, it seems no longer required that the activities of the company do predominantly comprise financing or licensing activities, to trigger the spontaneously exchange of information with the relevant foreign tax authorities.