

Israel Desk E-mail Bulletin

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Dutch Participation exemption and other tax measures – 2010 tax proposals

Introduction

On September 15, 2009 the Dutch government announced its tax proposals for 2010 ("2010 Tax Proposals"). This flash contains a summary of the most important tax measures proposed, being (i) amendments to improve the participation exemption regime and (ii) the patent box, (iii) an option to extend the loss carry back period to three years and (iv) the broadening of the exemption and refund possibilities in the dividend withholding tax. It is proposed that these tax measures take effect as of January 1, 2010.

In June 2009 the Dutch Ministry of Finance published a consultation paper proposing changes to the participation exemption and changes to the treatment of interest, including limitations on interest deduction and the introduction of a group interest box with an effective tax rate of 5% (see our Tax Flash no. 9). The proposed changes to the participation exemption of the consultation paper, with a few minor adjustments, are part of the 2010 Tax Proposals. The treatment of interest (including the introduction of a group interest box) has not been addressed in the 2010 Tax Proposals. The publication of a separate legislative proposal for the treatment of interest is expected before the end of 2009.

Ad (i) – Changes to the participation exemption regime

Currently, the participation exemption does not apply to an investment in a so-called 'low-taxed passive investment subsidiary'. In such case a credit system applies instead of the full participation exemption. A subsidiary is regarded a low-taxed passive investment subsidiary if the majority of its direct and indirect (through lower-tier subsidiaries) assets are of a passive nature ("Asset Test") and the subsidiary is not liable to a corporate income tax on its profits of at least 10% determined according to Dutch Tax standards ("Subject-to-Tax Test").

Reintroduction of the Motive Test

Prior to 2007, the motive of the taxpayer for holding shares in a (foreign) subsidiary was of importance to determine whether or not the participation exemption applied. The 2010 Tax Proposals reintroduce this motive test. Under the new rules, the participation exemption will not apply to domestic and foreign subsidiaries which are held as passive investments ("Motive Test"). The Asset Test and the Subject-to-Tax Test will remain in place in slightly amended and somewhat

**E-mail Bulletin no. 12,
16 September, 2009**

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The experience of the members as regards the Israeli market is combined with their extensive knowledge of international tax law, corporate structuring, banking and securities law, regulatory law, employment law. In addition to being part of the Israel Desk, the members also participate in Loyens & Loeff teams that focus on specific industries and sectors, such as energy, real estate, private equity, fund structuring, corporate finance, and financial products.

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simplified form. If the taxpayer can demonstrate that one of these tests is fulfilled, the participation exemption will apply even if the Motive Test is failed.

The Motive Test

A subsidiary is considered to be held as a passive investment if the taxpayer's objective is to obtain a return that may be expected from normal active asset management. If the taxpayer has a mixed motive, the predominant motive is decisive. According to the explanatory notes to the 2010 Tax Proposals, a subsidiary is not held as a passive investment if the subsidiary is engaged in the same line of business as the taxpayer. Subsidiaries of top holding companies with an active management function and subsidiaries (engaged in a business) of intermediate holding companies will not be considered to be held as passive investments.

The Motive Test is deemed not to be met if more than half of the subsidiary's consolidated assets consist of shareholding(s) of less than 5% or if the predominant function of the subsidiary – together with the function of lower tier subsidiaries – is to act as a group finance company. Whether a captive insurance company is held as a passive investment will depend, according to the explanatory notes to the 2010 Tax Proposals, on whether the captive deals under at arm's length conditions, whether it has qualified personnel and whether it is subject to local regulatory supervision.

The Subject-to-Tax Test

Under current law this test requires a 10% effective tax rate determined according to Dutch standards. The 2010 Tax Proposals replace the current test with a requirement that the subsidiary is subject to a 'realistic levy' by Dutch Tax standards. According to the explanatory notes to the 2010 Tax Proposals this is the case if the subsidiary is subject to a profits-based tax with a regular statutory rate of at least 10%. In principle, it will no longer be necessary to calculate the effective tax rate according to Dutch Tax standards. Tax base deviations, such as deviations resulting from different depreciation rules, special investment deductions, loss compensation or tax consolidation rules will not cause a tax to disqualify as a realistic levy. However, according to the explanatory notes to the 2010 Tax Proposals tax base differences caused by, e.g., tax holidays or deductible dividends may cause a levy to disqualify as a realistic levy. The same is true in cases where taxation is deferred until profits are distributed and in situations in which locally a participation exemption system applies that is significantly broader than the Dutch system.

The Asset Test

The current Asset Test will not change substantially. As under current law, the Asset Test will be met if the taxpayer demonstrates that less than 50% of its directly and indirectly held assets consist of passive assets. However, a number of categories of assets that currently qualify as passive assets will no longer be qualified as such under the 2010 Tax Proposals, such as real estate, assets that are used in an active leasing business and assets the income of which is subject to a profits-based tax which results in a 'realistic levy' by Dutch Tax standards (same meaning as for purposes of the Subject-to-Tax Test). As under current law, intragroup receivables are in principle passive assets, unless they are used by an active group finance company or are financed (90% or more) by third party debt or are subject to a profits-based tax which results in a 'realistic levy' by Dutch Tax standards.

Ad (ii) – Innovation box

Under the so-called patent box, income from patented intangibles developed by the taxpayer is currently taxed at an effective tax rate of 10%. To make the patent box, which will be renamed 'innovation box', more attractive, three amendments are proposed:

1. The effective tax rate in this box will be reduced from 10% to 5%.
2. The total net proceeds which may be taxed over the years at the 5% innovation box rate will no longer be capped at four times the total amount of research and development expenses of the intangible assets included in the innovation box. Also the cap of € 400.000 for intangible assets that result from certain research and development projects will be abolished.
3. The innovation box will no longer apply to operational losses, which will thus be deductible at the regular tax of 25.5%, subject to recapture, i.e. the 5% innovation box rate will only apply after recovery of those losses and expenses at the regular tax rate.

The requirement that the intangible assets have to be self-developed remains in place.

Ad (iii) – Election for loss carry back period of three years

In order to offer the Dutch trade and industry additional liquidity, the 2010 Tax Proposals allow taxpayers to elect for an extension of the loss carry back period to three years (instead of one year). The election is only available for losses suffered in the taxable years 2009 and/or 2010. If a taxpayer makes use of the election, which can be done in the annual tax return, two additional limitations apply:

1. The loss carry forward period for the taxable years 2009 and/or 2010 will be limited to a maximum of six years (instead of nine years).
2. The maximum amount of loss that can be carried back to the second and third year preceding the taxable year will be limited to €10 million per year. The amount of loss that can be carried back to the year directly preceding the taxable year for which the election is made will remain unrestricted.

Ad (iv) – Dividend withholding tax

Dividends paid to parent companies in Norway and Iceland with a shareholding of at least 5% in a Dutch subsidiary will be exempt from dividend withholding tax in a way similar to dividends paid to parent companies in EU Member States. Moreover, tax exempt entities (such as pension funds) that are resident in Norway and Iceland will be able to claim a refund of Dutch dividend withholding tax (under the condition that they are comparable with Dutch exempt entities). In addition, two general requirements under the Parent-Subsidiary Directive for applying the exemption from dividend withholding tax, i.e. that the parent company has a qualifying legal form and that it is subject to tax, will be abolished. However, the exemption will not apply if the parent is subject to a tax regime similar to a Dutch investment institution.

Members of the Israel Desk visit Tel-Aviv on a regular basis. If you would like to make an appointment or would like to receive more information with respect to the above, please feel free to contact jeroen.janssen@loyensloeff.com or any other member of the Israel Desk.

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