

Israel Desk E-mail Bulletin

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INTRODUCTION

This Year End Tax Bulletin summarises the most significant tax developments that took place in the Benelux region during 2008. In addition, it highlights some of the legislative changes announced for 2009. It focuses on developments and changes that are relevant for internationally operating companies. Given the general nature of this Tax Bulletin, the information contained in this publication should not be regarded as a substitute for detailed legal advice. You are however most welcome to contact us if you would like to receive more information on any of the below topics.

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PART I – THE NETHERLANDS

1. Reduction of Dutch corporate income tax rates

The 2009 Tax Budget includes a reduction of the Dutch corporate income tax rate with retroactive effect to 1 January 2008:

Taxable amount (€)		Original rates for 2008	Amended rates for 2008	Rates for 2009 and 2010
-	40,000	20.0%	20.0%	20.0%
40,000	200,000	23.0%	20.0%	20.0%
200,000	275,000	25.5%	20.0%	25.5%
275,000	-	25.5%	25.5%	25.5%

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Loyens & Loeff
Fred. Roeskestraat 100
1076 ED AMSTERDAM
T: +31 20 578 57 85
F: +31 20 578 58 20



For a company with a taxable profit of more than € 275,000 and its book year equal to the calendar year, the reduction means a saving of € 8,925 in 2008 and € 4,800 in 2009 compared to the original rates for 2008.

2. Reintroduction of accelerated and random depreciation

The Dutch Government decided to temporarily reintroduce accelerated and random depreciation, in order to stimulate investments. Investments made between 1 January 2009 and 31 December 2009 may be depreciated in two years; with a maximum of 50% in 2009 and 50% in 2010. The accelerated and random depreciation is applicable to most business assets (exceptions amongst others apply to industrial buildings and immaterial fixed assets like software).

3. Deductibility Stock Appreciation Rights

In view of limitations on the deductibility of costs related to stock option plans, many companies introduced Stock Appreciation Rights (“SARs”) instead. However, as from 1 January 2009, SARs will also no longer be deductible for Dutch corporate income tax purposes if the annual salary of the employee concerned exceeds € 500,000. Transitional rules apply to SARs granted prior to 1 January 2009 if taxation hereon takes place before 1 January 2010.

4. Changes to the tonnage tax scheme

The Dutch tonnage tax scheme replaces the commercial profit of qualifying shipping companies by a notional profit based on the net tonnage of the vessels operated. The 2009 Tax Budget proposes to reduce the tonnage rates for larger vessels, i.e. in excess of 50,000 tons. The tonnage rates for the year 2009 will be as follows:

<i>Notional profit amount per day per 1,000 net tons</i>	<i>Original rates for 2008</i>	<i>Rates for 2009</i>
up to 1,000 net tons	€ 9.08	€ 9.08
between 1,000 and 10,000 net tons	€ 6.81	€ 6.81
between 10,000 and 25,000 net tons	€ 4.54	€ 4.54
between 25,000 and 50,000 net tons	€ 2.27	€ 2.27
<i>in excess of 50,000 net tons</i>	€ 2.27	€ 0.50

Another measure relates to management activities under the tonnage tax scheme. Previously, the application of the tonnage tax scheme to management activities meant that the management fees were effectively not deductible and in certain cases, the notional tonnage tax profit for ship managers appeared to be higher than the commercial profits realised. As such, it is now proposed to reduce the tonnage tax basis for the ship manager to 25% of the notional tonnage tax profit of the managed vessels (calculated in accordance with the rates summarised above).

These measures will apply with retroactive effect as from 1 January 2009, once approval has been obtained from the European Commission.

5. Simplification of the Packaging Tax

As from 1 January 2008, the Netherlands levies a tax on packaging materials (the “**Packaging Tax**”). This tax is levied on the total weight of the packaging, measured in kilograms. The applicable rate depends on the use of packaging materials (for example sales packaging or transport packaging) and the kind of packaging material (for example plastics, wood or paper). The Dutch corporate sector strongly criticized the introduction of the Packaging Tax because it increases the administrative burden of the companies. After consultation of the corporate sector, a number of simplifications were introduced by the Ministry of Finance in the 2009 Budget. A summary of the most important measures can be found on our [website](#).

6. New guidelines for application of Dutch participation exemption

On 26 February 2008, a decree was published on certain topics related to the application of the Dutch participation exemption (the “**Decree**”). The Decree has retroactive effect as from 1 January 2007.

The Dutch participation exemption provides for a full exemption of all benefits (dividends and capital gains) derived from a qualifying shareholding in a subsidiary. A shareholding in a subsidiary generally qualifies for the participation exemption if it represents 5% or more of the nominal issued paid-up capital of the subsidiary, unless the subsidiary is a low-taxed passive investment company (“**LTPIC**”). A subsidiary is not an LTPIC if, amongst others, its assets, together with the assets of any lower-tier subsidiary, qualify for 50% or less as passive investments (the “**Asset Test**”). For purposes of this test, (the pro rata part of) all assets of all (first-tier, second-tier, etc.) subsidiaries in the chain of ownership must be added, and must be earmarked as either active or passive. A real property holding company is generally not an LTPIC. A subsidiary is considered a real property holding company if its assets on a consolidated basis (including the assets owned by lower-tier subsidiaries, other than assets held by subsidiaries that qualify as Dutch REITS) consist of 90% or more of real property. Hence, a shareholding of 5% or more in such entity will qualify for the participation exemption.

The Decree clarifies that for purposes of the Asset Test:

- real property owned by a subsidiary and leased to an affiliate engaged in an active trade or business, is not a passive investment, provided that the lessor directly or indirectly owns the lessee or vice versa or both are held, directly or indirectly, by the (lower-tier) subsidiary;
- a receivable held by subsidiary A on affiliate B is not a passive investment if such receivable is matched by an intra-group loan from another affiliate, C, provided A directly or indirectly owns C or vice versa or both are held, directly or indirectly, by the (lower-tier) subsidiary; and
- trade receivables with a term of less than 3 months arising in the conduct of an active trade or business are not passive investments.

The Decree also clarifies that real property includes (i) certain rights on real property such as long leases, building rights and rights of servitude and comparable rights existing under non-Dutch law, and (ii) the full economic ownership of real property.

7. Tax measures against “excessive remuneration” elements

Recently a legislative proposal on “excessive remuneration” elements was adopted by the Dutch Senate.

This proposal includes the following measures:

- an employer taxation of 30% on excessive redundancy payments;
- an employer taxation of 15% on back service pension contributions; and
- a taxation of carried interest, sweet equity and similar forms of remuneration (“**lucrative interests**”).

Employer taxation on excessive redundancy payments

As from 1 January 2009, an employer taxation of 30% applies to excessive redundancy payments, in case of termination of employment on or after 1 January 2009. A redundancy payment will only be regarded as “excessive” if:

- the annual salary of the employee exceeds € 500,000; *and*
- the redundancy payment amounts to more than one annual salary.

Employer taxation on back service pension contributions

As from 1 January 2010, an employer taxation of 15% applies to back service pension contributions if and insofar as pension rights are built up based on a final pay scheme (*eindloonregeling*) and the pensionable salary exceeds € 500,000 per annum. This taxation will entirely be at the expense of the employer. The taxation of pension rights will not change for the employee. This tax measure will enter into force on 1 January 2010, allowing employers a fair period of time to adjust pension commitments.

Taxation of lucrative interests

As from 1 January 2009, a new tax regime will be effective in respect of shares, receivables or rights with similar economic characteristics, jointly referred to as “lucrative interests”. This regime will also apply to existing remuneration arrangements that are considered “lucrative” and, as such, has retroactive effect.

Shares constitute a lucrative interest if there are various classes of shares and either (i) the shares held by the taxpayer rank junior to other classes of shares and the class of shares held by the taxpayer constitute less than 10% of the total paid-in share capital, or (ii) the taxpayer owns preference shares with a preferred dividend of at least 15% per annum. Receivables constitute a lucrative interest if the yield depends on 15% or more of managerial or shareholder targets such as profit, turnover, EBIT, cost reduction, realisation of an exit and so on. In addition, the new regime for lucrative interests also applies to loans payable which may be (in whole or in part) waived by the creditor and it can reasonably be assumed that such waiver is meant to form a remuneration for services rendered by the taxpayer or certain related persons. Finally, there is a catch-all provision for rights that, from an economic perspective, resemble the shares or receivables set out above, as well as other rights or obligations that may increase in value dependent on satisfaction of managerial or shareholder’s targets.

Any income derived from these lucrative interests will, in principle, be taxed as ordinary income in box 1 at progressive rates up to 52%, if such lucrative interest is held directly by the employee. In principle, the new regime will also apply to non-resident taxpayers if the lucrative interest is meant to form remuneration for services rendered in the Netherlands (subject, however, to the provisions of an applicable tax treaty for the avoidance of double taxation).

It is, however, possible to escape from box 1 taxation, if:

- the lucrative interest is held indirectly by a holding company, in which the taxpayer owns a substantial interest (generally an interest of 5% or more); and
- the net income derived by the holding company from the lucrative interest is passed on for at least 95% to the taxpayer within the same calendar year.

If the taxpayer and/or the holding company are a tax resident of the Netherlands, this will result in box 2 treatment (25% income tax). If both the taxpayer and the holding company are a non-resident, this will result in no taxation in the Netherlands on the lucrative interest. Needless to say it is important that any non-Dutch tax consequences must be observed when interposing an entity.

8. Adoption of the VAT Package

In February 2008, the European Council adopted a wide range of changes in the VAT rules, known as the "VAT Package". The VAT Package will come into force in the EU Member States as of 1 January 2010. However, taxpayers may want to take action in 2009 to prepare themselves for this new VAT regime.

Change place of supply business to business services

Currently, all services (both business to business services, as well as business to consumer) are generally subject to VAT in the country of residence of the service provider. This general VAT rule on the supply of 'business to business services' will change as of 1 January 2010. As of that date, the general rule will be that services performed to VAT entrepreneurs will be subject to VAT in the country of residence of the recipient of the services by means of the reverse charge mechanism, i.e. the VAT obligations are shifted from the service provider to the service recipient, including the obligation to report the amount of reverse charge VAT.

Under the revised VAT rules, special place of supply rules will be introduced regarding (among others) services connected to immovable property, cultural, educational and sporting services, as well as restaurant services. In addition, the EU Member States will have the option to treat services performed outside the EU as services as being performed within their territory based on the regular rules of supply, provided that the effective use and enjoyment of such services takes place within their territory.

Listing for services

Suppliers of services will have to submit a listing of all services that are subject to VAT in other EU Member States by means of the reverse charge mechanism.

Eighth Directive refund requests

The rules regarding requests of EU-based VAT entrepreneurs for a refund of VAT in other EU Member States will change. As of 1 January 2010, EU-based VAT entrepreneurs will have to file these requests electronically with the tax authorities in their country of residence.

PART II – BELGIUM

1. Confirmation of the Notional Interest Deduction Regime

Last year, there were rumours that the Belgian Government intended to amend the Notional Interest Deduction Regime (“**NID Regime**”) as the budgetary impact was higher than expected. Both the Prime Minister and the Minister of Finance have on several occasions denied with great emphasis these rumours. The Belgian Tax Administration moreover issued a circular letter on 3 April 2008 (the “**Circular Letter**”) confirming and clarifying the NID Regime. Following the publication of this Circular Letter, there now exists more legal certainty as to the NID Regime and the applicable anti-abuse provisions.

The main items from the Circular Letter can be summarised as follows:

- The general anti-abuse provision and the sham doctrine can only be applied in exceptional circumstances to challenge the notional interest deduction.
- The Tax Administration takes the position that specific case law on so-called cash-drain transactions also applies to Belgium companies borrowing funds to capitalise a subsidiary using the NID Regime. This case law (dealing specifically with certain types of options) limits the tax deductibility of expenses made exclusively with the aim of saving taxes, e.g. base erosion. We note that this position of the Tax Administration is considered highly controversial.
- The notional interest deduction does, as other tax deductions, not apply to the part of the profit originating from “economic abnormal transactions”. The Tax Administration takes the position that the establishment of a company or the increase of the share capital in a company must be justified by economic / business reasons. If no such reasons are considered present, the notional interest deduction may be denied. While the accuracy of this position is also questionable, it emphasises the importance of economic substance that is given to certain structures.

PART III – LUXEMBOURG

1. Reduction corporate income tax rate

On 22 May 2008, the Luxembourg Prime Minister announced a gradual reduction of the corporate income tax rate from the current rate of 29.63% to, ultimately, a rate of 25.5%. The Prime Minister announced that the rate reduction would be accompanied with a broadening of the corporate income tax base at the same time. The Luxembourg corporate income tax rate actually consists of nation-wide corporate income tax at 22% on which a surcharge of 4% is levied and local business tax which rate varies per community and is 6.75 for Luxembourg City. The stated rate of 29.63% is the current general combined rate for Luxembourg City. The first step of the reduction will have effect as of 2009 and decreases the nation wide corporate income tax rate to 21%, which will result in a general combined rate for Luxembourg City of 28.59 %.

2. Abolishment capital duty

On 22 May 2008, the Luxembourg Prime Minister announced the abolishment of Luxembourg capital tax as of 2009. A fixed registration duty of € 75 will be introduced for (i) incorporation of Luxembourg entities (ii) amendment of the bylaws of Luxembourg entities and (iii) the transfer of the statutory or actual seat to Luxembourg. Contributions to Luxembourg entities of real estate situated in Luxembourg will be subject to 1.2% registration duty and 0.5% transcription duty in case the contribution is rewarded by shares and to 6% registration duty and 1% transcription duty in other cases. An exemption will be available for qualifying reorganisations.

3. 80% tax exemption for income from intellectual property

On 1 January 2008, Luxembourg introduced a special tax regime for income from intellectual property (the “**IPR Regime**”), based on which an 80% exemption can be obtained for net income and net capital gains arising from the exploitation of intellectual property. This IPR Regime thus results in a reduction from the general combined corporate income tax rate of 29.63% (Luxembourg City) to 5.93% effectively. This effective rate is further reduced to 5.71% for 2009 as a result of the proposed decrease in the statutory income tax rate.

The IPR Regime exempts 80% of net income received as consideration for the use or the authorization to use (i) copyrights on software, (ii) patents, (iii) trademarks, (iv) designs, and (v) models. On 1 October 2008 it was proposed to apply the IP-regime also to domain names. In order to avoid possible abuse, the IPR Regime stipulates that the exemption is not applicable to intellectual property that is acquired from related companies. Related companies are defined for this purpose as companies that (A) own directly at least 10% in the capital of the taxpayer, (B) are owned directly for at least 10% by the taxpayer, or (C) are owned directly for at least 10% by a third company that also holds at least 10% directly in the taxpayer.

It appears that the European Commission raised provisional questions with regard to the state aid character of the IPR Regime. The status of the discussion is currently unknown. If the regime would qualify as prohibited state aid, all tax benefits obtained under the IPR Regime must in a worst-case-scenario be repaid.

4. Broadening exemption from dividend withholding tax

On 1 October 2008, a bill was proposed introducing a reduction of Luxembourg withholding tax rate to 0% for dividends or interest on profit participating securities paid to qualifying parent companies. A parent company will be “qualifying” if such company:

- is considered a tax resident in a country with which Luxembourg has concluded a tax treaty for the avoidance of double taxation;
- is subject to a tax comparable to the Luxembourg corporate income tax regime; and
- owns (or commits itself to own) a shareholding of at least 10%, or having an acquisition cost price of €1.2M, for a period of at least 12 months.

5. Holder of call option entitled to participation exemption

The Luxembourg Administrative Court held in its decision of 26 June 2008 that a holder of a share purchase option is entitled to the Luxembourg participation exemption for dividends received as a result of assignment by the writer of the option, if (i) the option holder has voting rights in the shareholders meeting, (ii) the option gives full economical ownership to the underlying shares, and (iii) the option is likely to be exercised. In general the Administrative Court takes the position that economic ownership is more important than legal ownership for purposes of applying the participation exemption.

PART IV – EU ASPECTS

1. Cross border fiscal unity

On 11 July 2008, the Dutch Supreme Court issued its decision in a case involving cross-border tax grouping or cross-border fiscal unity. The Dutch Supreme Court decided to refer the case to the European Court of Justice (the “ECJ”) for a preliminary ruling. Under conditions, Dutch companies can by request form a so-called fiscal unity. Entities within a fiscal unity are treated as one single taxpayer for Dutch corporate income tax purposes. Corporate income tax will in that case be levied from the parent company. One of the conditions to form a fiscal unity is that the companies have a Dutch legal form and are also effectively managed from the Netherlands. It is therefore not possible to form a fiscal unity with other EU based entities. A Dutch holding company filed a request with the Dutch tax authorities to form a fiscal unity with its Belgium subsidiary. The tax authorities rejected this request.

After describing the framework of the Dutch legislation, the Supreme Court investigated whether a restriction of the freedom of establishment is present and furthermore, whether such restriction can be justified by the grounds accepted by the ECJ in Marks & Spencer. The Supreme Court was not convinced that the restriction would be justified. The Court noted that it should be possible to make minor adjustments to the current domestic legislation to ensure a balanced allocation of taxing powers and to avoid a risk of double loss compensation and tax evasion. The Supreme Court pointed out that it is uncertain whether Community law would force the Netherlands to adjust its system (for example, by introducing loss recapture rules in respect of cross border loss compensation within cross border tax groups) or whether it is sufficient under Community Law that the restricting rules as they currently stand fall within the scope of the Marks & Spencer justification grounds. In conclusion, the Supreme Court referred the question to the ECJ whether Article 43 EC in conjunction with Article 48 EC precludes the domestic legislation as set out above.

2. Limit on the recovery of input VAT on costs attributable to non-economic activities

On 13 March 2008, the ECJ rendered its decision in the Securenta case (C-437/06) concerning the question whether a VAT-entrepreneur can recover the input VAT on costs directly attributable to non-economic activities. Securenta is a VAT-entrepreneur that performs economic activities consisting of acquiring, managing and selling real estate. Securenta also performs non-economic activities for VAT purposes consisting of acquiring, holding and selling securities, financial holdings and investments of all types. The capital required for these economic and non-economic activities was acquired by Securenta by the issuance of (own) shares. Securenta argued that the input VAT for the costs

connected with the acquisition of new capital could be recovered because the issue of shares was linked to the reinforcement of the company's capital and therefore had benefited the economic activities of Securenta in general.

The ECJ decided that Securenta can recover the input VAT on costs connected with the issuance of shares to the extent that these costs are attributable to the performed (VAT taxed) economic activities. However, the input VAT on costs that are directly attributable to the non-economic activities performed by Securenta (the acquisition, holding and sale of securities) cannot be recovered. This decision of the ECJ could affect the recovery of input VAT by VAT-entrepreneurs that from a VAT point of view also perform non-economic activities, e.g. the holding of securities.

3. Cross border merger legislation implemented in the Benelux

In 2008, the Belgian and Dutch Parliament each approved a bill regarding the implementation of the Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies. As such, a company incorporated under the laws of Belgium and the Netherlands can merge with a company incorporated under the laws of another Member State of the EU or the EEA. In Luxembourg, the implementation process is underway; a bill is currently before the Luxembourg Parliament. For other variations of cross-border mergers which are not regulated by domestic laws, European case law (more specifically the SEVIC judgement of the ECJ of December 2005) may offer comfort. This case law is based on the freedom of establishment and is generally broader in scope than the different domestic laws.

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