LOYENS LOEFF

Oil & Gas Newsletter

7 December 2009

**Topics covered by this Newsletter**

This Newsletter adresses the letter of the Dutch State Secretary of Finance dated 5 December 2009 with respect to the progress of the topics mentioned in the Consultation Paper on 14 June 2009, as well as to some other topics.

**Introduction**

On 5 December 2009, the Dutch State Secretary of Finance sent a letter (as a follow-up to the Consultation Paper released on 14 June 2009) to Dutch Parliament in which he announced that he has abandoned plans to introduce the long anticipated mandatory group interest box and certain measures to restrict the deductibility of interest in the near future. The feasibility of these measures may be taken into account in a broader study of the Dutch tax system which is currently subject of a specific Study Committee. Instead, the government considers introducing a limitation on the deductibility of losses of foreign permanent establishments. According to an accompanying press release from the government, a legislative proposal is expected in the first half of 2010.

Below we briefly set out the topics addressed in the relevant letter. These topics will also be addressed during our Seminar of coming Wednesday.

**Consultation Paper – Progress**

As mentioned in our Oil & Gas Newsletter dated 17 June 2009, the topics addressed in the Consultation Paper included:

a. a reduced effective corporate tax rate with respect to group financing income and expense and proceeds derived from a 'war chest';

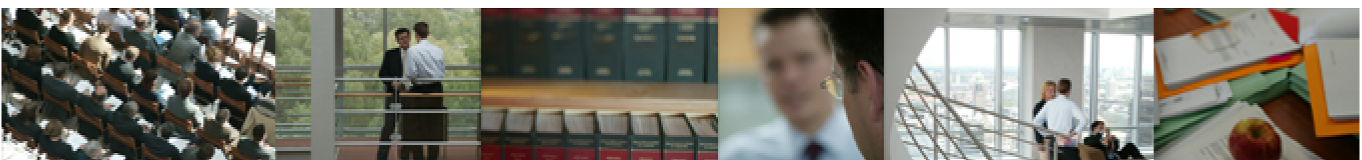
b. a partial disallowance of group and third party financing charges. In this regard, the Consultation Paper proposes two alternative regimes:

   i. a provision which specifically targets financing expenses if they meet certain criteria, or
   ii. an 'earnings stripping' provision;

and,

c. simplification of the participation exemption requirements.

With respect to the measure proposed under a. it has become clear to the government that a mandatory group interest box could possibly have negative consequences for (foreign) investments in the Netherlands. If the proposal is amended to counter this effect, it is questionable whether the revised proposal would still fall within the scope of the European Commission's approval of the mandatory group interest box. The government wants to introduce a mandatory group interest box only if the negative effects on the investment climate for (foreign) investment in the Netherlands can be avoided. Based on the current insights, however, the government has significant doubts whether this is possible and, therefore, has abandoned plans to introduce the mandatory group interest box for the time being.



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The measure proposed under b. has been put off. After consideration, the government has doubts as to whether (certain aspects of) both measures are compatible with EC law.

As mentioned in our Oil & Gas Newsletter dated 16 September, the relaxation of the participation exemption regime has been included in the 2010 Tax Proposal.

**Limitation on Deductibility of Foreign Branch Losses**

Dutch companies can set off losses of foreign permanent establishments against their Dutch source profits. These foreign losses are recaptured to the extent that the foreign permanent establishment generates profits in a later year. Although this concerns a timing benefit for taxpayers, the government considers that in practice the recapture can be postponed indefinitely, for instance by converting a permanent establishment into a subsidiary. Furthermore, the government is of the view that the regime leads to a compliance burden for both taxpayers and the Dutch tax administration. In addition, the government raises the more fundamental question whether foreign losses should be included in the Dutch tax base. The government therefore considers introducing a measure which entails that losses of a foreign permanent establishment are not deductible. Losses realized on the termination of a foreign permanent establishment would remain tax deductible.

**Impact on E&P Industry**

The limitation on deductibility of foreign branch losses could especially have impact on the E&P industry. Under the existing rules, Dutch corporate may deduct foreign branch losses from their Dutch tax base. When the branch starts realising profits, these losses have to be recaptured for the purpose of the avoidance of double taxation. In case of E&P activities, the exploration (loss) phase does in many cases not lead to production. The deduction of losses arisen from failed exploration is final. For taxpayers with merely foreign explorations this is not of any additional value, as they will never be able to use the losses. However, for taxpayers with Dutch taxable income, the final deduction of exploration losses is beneficial, as these taxpayers will be able to set off the final exploration losses against the Dutch profits. The proposed rule could therefore possibly have negative consequences for taxpayers that have both foreign exploration activities and Dutch operations, as these taxpayers would no longer be allowed to set off their foreign branch losses against their Dutch income.

For the impact of the measures mentioned in the Consultation Paper, please refer to our Oil & Gas Newsletter of 17 June 2009.

For further information with respect to the above, please feel free to contact any of the members of the Loyens & Loeff Energy Team.

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