

Tokyo Tax Newsletter December 2009

Introduction

This is the January 2010 edition of our periodical Tokyo Newsletter Tax. This Newsletter is intended for Japanese businesses investing in or through the Netherlands, Belgium, Luxembourg, Switzerland and the EU. It provides a summary update of tax developments in the Kingdom of the Netherlands and touches on developments in Belgium, Luxembourg, Switzerland and the European Union.

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The Netherlands

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Introduction

On September 15, 2009 the Dutch government announced its tax proposals for 2010 ("2010 Tax Proposals"). It is proposed that these tax measures take effect as of January 1, 2010.

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 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

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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.

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.

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.

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.

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Belgium

Budget 2010

In October 2009, the 2010 budget proposal, which contains a number of tax measures, was presented by the Belgian Prime Minister. The main tax measures can be summarised as follows:

Corporate income tax

- Rate for notional interest deductions will be limited to 3.8% for tax years 2011 and 2012;
- Dividends received deduction regime:
 - The lump sum participation requirement will be increased from EUR 1.2 million to EUR 2.5 million (the alternative participation requirement of 10% in the share capital of the subsidiary will remain unchanged);
 - The participation requirement will be extended to banks, insurance companies and stock exchange companies.

Measures to combat tax fraud:

- The general anti-abuse provision (article 344 ITC) will be rewritten along the lines of the anti-abuse provision of the act of 11 December 2008 implementing the Merger Directive to make it more effective and to increase legal security;
- Payments made (directly or indirectly) to tax havens and uncooperative jurisdictions will have to be reported; and
- Payments made (directly or indirectly) to uncooperative jurisdictions will not be tax deductible.

Value Added Tax

- The sale of land will be subject to VAT (21%) if the land is sold with a building. This measure will bring Belgium in compliance with the 2008 ECJ decision in the Breitsohl case (C-400/98). The new measure will be implemented after consultation with the regions and become applicable in 2011.
- To facilitate electronic invoicing, electronic invoices will be put on an equal footing with paper invoices by implementing technology-neutral VAT invoicing requirements.
- If a taxpayer does not file a timely VAT return or pay his VAT liability in a timely manner, the Belgian administration will initiate a procedure whereby a special account is opened on behalf of the taxpayer. The Belgian administration intends to accelerate this procedure with a view to proceeding faster with collection measures.
- In view of the extended reporting for intra-Community transactions for services as from 1 January 2010 within the framework of the VAT Package, the Belgian government expects to collect EUR 60 million in additional revenue per year.
- The Belgian administration will start or continue with a number of specific control measures (for example, with respect to benefits in kind, fraud with VAT credits, etc.).

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New administrative circulars on participation exemption regime

The Belgian tax authorities published two administrative circulars on the applicability of the participation exemption regime.

Belgium has implemented the Parent-Subsidiary Directive by first including qualifying dividends received in the taxable profits of a Belgian parent company and, subsequently, granting the Belgian parent company a dividend received deduction of 95% of the qualifying dividends. However, the dividend received deduction is limited to the net operating profits, meaning that any 'excess' dividend received deduction cannot be used and does not increase the tax losses of the Belgian parent company. Thus, any 'excess' dividend received deduction cannot be used, nor can it be carried forward. The overall effect of the limitation of dividend received deduction is that the net operating losses of the parent company cannot be offset against future taxable profits.

The circulars confirm that excess dividends received deductions related to qualifying dividends (from within EU Member States and/or from certain third countries with which Belgium has concluded a double tax treaty) may be carried forward. For the carry forward to apply to the latter category, the relevant tax treaty should provide for the same treatment as would apply to dividends paid between Belgian companies (i.e. the treaty would need to have an equal treatment clause in the article relating to methods for the elimination of double taxation).

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Treaty update

Belgium signed a new protocol to the already existing double taxation treaty with Australia, allowing for a full exchange of federal tax information between the two countries.

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Luxembourg

Applicability of EU Parent Subsidiary Directive to Financial instruments

The Luxembourg Administrative Appeals Court has confirmed in June 2009 its interpretation of the compatibility of financial instruments with the Parent Subsidiary Directive as implemented in Luxembourg. In view of the Court, the stake of the holder of certain financial instruments (i.e. call options in the case hand) should be considered to qualify for the application of the Luxembourg participation exemption, as long as the holder of the instruments holds the rights attached to such instruments for its own account (i.e. voting rights, financial risk, dividend rights). This extensive interpretation of the Parent Subsidiary Directive in Luxembourg tax legislation confirms the flexibility provided by Luxembourg for tax planning and structuring with the use of various financial and derivative instruments.

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Luxembourg back on the OECD 'White List'

According to the press release on the OECD's web site, Luxembourg has been removed from the OECD Grey List (i.e. jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented it) and has been promoted to the OECD's 'White list'. The Luxembourg government announced it intends to continue negotiating agreements and hopes to bring the number of double taxation treaties which meet the OECD standards to 20 before the end of the year.

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Treaty update

At the end of July 2009, Luxembourg signed a double tax treaty with Monaco, which incorporates the provisions for exchange of information between the two countries' tax authorities in accordance with the OECD standard.

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Switzerland

Switzerland promoted to OECD 'White List'

Pursuant to the conclusion of new double tax treaties and amendments to existing double tax treaties, Switzerland now has concluded a total of twelve double tax treaties in compliance with the OECD Model Convention. Consequently, Switzerland will now be removed from the OECD 'Grey List' of countries deemed uncooperative in international tax matters, and will be placed on the OECD's much-coveted 'white list' of countries that have fulfilled the OECD's requirement to conclude twelve tax information exchange agreements, providing for administrative assistance in tax matters under Article 26 of the OECD Model Convention.

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Treaty update

- Switzerland and Qatar signed a double tax treaty on income based on the OECD Model Convention. The treaty will be effective as per January 1 of the year following the year of entry into force (ratification of both states required);
- New protocol to the double tax treaty between Switzerland and USA. The main amendment relates to the "exchange of information clause". Information will be exchanged on specified request by one of the states. Such request must include specific information on the subjected person, the time period which it relates to, the purpose of the request and its relevance. The new exchange of information scheme applies immediately, i.e. as of September 23, 2009;
- New protocol to the double tax treaty between Switzerland and the UK. As with the US, a clause has been included on the exchange of information, pursuant to Swiss treaty policy, where information will be exchanged only on specific request. The new provision will be effective only as of January 1, 2011, after ratification by both countries;
- Similar exchange of information clauses as have been included in the protocols to the tax treaties with the USA and the UK, have been included in the protocols to the tax treaties concluded by Switzerland and Finland, Norway, Mexico, Austria, France, Denmark and Luxembourg.

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EU developments

ECJ ruling regarding input VAT attributable to the sale of subsidiaries

On 29 October 2009 the European Court of Justice ('ECJ') delivered its judgement in the SKF case. The ECJ ruled that the input VAT on expenses which are directly linked to the sale of shares in subsidiaries to an EU-based purchaser cannot be deducted and, therefore, is an actual cost for the seller. However, this does not necessarily mean that all input VAT incurred in relation to a share sale is never deductible: some input VAT may, under certain circumstances, be recoverable. According to the ECJ a right to deduct may exist either if the sale of shares qualifies as a transfer of a going concern or if the costs are attributable to the general business activities of the (active) holding company. This decision will have impact on and may create opportunities for VAT-taxable persons who have sold or will sell shares in other companies.

Consequences for the Benelux practice

Although the decision of the ECJ limits the deductibility of input VAT on expenses that are directly attributable to the sale of shares within the EU, it also offers opportunities.

For some years, Belgium has allowed the deduction of VAT in the case of issuance and the acquisition of shares necessary for the management of group companies. As a result of the SKF case this will also be possible in relation to business reorganisation involving sale of shares.

Until now, the Luxembourg VAT administration has been quite reluctant regarding the deduction of the VAT incurred in connection with shares. This case could thus offer some opportunities for the taxpayers, especially active holdings, and this should be monitored taking into account the circumstances at hand.

In the Netherlands, an active holding company is under certain circumstances already allowed to deduct the input VAT on the sale of shares on its pro rata basis. This decision of the ECJ will limit the deduction insofar as the costs are directly attributed to the sale of the shares. On the other hand: the ECJ ruling also provides additional options to reclaim VAT if subsidiaries are sold.

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