

## Brazil Desk Email Bulletin

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### **Dutch government abandons plans for mandatory group interest box and proposed limitations on interest deduction; proposal to limit interest deduction for acquisition holdings only and to restrict deductibility of PE losses**

On 5 December 2009, the Dutch government sent a letter (as a follow-up to the Consultation Paper released on 15 June 2009) to Parliament in which it announced that it has abandoned plans to introduce a 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 proposes to proceed only with a measure to limit the deductibility of interest incurred by acquisition holdings. In addition, 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.

#### *Interest deduction limitation for acquisition holdings*

This measure was also included in the Consultation Paper. The acquisition of Dutch target companies is often structured through a so-called acquisition holding, which finances the acquisition of the Dutch target company with (third party or group) debt. By forming a fiscal unity between the acquisition holding and the Dutch target, the interest expense on the acquisition debt can be used to set off against the operating profits of the Dutch target, thus reducing the Dutch tax base. The government intends to address the perceived tax base erosion and anti-competitive effects of this structure by introducing a measure which entails that, after the formation of a fiscal unity between the acquisition holding and the target company, the interest on the (third party or group) debt related to the acquisition of the target company cannot be set off against the profits of the target company. The measure will only apply if the debt/equity ratio of the fiscal unity after the acquisition of the target company exceeds a certain ratio, which is yet to be determined (the Consultation Paper mentioned a debt/equity ratio of 75/25).

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Loyens & Loeff is an independent Benelux law firm with over 900 lawyers and offices in the main financial centres around the world. Loyens & Loeff combines an integrated corporate law, regulatory and tax practice.

In order to be able to give the best advice possible to our clients, Loyens & Loeff formed the Brazil Desk.

The members of the Brazil Desk strongly focus on Brazilian clients that invest or trade in Europe or other regions, as well as on international companies and financial institutions that want to expand their businesses to Brazil. In many cross border (including cross Atlantic) transactions, benefits can be derived by investing through the Benelux (Belgium, Netherlands and Luxembourg).

The team comprises members from various Loyens & Loeff practice groups. Members of the Brazil Desk visit Brazil three to four times a year.

Members of the Brazil Desk speak the Portuguese language.

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The main objection raised against this measure in the Consultation Paper was that it would be difficult to comply with the required debt/equity ratio since the formation of a fiscal unity typically reduces the fiscal equity of the acquisition holding (in the fiscal consolidation, the hidden reserves and goodwill of the target company are eliminated). The government has announced that its proposal will be aimed at excessive interest deduction, while at the same time taking into account the reduction of the fiscal equity of the acquisition holding as a consequence of the formation of a fiscal unity in bona fide cases.

### *Limitation on deductibility of permanent establishment 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.

### *Mandatory group interest box*

Pursuant to the mandatory group interest box, the balance of qualifying items, such as group interest income and interest expenses, would be subject to an effective tax rate of 5%. Further to the response to the Consultation Paper, it has become clear to the government that a mandatory group interest box could possibly have negative consequences for (foreign) investment 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.

### *Other interest deduction limitations*

The introduction of two alternative measures (as discussed in the Consultation Paper) to partially disallow the deduction of (third party and group) financing expenses (i.e. deductibility of interest on loans attributable to participations and a general "earnings stripping" measure) has been put off. After consideration, the government has doubts as to whether (certain aspects of) both measures are compatible with EC law.

We trust to have fully informed you. Should you have any questions, please do not hesitate to contact us.

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