Decoding Dividend Withholding Tax: Attention Points for U.S. MNEs Investing in Switzerland and the Netherlands

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Introduction

Navigating the complexities of dividend withholding tax (WHT) is crucial for U.S. multinational enterprises (MNEs) investing in Switzerland and the Netherlands. This article delves into the key considerations for U.S. MNEs, highlighting the distinct tax treatments in these jurisdictions. The article predominantly focuses on U.S. MNEs, as the tax treatment of private equity funds, family offices, and other legal entities can differ from that of MNEs under both Dutch and Swiss tax law. From a Swiss tax perspective, this article will provide guidance on navigating the pitfall of the old reserves practice, with a view to the future of a potential new tax treaty between the United States and Switzerland. From a Dutch tax perspective, the relevant conditions of the Dutch domestic dividend WHT exemption will be discussed, as well as its interaction with the tax treaty between the United States and the Netherlands. Additionally, the impact of the new Dutch tax entity classification rules effective January 1, 2025 will be addressed. By examining the specific domestic WHT regulations, bilateral tax treaty provisions and thereby highlighting pitfalls, this article intends to provide an overview of attention points that may be of importance for U.S. MNEs under the current and potential future WHT landscapes of Switzerland and the Netherlands.

Part 1: Switzerland

1.1 Current Landscape

In principle, Switzerland levies a 35% dividend WHT on actual and deemed dividends. The Swiss payor must deduct the tax and remit it to the Swiss federal

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tax administration (SFTA). Non-Swiss tax resident beneficiaries can fully or partially refund or reduce the tax based on the applicable double tax treaty. Under the current double taxation agreement between the United States and Switzerland (CH/US Treaty), the principal reduced WHT rates are as follows: a rate of 5% on the gross amount of dividends when the beneficial owner is a company that holds at least 10% of the voting stock of the company paying the dividends,[1] and a rate of 15% on the gross amount of dividends in all other cases.[2] In summary, several requirements must be met under the CH/US Treaty for the reduced rates to apply, in particular: the claimant must be a resident of Switzerland or the United States within the meaning of the CH/US Treaty, the claimant must be the person deriving the income and the beneficial owner of the income, the claimant must qualify under the Limitation on Benefits (LoB) clause of the CH/US Treaty, and there must not be a constellation of treaty abuse.

The unique facets of the Swiss tax system must be considered in this context, as they add complexity to the requirements mentioned above. In addition to meeting the standard conditions of the CH/US Treaty, the direct parent entity needs to meet the SFTA's general substance requirements to receive the CH/US Treaty's benefits and apply the reduced Swiss WHT rate for dividends. In short, the SFTA's substance requirements are subject to a facts and circumstances test (no check-the-box test) and cover financial substance, physical substance, and functional substance.[3] The requirements are not always cumulative; for example, where a direct parent entity belongs to a MNE and is directly or indirectly held by an operating company in a treaty jurisdiction, solely fulfilling the financial substance requirement is typically sufficient.[4]

The SFTA's practice on substance requirements is based on its long-standing practice and is not enshrined in legislation or a circular letter.[5] If a U.S. recipient cannot claim a refund of WHT, the Swiss WHT of 35% becomes a definitive tax burden. This rate is one of the highest internationally, making it recommended to observe the SFTA's substance requirements in addition to the CH/US Treaty's explicit requirements. Alongside the SFTA's practice on substance requirements, other important and perhaps lesser-known WHT pitfalls exist for U.S.–Swiss intra-group dividends within the Swiss tax system. This article will explore one of these pitfalls, the old reserves practice, in further depth. In practice, it is worth noting that a WHT refund claim may also be denied based on other general or special anti-abuse rules, such as the concept of (extended) international transposition, liquidation by proxy, and others.

1.2 Current Landscape: The Old Reserves Practice

1.2.1 Concept

An important pitfall to consider, especially when a U.S. company engages in restructuring or buying a Swiss company, is the so-called old reserves practice. If a current shareholder is not entitled to a WHT refund or is only entitled to a partial refund, the potential residual WHT may be reduced through restructuring or third-party sales. If the SFTA finds this arrangement abusive, it can refuse to refund the WHT to the new domestic or foreign recipient of the dividends, either in whole or in part.

In this context, the SFTA developed the old reserves practice. The old reserves practice applies when the residual WHT liability on existing distributable, non-operational funds is reduced through intra-group restructuring or a third-party transaction.[6] The abusive element of the arrangement is not primarily directed at the restructuring or the sale. Instead, it involves improving the refund position by combining the retention of distributable non-operating funds (referred to as 'old reserves') with the transfer of ownership to a more favorable refund regime under a different tax treaty.[7] Further, the accusation of abusive behavior, which justifies the refusal to refund the WHT under the old reserves practice, is typically made against a shareholder who can determine the company's dividend policy.[8] This controlling power is usually attributed to shareholders holding more than 50% of the voting rights or to minority shareholders who can form a blocking minority through a shareholder agreement.[9]

Old reserves are identified through a two-fold test: the asset test, which considers non-operating funds in the Swiss company, and the equity test, which assesses whether these funds are distributable under Swiss commercial law. Generally, old reserves are defined as reserves that are freely distributable at the time of a transaction and backed by funds not required for business operations. Thus, old reserves are determined not only by the freely distributable reserves but also by the asset side of the company's balance sheet. Consequently, if reserves are available for distribution but the company (including subsidiaries) lacks sufficient cash, cash equivalents, or non-operational funds to distribute these reserves, or if

the cash is needed for commercial operations, the old reserves practice should, in principle, not apply.

1.2.2 Illustrative Examples

According to the SFTA's existing practice, if the old reserves practice applies, the new shareholder cannot claim a refund of Swiss WHT until the old reserves are fully distributed. Additionally, a WHT refund is denied for the distribution of current profits if old reserves are still available.[10] The Swiss Federal Supreme Court confirmed that a refund is also refused if more than five years have passed between the restructuring or sale and the dividend distribution.[11] In turn, time cannot "heal" old reserves. The WHT claim on the amount of the old reserves is calculated by multiplying the amount of the old reserves by the rate, which is the difference between the non-refundable WHT rate of the previous shareholder at the time of the transfer and the non-refundable WHT rate of the new shareholder.

> **Example 1.** *A Swiss resident company (SwissCo) is held by a US company (USCo). Under the CH/US Treaty, USCo is subject to 5% residual WHT and meets both the LoB provision and the SFTA's substance requirements. A Dutch group company (DutchCo) acquires 100% of the shares in SwissCo and is eligible for 0% WHT by virtue of the CH/NL Treaty. At the time of acquisition, SwissCo has non-operational funds distributable under Swiss commercial law amounting to CHF 1 million.*
>
> *The SFTA will apply the same 5% residual WHT rate from the CH/US Treaty on dividends from SwissCo to DutchCo, up to the amount of the old reserves of CHF 1 million. Consequently, the WHT refund of CHF 50'000 is refused.*

Since the buyer's WHT refund position is improved and the Swiss target company has non-operational funds distributable under Swiss commercial law at the time of acquisition, the old reserves practice applies. The WHT on the old reserves will be due on every dividend distribution by the Swiss resident company until the old reserves have been fully distributed, following the first-in, first-out principle. However, where the sold entity lacks non-operating funds (including at the subsidiary level) that were freely distributable at the time of transfer, a WHT refund refusal based on the old reserves practice is unlikely.

The legal consequences of the old reserves practice often only become apparent later, during a distribution, rather than immediately at the time of sale or restructuring. Similarly, old reserves can be "inherited" in subsequent transactions over the years, as the passage of time does not eliminate them.[12]

> **Example 2.** *The shares of a Swiss resident company (SwissCo) are 100% held by a US company (USCo), which is subject to a 5% residual WHT rate as in Example 1. In Year X, USCo sells 100% of the shares in SwissCo to a Luxembourg company (LuxCo). At the time of the sale, SwissCo has non-operational funds distributable under Swiss commercial law amounting to CHF 5 million. Since LuxCo is in a more favorable WHT position after the sale than USCo (with full WHT refund entitlement, assuming all explicit and implicit conditions are met), the SFTA would apply the old reserves practice to the old reserves in SwissCo.*
>
> *In Year X+1, LuxCo contributes its participation in SwissCo to a Dutch group company (DutchCo). At the time of the contribution, SwissCo still has non-operational funds distributable under Swiss commercial law amounting to CHF 5 million. Although DutchCo is entitled to the same WHT position as LuxCo, the old reserves practice would still apply on the 'inherited' old reserves at the time of sale by USCo.*

The above examples highlight the importance of clarifying the old reserves position in advance when dealing with the sale or restructuring of Swiss companies. The old reserves practice typically arises in situations where the shareholder is not entitled to a full WHT refund.[13] In restructuring or acquisition scenarios involving a Swiss company, it is advisable to first confirm that the Swiss company's shareholder is entitled to a full WHT refund or is in a better refund position than the U.S. buyer. For additional certainty, this can be confirmed through a Swiss advance tax ruling. Where liquidity permits, distributing the non-operational and distributable funds prior to the transaction may also help avoid adverse old reserves consequences, although this is not always practical.

While determining the company's distributable funds under commercial law is relatively straightforward, assessing the extent to which certain funds are necessary for the company's operations cannot be evaluated solely on objective criteria. Funds are not considered necessary for operations if they are not required to fulfill the company's business purpose.[14] Determining this requires a case-by-case assessment. In some cases, this grey area provides the taxpayer with room for argument. Depending on the

nature of the assets and the business or industry in which the Swiss company operates, it may be possible to obtain a Swiss advance tax ruling confirming that the funds were indeed operational for the business. Consequently, these operational assets, even if backing freely distributable reserves, would not taint them as old reserves.

1.3 Looking to the Future: New CH/US Treaty?

1.3.1 Background

The U.S. Senate's approval of the 2009 protocol of amendment to the CH/US Treaty after nearly 10 years on July 17, 2019 marked an important milestone in tax relations between Switzerland and the United States. An important milestone that helped pave the way for general discussions on revising the CH/US Treaty. One of the potential revision points surrounds the WHT rate, which could be reduced to 0% (so-called "zero rate") on dividends from qualifying holdings. On December 13, 2022, the Swiss State Secretary met with the U.S. Deputy Secretary of the Treasury to discuss bilateral and multilateral financial and tax issues. During these talks, the Swiss State Secretary addressed ongoing negotiations to revise the CH/US Treaty and agreed to clarify mutual concerns throughout 2023, with negotiations expected to conclude in fall 2024.[15] While the revised CH/US Treaty has not taken shape yet, it is expected that certain provisions will likely be drafted in line with the 2016 U.S. Model Income Tax Convention (the "2016 Model"), which the U.S. Treasury Department uses as its baseline text in negotiating tax treaties.[16] Like the Organisation for Economic Co-operation and Development (OECD) Model Convention, the 2016 Model Convention does not automatically take effect. Instead, specific treaties must be negotiated to include the 2016 Model's new provisions. Given that the 2016 Model represents the Treasury's current stance on various treaty matters, it is crucial to analyze its provisions and stay informed about future developments, particularly in situations like the present one where treaty renegotiations are expected.

Another notable feature of the 2016 Model is its amended LoB clause, which imposes stricter criteria for treaty eligibility to curb treaty shopping. The United States has established agreements with full WHT exemptions on intra-group dividends with just 13 of its treaty partners. All these treaties include the more stringent LoB rules, particularly the higher requirements for the stock exchange test. Therefore, while the zero rate is desirable, the more stringent LoB requirements need to be anticipated and weighed against this benefit. This article will not discuss the 2016 Model's LoB clause but will instead focus on the implications of a zero rate in the new CH/US Treaty.

1.3.2 Implications for the Old Reserves Practice

The desired zero rate for dividend WHT on qualifying holdings may be on the horizon for the CH/US Treaty. Naturally, this creates an improved refund position for qualifying holdings. The SFTA has explicitly clarified that if a change in the law improves the refund position in an existing constellation, the old reserves practice is not triggered.[17] Therefore, the old reserve practice should not apply if the legal situation changes for an unchanged ownership structure (*e.g.*, if the CH/US Treaty is amended to include a zero rate).[18] While the outcome in unchanged, existing ownership structures is fairly clear, there may be room for argument that this may also apply to fact patterns in changed ownership structures.

> **Example 3.** *In Year X, USCo contributes 100% of its shares in SwissCo to a Dutch resident company (Dutch ParentCo; full WHT refund entitlement, assuming all explicit and implicit conditions are met). At the time of the contribution, SwissCo has non-operational funds distributable under Swiss commercial law amounting to CHF 2 million. USCo, SwissCo and Dutch ParentCo are all part of the same group. In Year X+1, a new CH/US Treaty enters into force, including a zero WHT rate. In Year X+2, SwissCo distributes a dividend for the first time.*

At the time USCo contributed SwissCo (Year X), it was entitled to the residual rate of 5% under the US/CH Treaty. By the time of the distribution, the new CH/US Treaty was in force, meaning USCo, as the previous shareholder, would have theoretically been entitled to the same beneficial refund position in Year X+2 under the CH/US Treaty as the current Dutch ParentCo. Consequently, no effective refund position improvement occurred through contributing the participation to Dutch ParentCo.

Oesterhelt stipulates that the old reserves are not fixed at the time of the restructuring in case of law changes.[19] Instead, they can benefit from a later improvement in the refund situation, provided they have not yet been distributed.[20] This follows from the Swiss tax avoidance doctrine, which requires both a subjective element (intention

to avoid), and an objective element (actual tax savings).[21] This should apply at least with regard to the old reserves practice in the case of intra-group restructurings.[22] The fact that the improved refund position was not known at the time of the restructuring is irrelevant, as the objective element of tax avoidance must be fulfilled cumulatively with the subjective element.[23] However, Oesterhelt notes that this application of the old reserves practice in the case of a third-party sale remains somewhat unclear.[24] Obviously, the mentioned line of reasoning should be discussed with the SFTA through an advance tax ruling process.

While the zero rate is a positive development, special attention is still required. For instance, if the new zero rate applies, constellations where a Canadian shareholder holds a Swiss target company acquired by a U.S. company might pose an old reserves issue. Here, the new shareholder's refund position is improved from the 5% or 15% residual WHT rate of the CH/Canadian Treaty[25] to the CH/US Treaty's zero rate (assuming all explicit and implicit conditions are met under the new treaty). Previously, these constellations were less susceptible to the old reserves pitfall and therefore illustrate the continued importance of critically reviewing the refund position.

1.4 Conclusion

The restrictions on WHT relief imposed by the old reserves practice typically only become evident once future distributions are made and not at the time of the investment. To avoid unexpected surprises, U.S. MNEs should dissect their WHT refund position before acquiring participations in Swiss companies. This review should also include the refund position of the previous shareholders. Additionally, since the old reserves practice does not form an independent set of objective facts, it is also still necessary to examine the general criteria for tax avoidance and treaty abuse.[26]

Part 2: The Netherlands

2.1 Current Landscape: NL WHT Exemption and NL/US Treaty

2.1.1 Background

In principle, the Netherlands levies a 15% dividend WHT from persons (entities or individuals) who are entitled to (deemed) profit distributions paid by certain companies (*e.g.,* (public) limited liabilities companies) residing in the Netherlands. Dutch dividend WHT is levied from the beneficiary of the proceeds *via* a withholding at source at the level of the Dutch company distributing the profits (*i.e.*, the withholding agent). The withholding agent is responsible for the payment of the dividend WHT and the filing of a dividend WHT return.

The Netherlands has one of the largest networks of double tax treaties to eliminate double taxation and as such concluded a double tax treaty with the United States. The most recent version of this treaty was concluded on December 18, 1992, with an additional protocol agreed upon on March 8, 2004 (the NL/US Treaty). The NL/US Treaty provides for an exemption of WHT on dividends, provided that the relevant conditions set forth in the NL/US Treaty are met, among which the provisions of Article 26[27] (*i.e.*, the LoB clause) of the NL/US Treaty. However, in practice, U.S. MNEs rarely need to rely on this WHT exemption provided in the NL/US Treaty when investing in the Netherlands. Since January 1, 2018, the Netherlands has unilaterally extended its domestic dividend WHT exemption to all qualifying corporate residents located in a jurisdiction with which the Netherlands has entered into a double tax treaty that includes a dividend article (the NL WHT Exemption).

As such, U.S. MNEs meeting the conditions of the NL WHT Exemption are not subject to Dutch dividend WHT, regardless of whether the (generally more stringent) requirements of the NL/US Treaty are met. There are, however, (limited) scenarios where the NL/US Treaty could provide for a more favorable outcome than under the Dutch domestic dividend WHT rules, which will be discussed in Section 2.4.

In addition to the dividend WHT, the Netherlands levies a so-called conditional WHT in limited situations on certain dividend payments to entities holding a qualifying interest (*i.e.*, generally a shareholding representing more than 50% of the voting rights) located in certain low-taxed or European Union (EU) Blacklisted jurisdictions.[28] These rules can also apply if outbound payments are made to hybrid entities and in cases of abuse. Since these rules generally do not apply to U.S. corporate shareholders investing directly in the Netherlands, these rules will not be further addressed.

2.2 NL WHT Exemption

2.2.1 Introduction

The NL WHT Exemption applies when certain cumulative requirements are met by a U.S. corporate shareholder.

The most relevant requirements are the following. The U.S. corporate shareholder should be able to (i) apply the Dutch participation exemption on its shareholding in the Dutch company making the dividend payment, (ii) not fulfill a function comparable to a Dutch investment institution (*vrijgestelde belegingsinstelling* or *fiscale beleggingsinstelling*), and (iii) no abuse should be considered present. Additionally, the NL WHT Exemption contains specific provisions that address situations whereby a Dutch company makes a dividend payment to a hybrid entity (the NL Hybrid Provision).

2.2.2 Conditions NL WHT Exemption

First, the U.S. corporate shareholder should hold participation in the Dutch company that would qualify for the Dutch participation exemption if the shareholder would be tax resident in the Netherlands. Generally, the Dutch participation exemption regime applies to income derived from a 5% or more share capital interest. In the context of a U.S. MNE, this condition is typically met. However, this condition can create issues if the U.S. shareholder is a pension fund, as a pension fund may not be able to apply for the Dutch participation exemption in case it would reside in the Netherlands for Dutch tax purposes, due to its tax-exempt status. The latter has been specifically confirmed by the Dutch State Secretary in parliamentary proceedings.[29] Second, the Dutch corporate shareholder cannot fulfill a function that is similar to a Dutch investment institution. Again, such conditions should generally not give rise to issues in the case of U.S. MNEs investing in the Netherlands.

Finally, there should be no abuse associated with the U.S. corporate shareholder holding its share capital interest in the Dutch subsidiary. The latter condition is typically applied by way of the following two tests. Only in case both tests are met is abuse considered present resulting in the U.S. corporate shareholder not being eligible for the benefits of the NL WHT exemption. These tests review whether the beneficiary of the dividend holds its shareholding with the main purpose, or one of the main purposes, of avoiding Dutch dividend WHT at the level of another person or entity (the Avoidance Test) and whether such holding is considered to be an artificial arrangement or transaction. An arrangement is considered artificial if it has not been entered into based on valid commercial reasons reflecting economic reality (the Artificial Arrangement Test).

Based on parliamentary papers, the Avoidance Test requires a comparison between the (existing) situation in which the Dutch company distributes a dividend to its direct foreign shareholder and the (hypothetical) situation in which the Dutch company would have distributed such dividend to the beneficiary of such direct shareholder.[30] Thereby applying in essence a "look-through" approach. If, compared to the hypothetical situation, less dividend WHT is due in the existing situation, an avoidance motive is deemed to be present based on the Avoidance Test. Based on the parliamentary papers, this test is purely a mathematical comparison, *i.e.*, if the existing situation poses a benefit, it is assumed that one of the principal purposes of the current shareholding structure is to obtain such benefit. For purposes of the Avoidance Test, the (actual) principal purpose is not separately assessed. A court case is currently pending at the Dutch Supreme Court addressing the question, *inter alia*, whether this interpretation of the Avoidance Test aligns with the provisions in the Parent-Subsidiary Directive[31] enacted by the European Union.[32] The Artificial Arrangement Test is satisfied, *i.e.*, there is abuse if holding the shares in the Dutch company is part of an artificial arrangement or transaction. This will be the case if the shareholding structure is not motivated by valid business reasons reflecting economic reality. According to parliamentary papers, there is no artificial arrangement or transaction if the direct shareholder operates a business enterprise and the shareholding in the Dutch company can be functionally attributed to that business enterprise. In a U.S. MNE structure, where (i) the ultimate parent entity of the U.S. MNE is located in the United States and (ii) no intermediate holding companies that operate a business enterprise are located in non-treaty jurisdictions, the direct U.S. shareholder is typically able to fulfill this condition.

2.2.3 The NL Hybrid Provision

The NL Hybrid Provision distinguishes two scenarios. The first situation deals with a case where the shareholder is considered to be an opaque entity from a Dutch tax perspective, but as a transparent entity from a foreign tax perspective. Such an entity is referred to as a "hybrid entity." The second scenario addresses the situation where the shareholder is treated as a transparent entity from a Dutch tax perspective but as an opaque entity from a foreign tax perspective. In this second scenario, the entity is referred to as a "reverse hybrid entity." In view of the Dutch tax classification rules currently in force, which tend to treat most foreign entities as opaque for Dutch tax purposes, only the first situation will be addressed in the examples here below.

The NL WHT Exemption includes a specific rule for situations whereby the shareholder of the Dutch company is treated as an opaque entity for Dutch tax purposes but as a transparent entity under the tax laws of the country in which it is established. Based on this provision, the NL WHT exemption applies provided that (i) each participant in the hybrid entity is individually eligible for the benefits of the NL WHT exemption in case they would have their interest in the Dutch company directly, and (ii) in the relevant jurisdiction of each participant the dividend distribution will be included in the taxable income of such participant. The NL Hybrid Provision typically kicks in when a U.S. MNE holds its shareholding in a Dutch company *via* a disregarded Delaware LLC as under the Dutch tax classification rules a Delaware LLC is typically considered as an opaque entity for Dutch tax purposes.

2.3 Current Landscape: NL WHT Exemption Attention Points

As follows from Sections 2.1 and 2.2, the NL WHT Exemption is a generous provision that allows most U.S. MNEs to repatriate funds out of the Netherlands free of Dutch dividend WHT. There are nonetheless situations in which the application of the NL WHT Exemption can become challenging. Most of these situations are caused by the somewhat atypical current Dutch tax entity classification rules, which will fortunately be amended as of January 1, 2025. This amendment will be discussed in more detail in Section 2.4. Hereinafter, some examples are provided of situations where the application of the NL WHT Exemption appears to be difficult, but the necessary relief is granted under the provisions of the NL/US Treaty.

Example 1. *A US Real Estate Investment Trust (REIT) holds all outstanding share capital in a Dutch company holding real estate. To maintain its REIT status, the US shareholder is required to annually distribute at least 90% of its taxable profits. A substantial part of the average number of outstanding common shares in the REIT during any twelve-month period is traded at the NYSE during that period.*

It follows from Section 2.2.1 that one of the conditions for applying the NL WHT Exemption is that the U.S. shareholder cannot perform a similar function comparable to a Dutch investment institution. A Dutch investment institution (*i.e.*, *fiscale beleggingsinstelling*) is required to distribute its profits within eight months after the end of its respective book year. As such, the Dutch tax authorities might be inclined to disallow the application of the NL WHT Exemption, based on the U.S. real estate investment trust (REIT) being comparable to a Dutch investment institution.

However, pursuant to the provisions of the NL/US Treaty in Article 10 and Article 26, a U.S. REIT should be able to apply the WHT exemption provided under the NL/US Treaty, since U.S. REITs should fulfill both conditions in the dividend article as well as the LoB clause.

Example 2. *A US-based pension fund that is constituted and operated exclusively to administer or provide benefits under one or more funds or plans established to provide pension, retirement or other employee benefits acquires a portfolio company located in the Netherlands. It is expected that the Dutch portfolio company will annually distribute dividends. In the hypothetical situation that the US-based pension fund would be located in the Netherlands, it would (also) be treated as a tax-exempt entity.*

It follows from Section 2.2.1 that one of the conditions for the NL WHT Exemption is that the U.S. shareholder would need to be able to apply the participation exemption on its shareholding in the Dutch company, in case it would have been a tax resident in the Netherlands. The Dutch State Secretary indicated that this could mean that foreign pension funds are not able to benefit from the NL WHT Exemption, as tax-exempt entities cannot apply the Dutch participation exemption regime.

However, according to the relevant provisions of the NL/US Treaty in Article 10 and Article 35, a U.S. pension fund should be able to apply the WHT exemption provided in the NL/US Treaty, since a U.S. pension fund should fulfill both the conditions in the dividend article and the article addressing the eligibility of a pension fund for the benefits of the NL/US Treaty.

Example 3. *A US MNE invests in a Dutch company via a Delaware LP that is considered transparent for US tax purposes. In addition to the US MNE, also the senior management participates in the Delaware LP, as such acting as minority investors in the Dutch company. Based on the relevant provisions on the admission and substitution of limited partners in the Delaware LP agreement, Delaware LP is considered as an opaque entity under the current Dutch tax entity classification rules.*

In this situation, the Delaware LP is considered a hybrid entity because it is considered opaque for Dutch tax purposes but transparent from a U.S. tax perspective. According to Section 2.2.2, the NL Hybrid Provision requires that each participant in the hybrid entity should individually be entitled to the NL WHT Exemption if they would have held a direct interest in the Dutch company. In this situation, this condition is not met because the NL WHT Exemption is only available to corporate shareholders, not to individuals (*i.e.*, the members of the senior management).

Article 24 of the NL/US Treaty provides for a look-through approach if a U.S. MNE treats the item of income paid to a Delaware LP as being derived by the U.S. MNE. As such, the U.S. MNE may still be able to benefit from a reduced dividend WHT rate as provided in the NL/US Treaty, if the U.S. MNE meets the relevant conditions of the NL/US Treaty (*i.e.*, the LoB clause).

2.4 Looking to the Future: New Dutch Tax Entity Classification Rules

As noted in Section 2.2.2, the current Dutch entity tax classification rules for foreign entities tend to treat foreign entities as opaque entities for Dutch tax purposes. This is particularly true for the classification of foreign limited partnerships, as the Netherlands has fairly unique rules for classifying Dutch and foreign limited partnerships for tax purposes. Under the current Dutch entity classification rules, Dutch (and foreign) limited partnerships are only considered as transparent entities if the admission and substitution of limited partners require the prior unanimous consent of all partners (*i.e.*, limited, and general partners). If such a unanimous consent requirement is not included in the relevant provisions of the limited partnership agreement or not adhered to in practice, the limited partnership will be considered opaque from a Dutch tax perspective, regardless of its tax treatment in its country of residence. This often results in mismatches in an international context, as other countries generally classify limited partnerships as transparent entities for tax purposes.

To enhance the attractiveness of the Netherlands as an investment hub and to reduce mismatches in an international context, new Dutch tax entity classification rules will come into effect on January 1, 2025. The envisaged changes in the Dutch tax entity classification rules may also facilitate the Netherlands becoming an attractive jurisdiction for international joint venture arrangements. Moreover, these amended classification rules will make it easier for Dutch investors to participate in foreign limited partnerships. Under the new Dutch tax entity classification rules, all limited partnerships formed under Dutch law (most notably, Dutch "*commanditaire vennootschappen*" or "*CVs*") will, in principle, become transparent entities for Dutch tax purposes by default.[33] Additionally, entities formed under foreign law will be classified in accordance with their most similar Dutch equivalent under Dutch corporate law (similarity approach). If no clear equivalent entity can be identified under Dutch corporate law, the Dutch tax classification will generally follow the tax classification applied in the foreign jurisdiction.

As such, the Delaware LP will generally be classified as a transparent entity for Dutch tax purposes as from 2025, as it is considered to be equivalent to a Dutch CV. The new Dutch tax entity classification rules will generally not alter the classification of a Delaware LLC under the similarity approach. A Delaware LLC is typically considered equivalent to a Dutch limited liability company, which is treated as an opaque entity for Dutch tax purposes. This means that the Delaware LLC will typically continue to be classified as an opaque entity from a Dutch tax perspective after 2024.

The application of the new Dutch tax entity classification rules will be discussed in more detail based on the last Example mentioned in Section 2.3:

> **Example.** *A US MNE invests in a Dutch company via a Delaware LP that is considered as transparent for US tax purposes. In addition to the US MNE, also members of its senior management participate in the Delaware LP, as such acting as minority investors in the Dutch company.*

Following the enactment of the new Dutch tax entity classification rules, the Delaware LP will be considered transparent both from a U.S. and Dutch tax perspective. As such, the relevant conditions of the NL Hybrid Provision no longer apply to assess whether a distribution made by the Dutch company would be exempt from Dutch dividend WHT under the NL WHT Exemption. In this Example, the U.S. MNE is automatically considered to be the beneficiary for Dutch dividend WHT purposes for its share of the dividend distributed and as such meets the conditions discussed in Section 2.2.1. Therefore, the generally more stringent provisions of the NL/US Treaty (*i.e.*, the Limitation on Benefits article) no longer need to be relied upon.

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3 Conclusion

The Netherlands offers a generous unilateral domestic dividend WHT exemption, available to most U.S. MNEs with investments in the Netherlands. While claiming the benefits of the NL/US Treaty will generally not be necessary for U.S. MNEs to claim the Dutch dividend WHT exemption, in practice a few exceptions apply. Some of these exceptions originate from the application of the current Dutch tax entity classification rules. With the new Dutch tax entity classification rules in place as of January 1, 2025, even more U.S. MNEs are expected to fully rely on the NL WHT Exemption.

Conclusion

Understanding the intricacies of dividend WHT is crucial for U.S. MNEs investing in Switzerland and the Netherlands. This article highlighted the distinct tax treatments in these jurisdictions, focusing on the specific challenges and opportunities for U.S. MNEs. From a Swiss tax perspective, the old reserves practice may pose challenges, often revealing restrictions on WHT relief only when future distributions are made. To avoid unexpected surprises, U.S. MNEs should thoroughly assess their refund position before acquiring participations subject to Swiss WHT, including the refund position of previous shareholders. From a Dutch tax perspective, U.S. MNEs often do not need to rely on the NL/US Treaty provisions to obtain an exemption from Dutch dividend WHT, but exceptions exist, particularly caused by the existing Dutch tax entity classification rules. With the new classification rules effective from January 1, 2025, even more U.S. MNEs are likely to rely on the NL WHT Exemption. This article examined the specific domestic WHT regulations, bilateral tax treaties, and potential pitfalls, providing an overview of the attention points for U.S. MNEs. Understanding these nuances will help U.S. MNEs better navigate the tax complexities and optimize their investments in both Switzerland and the Netherlands.

ENDNOTES

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1 Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with respect to Taxes on Income, art. 10(2)(a), Oct. 2, 1996.

2 *Id.*, art. 10(2)(b).

3 *See* Fabian Sutter & Beat Baumgartner, *Inward Investment and International Taxation: Switzerland*, 13 (2024), *www.loyensloeff.com/lexology-in-depth—inward-investment-and-international-taxation—inward-investment-and-international-taxation_-switzerland.pdf* (last visited Sep 18, 2024).

4 Fabian Sutter & Lukas Aebi, *Steuerumgehung bei der Erweiterten Internationalen Transponierung*, 4 IFF Forum für Steuerrecht 457, 461 (2022).

5 Elga Reana Tozzi, *Rückerstattung der Verrechnungssteuer im Internationalen Verhältnis*, 2 zsis), Feb. 2021, at 57, 63.

6 Raoul Stocker & Stefan Oesterhelt, Internationales Steuerrecht der Schweiz, 515 (2023).

7 *Id.*

8 *Id.* at 523.

9 *Id.*

10 Stefan Oesterhelt, *Anwendung der Altreservenpraxis auf Minderheitsaktionäre*, 6 Expert Focus 243–244 (2022).

11 Swiss Federal Supreme Court, Case 2C_80/2021 (2021).

12 Stocker & Oesterhelt, *supra* note 6 at 536.

13 Stefan Oesterhelt, *Altreservenpraxis, Internationale Transponierung und Stellvertretende Liquidation*, 2 IFF F 99, 104 (2017).

14 Nils Harbeke & Patrick Scherrer, Unternehmenssteuerrecht, 169 (2020).

15 Eidgenössisches Finanzdepartement, *Staatssekretärin Daniela Stoffel zu Finanz- und Steuergesprächen in den USA* (2022), *www.sif.admin.ch/de/nsb?id=92201* (last visited Oct 2, 2024).

16 PricewaterhouseCoopers LLP, *Final US Model Income Tax Treaty Could Significantly Reduce Access to Treaty Benefits*, Tax Notes (Practitioner Guidance) (2016).

17 Stocker & Oesterhelt, *supra* note 6 at 517.

18 Harbeke & Scherrer, *supra* note 14 at 167.

19 Stocker & Oesterhelt, *supra* note 6 at 518.

20 *Id.*

21 *Id.*

22 *Id.*

23 *Id.*

24 *Id.*

25 Convention between Canada and Switzerland for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, art.10(2), May 5, 1997.

26 Sutter & Aebi, *supra* note 4 at 465.

27 Convention between the Government of the United States of America and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. 10(3).

28 For example: for purposes of these conditional WHT rules, Bermuda and Cayman Islands would be considered low-taxed jurisdictions, whilst Russia and Panama would be considered EU-blacklisted jurisdictions.

29 Parliamentary Papers I, 34 785, No. E, Letter of Dutch State Secretary, 2.

30 Parliamentary Papers II, 34 788, No. 3, Explanatory Memorandum, 6-7.

31 Directive 2011/96/EU of the Council of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

32 Dutch Supreme Court, May 26, 2023, no. 22/02691.

33 An exception to this general rule could apply if a Dutch or foreign CV is considered a "*Fonds voor gemene rekening*."

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