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Dutch withholding taxes: recent developments

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1 Introduction

It has been an interesting year in the Netherlands from a withholding tax perspective. The legislative proposal for the withholding tax on interest and royalties will enter into force as of 1 January 2021, an additional withholding tax on dividends as of 2024 was announced and a member of parliament proposed to introduce an “exit tax” in the dividend withholding tax for certain cross-border reorganisations.

The Dutch government has focussed on payments from Dutch entities to (perceived) tax haven jurisdictions. Whether such entities have substance is not relevant for the withholding tax on interest and royalties and the proposed conditional withholding tax on dividends. This demonstrates that the Netherlands simply wants to end such payments, irrespective of whether the payments are made for genuine business purposes.

In this edition of Quoted we will discuss the introduced and proposed Dutch withholding taxes using cases and questions that have come up in practice. Each topic will be concluded with a summary containing some practical considerations.

2 Withholding Tax Act 2021

2.1 Background

As of 1 January 2021, interest or royalty payments (**IR Payments**) from the Netherlands will be subject to withholding tax in certain cases. By introducing this conditional withholding tax, the Netherlands surrenders one of its ‘crown jewels’: the basic principle that the Netherlands does not levy withholding tax on outgoing IR Payments. According to the parliamentary explanation, the conditional withholding tax has a prohibitive character and is being introduced to prevent the Netherlands from being used as a gateway to low-tax jurisdictions and jurisdictions on the EU list of non-cooperative countries (hereinafter referred to as: **LTJs**) and to reduce the risk of shifting the (Dutch) tax base to such jurisdictions.[1]

The introduction of a conditional withholding tax on IR Payments in the Netherlands has some history. In the Rutte III coalition agreement, an announcement was made that the current dividend withholding tax would be abolished and replaced by a conditional withholding tax on dividends to LTJs and in abusive situations.[2] It was furthermore announced that the conditional withholding tax on IR Payments was going to be introduced as from 1 January 2021. Both withholding taxes were envisaged to be combined in the Withholding Tax Act (*in Dutch: Wet Bronbelasting*). The proposed conditional withholding tax on dividends resulted in the legislative proposal ‘Withholding Tax Act 2020’[3] (**WTA 2020**) but was later withdrawn as the current dividend withholding tax was not to be abolished after all.[4] All in all, this has resulted in the introduction of the conditional withholding tax on IR Payments with effect as from 1 January 2021 and an announcement of a conditional withholding tax on dividends (see paragraph 3.1).

2.2 Withholding Tax Act 2021

Based on the Withholding Tax Act 2021 (**WTA 2021**), a withholding tax will be levied on IR Payments made as from 1 January 2021 by a company located in the Netherlands, or attributed to a permanent establishment (**PE**) in the Netherlands, to affiliated beneficiaries in LTJs or in abusive situations. In addition, withholding tax may be levied on IR Payments to hybrid entities. The withholding tax does not apply to IR Payments made to individuals.

The Dutch government has decided not to include an exception for beneficiaries who perform genuine economic activities in an LTJ. Due to the new ruling policy[5] it will furthermore not be possible to obtain a ruling on the tax consequences of a direct transaction with an LTJ. According to the parliamentary history, it will, however, be possible to obtain a ruling on the application of the anti-abuse provision and the question of whether there is affiliation with a beneficiary located in an LTJ.[6]

1 Parliamentary Papers II, 35 305, no. 3, Explanatory Memorandum, p. 1.

2 *Regeerakkoord 2017-2021* (Coalition Agreement 2017-2021), *Vertrouwen in de toekomst* (Confidence in the future), VVD, CDA, D’66 and ChristenUnie, 10 October 2017, p. 68.

3 Parliamentary Papers II, 35 028, no. 2.

4 Letter from the State Secretary of Finance dated 15 October 2018, no. 2018-0000175261, p. 1

5 Decision of the State Secretary of Finance dated 19 June 2019, no. 2019/13003.

6 Parliamentary Papers II, 35 305, no. 6, Memorandum in response to the Report, p. 35.

2.2.1 Taxpayers

The withholding tax is levied on the 'beneficiary' (*in Dutch: voordeelgerechtigde*) of the IR Payment. There are five categories of beneficiaries who may qualify for purposes of the withholding tax:

i. Entities located in an LTJ;
ii. PEs in an LTJ;
iii. Entities that are not located in an LTJ, but are involved in an abusive situation;
iv. 'Reverse' hybrid entities; and
v. Hybrid entities.

A jurisdiction is considered an LTJ, if it does not levy a tax on profits or has a statutory profit tax rate of less than 9%, or is included on the EU list of non-cooperative jurisdictions. Ultimately by 1 October of each year, the Netherlands publishes the list of jurisdictions without a profit tax or with a profit tax rate of less than 9%, which applies for the following year.[7] The EU list of non-cooperative jurisdictions can be however be updated until 31 December and applies to the following year. The withholding tax is in principle not applicable for IR Payments made to so-called 'dual resident entities' who are also established in a non-LTJ and are treated as the beneficiary of the IR Payment in that non-LTJ.

Since the Netherlands has concluded a tax treaty with a number of LTJs[8], on the basis of which a Dutch levy on IR Payments may be restricted, it has been decided to defer the introduction of the withholding tax until 1 January 2024 in respect of these treaty countries. The Dutch government intends to renegotiate the relevant treaties during this period.

2.2.2 Affiliation

As the government aims to keep the withholding tax exclusively within the scope of the freedom of establishment under European law, and not (also) within the scope of the free movement of capital, the withholding tax only applies in affiliated relations. If the free movement of capital – which also applies to countries outside the EU – would apply to the withholding tax, the levy of withholding tax would be significantly restricted.[9]

Entities are considered affiliated if: (i) the beneficiary has a direct or indirect qualifying interest in the withholding agent, (ii) the withholding agent has a direct or indirect qualifying interest in the beneficiary, (iii) a third party has a direct or indirect qualifying interest in the beneficiary and the withholding agent or (iv) there is a collaborating group[10] which jointly has a qualifying interest.

A 'qualifying interest' is considered an interest based on which directly or indirectly a decisive influence (i.e. control) can be exercised on the decision-making process. According to the parliamentary explanation, this in any case applies if more than 50% of the voting rights can be exercised.[11] The affiliation should be analysed for each link in the corporate structure, which means that a proportional approach does not apply.[12] Furthermore, the analysis should be made when the IR payments are considered to be received by the beneficiary (*in Dutch: genietingstijdstip*) (roughly speaking: the moment when the interest or royalty is paid).

2.2.3 Abuse

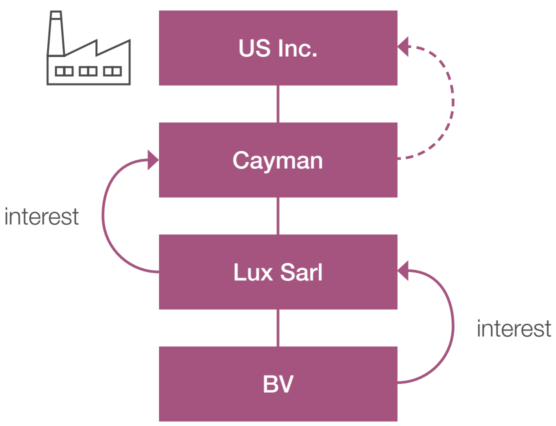
The WTA 2021 contains an anti-abuse provision to prevent the avoidance of withholding tax by means of interposing an entity in a non-LTJ. Abuse is considered present, if the beneficiary is entitled to the interest or royalties with the principal purpose or one of the principal purposes to avoid (Dutch) withholding tax with another party (subjective test) and the construction or arrangement can be considered artificial (objective test).

For purposes of the subjective test, the so-called 'look through approach' *(in Dutch: wegdenkgedachte*) is

7 Decree low-tax and non-cooperative jurisdictions for tax purposes. The internet consultation for designating the countries for 2021 was published on 9 October 2020. The proposed list for 2021 contains no changes compared to the 2020 list.
8 Bahrain, Barbados and the United Arab Emirates.
9 Parliamentary Papers II, 35 305, no. 3, Explanatory Memorandum, p. 4.
10 For the definition of a collaborating group, Article 10a(6) of the Dutch Corporation Tax Act 1969 is followed.
11 Parliamentary Papers II, 35 305, no. 3, Explanatory Memorandum, p. 3.
12 The example provided in the Explanatory Memorandum refers to a situation where a private limited company A (A BV) holds an interest of 60% in another private limited company B (B BV), which in its turn holds an interest of 60% in a private limited company C (C BV). In this example A BV and C BV are considered affiliated, as there is a decisive influence in each link of the corporate structure. The proportional interest of A BV in C BV is however only 36% (60% x 60%).

applied. Different to the application of the look through approach in the Dutch Corporate Income Tax Act (**CITA**)[13] and the Dutch Dividend Withholding Tax Act (**DWTA 1965**),[14] the look through approach should be applied to the first entity which is either established in an LTJ or is not abusive. Consequently, the anti-abuse provision in principle applies – subject to rebuttal – in situations where the IR Payment is made via an intermediary in an LTJ, but the ultimate beneficiary of the payment is established in a non-LTJ.

We refer to the following example. In the structure as depicted below, interest is paid to a Luxembourg company ('Lux Sarl') and subsequently on-paid to a company established in the Cayman Islands ('Cayman'). Based on the look through approach in the WTA 2021, the subjective test is not met, i.e. there is an assumption of abuse, regardless of whether the interest payment is on-paid to the US Inc. (since in this structure the look through approach should be applied to Cayman). We refer to paragraph 3.3.3 for a description of the consequences of applying the look through approach for Dutch dividend withholding tax (and corporate income tax) purposes, assuming a dividend payment is made.



In line with the *'Danish cases'*[15], the relevant substance requirements no longer serve as a 'safe harbour' for purposes of the objective test, but only shifts the burden of proof. If the relevant substance conditions are met, the burden of proof rests on the tax inspector to demonstrate that abuse is considered present (and vice versa).[16]

In relation to treaty countries, it is assumed that the anti-abuse provision may be applied due to the introduction of the principal purpose test (**PPT**) of the Multilateral Instrument (**MLI**) in many bilateral treaties. As however the Netherlands has opted not to notify all of its tax treaties (due to current treaty negotiations), the PPT may not have (yet) been included in these tax treaties. Consequently, the levy of withholding tax in relation to these countries may be (partly) restricted until entry into force of the PPT in those treaties.

2.2.4 Hybrid entities

IR Payments to reverse and regular hybrid entities may also fall within the scope of the conditional withholding tax. In this respect, it is not important (in all cases) whether the hybrid entity is also established in an LTJ, meaning that this provision has a wide scope. Separate rules apply for reverse hybrid entities (i.e. entities that are considered transparent from a Dutch tax perspective and non-transparent from a foreign tax perspective, such as a limited partnership (*in Dutch: commanditaire vennootschap*) in so-called: 'CV/BV structures') and regular hybrid entities (entities that are considered non-transparent from a Dutch tax perspective and transparent from a foreign tax perspective).

In situations involving a reverse hybrid entity, the participants are considered the beneficiaries of the IR Payment from a Dutch tax perspective. Withholding tax is only payable *to the extent* that these participants are affiliated with the Dutch withholding agent (i.e. in the example below, only Participant 1[17]). Moreover, this test does not require Participant 1 to be established in an LTJ. An exception applies, if it can be argued convincingly that the reverse hybrid entity is considered the beneficiary of the IR Payment based on the domestic legislation in the

13 Article 17, paragraph 3, sub b CITA.

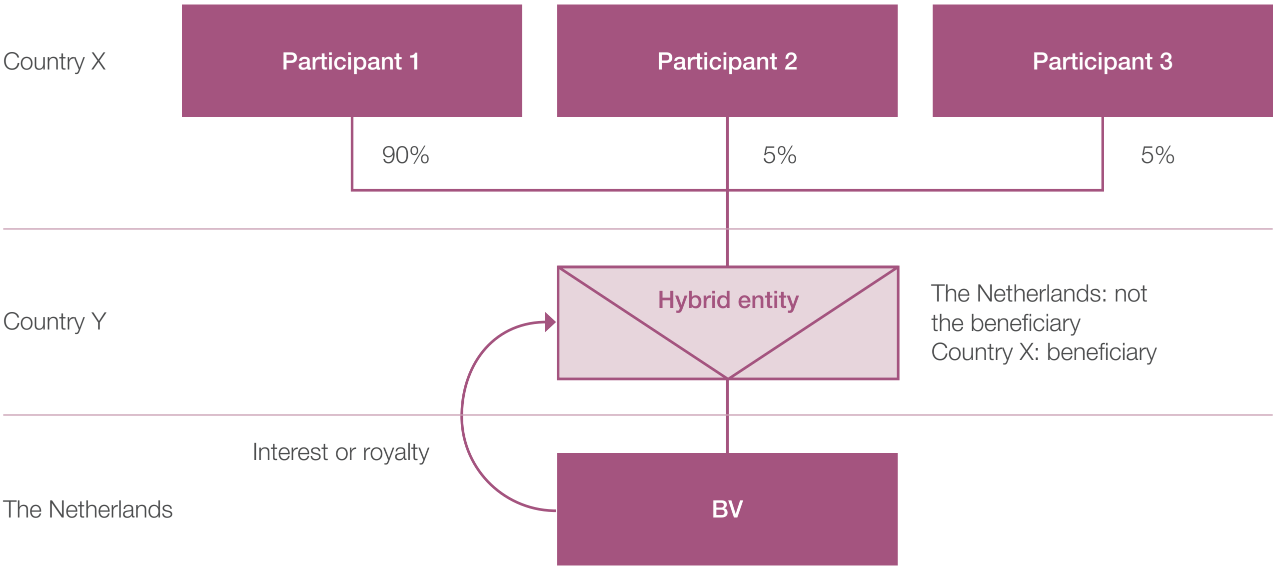
14 Article 4, paragraph 3, sub c DWTA 1965.

15 Court of Justice of the European Union, 26 February 2019, no. C-116/16 and C-117/16.

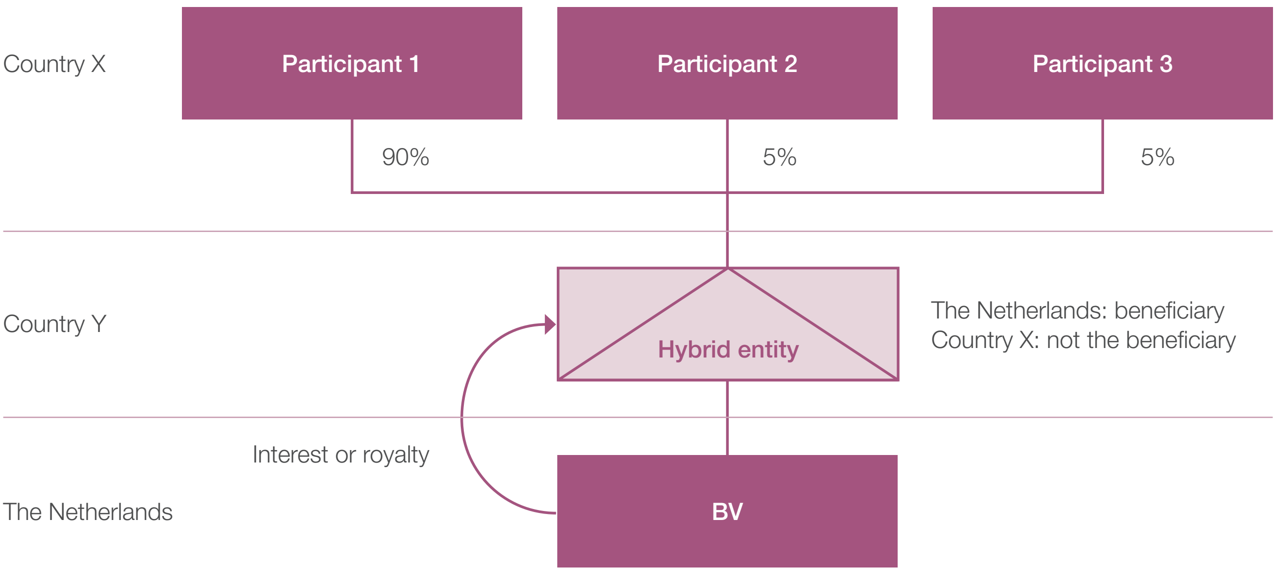
16 As described in paragraph 2.2. there is no possibility of providing evidence to the contrary in the case of direct IR Payments to entities (or permanent establishments) in an LTJ.

17 Unless Participant 1 forms a collaborating group together with Participants 2 and 3. In such cases, all participants are affiliated with the BV (the withholding agent).

state in which it is located. If applicable, the reverse hybrid entity may be considered the beneficiary for purposes of the WTA 2021, but only to the extent the participant(s) was (were) subject to the withholding tax.[18]



In situations involving a 'regular' hybrid entity, the hybrid entity is considered the beneficiary of the IR Payment from a Dutch tax perspective. Based on the WTA 2021, the 'regular' hybrid entity is subject to withholding tax, unless it can be argued convincingly that each *affiliated* participant[19]: (i) is considered the beneficiary of the IR Payment in the jurisdiction in which it is located and (ii) is not located in an LTJ. In the example below, the tax treatment and jurisdiction of Participants 2 and 3 are therefore not relevant (unless they form part of a collaborating group together with Participant 1). The exception does not apply to hybrid entities which are established in an LTJ, as these entities are already subject to withholding tax (without the possibility of rebuttal) based on the 'principal rule'.



18 Parliamentary Papers II 35 305, no. C, p. 7.

19 Initially the exception only applied to participants with a direct interest in the hybrid entity. However, based on the Memorandum of Amendment to the Miscellaneous Tax Measures Act 2021 (*in Dutch: Nota van Wijziging Wet Overige fiscale maatregelen 2021*), the interest in the hybrid entity may also be held indirectly, provided that the exception also applies to the entity or entities through which the indirect interest is held.

A relevant point to be considered is that if there is a regular hybrid entity in which a Dutch affiliated participant participates, the exception will not apply (as from a Dutch tax perspective the hybrid entity is considered the beneficiary). The withholding tax is therefore payable in full on the IR Payment.

Due to the entry into force of the ATAD2 rules on 1 January 2020 a deduction limitation for IR Payments to hybrid entities may apply. This deductibility restriction does *not* prevent the levy of withholding tax.

2.2.5 Levy of tax, tax base and rate

The term 'interest' should be defined broadly and similar to the definition under the earning stripping rule.[20] In respect of the term 'royalties', the definition in the most recent version of the commentary to the OECD Model Tax Convention is used.

Withholding tax is payable on the gross amount of the IR Payment, taking into account any transfer pricing adjustments pursuant to article 8b CITA. A gross up provision applies (*in Dutch: brutering*) if the withholding agent pays the withholding tax payable by the beneficiary or beneficiaries.

The withholding tax is payable when the IR Payment is considered to be received by the beneficiary (*in Dutch: genietingstijdstip*) being the moment at which the interest or royalty is paid or offset, made available, becomes interest-bearing or has become due and payable. Accrued interest or royalties that have not been paid during the calendar year will be deemed to have been paid on 31 December of that year. If subsequently an actual payment is made, any interest accrued in a previous year can be deducted from the payment to the extent the accrued interest has already been taxed.

The withholding tax is due through payment of the withheld withholding tax by the withholding agent. The withholding agent should withhold the withholding tax payable when the IR Payments are considered to be received by the beneficiary and transfer the withheld tax and file a tax return to the Dutch tax authorities (**DTA**) within one month following the end of the *calendar year* in which the withholding tax has become payable. This deadline is particularly important if the entity has a financial year that is different to the calendar year.

Entities established in the Netherlands, as well as foreign entities with a payment attributable to a Dutch PE, may be considered withholding agents for purposes of the WTA 2021. Similar to the CITA[21] and the DWTA1965[22], the WTA 2021 also contains an incorporation fiction, based on which entities incorporated under Dutch law are deemed to be located in the Netherlands. Accordingly, Dutch entities whose place of effective management has been relocated abroad can also fall in scope of the WTA 2021. In these situations, the levy of withholding is in principle not restricted, unless a tax treaty applies between the Netherlands and the jurisdiction in which the beneficiary is located.

The tax rate is equal to the highest Dutch corporate income tax rate (2021: 25%), but the 'effective' rate may be higher in certain situations (e.g. if a deduction limitation applies at the level of the withholding agent or due to fact that the withholding tax cannot be offset in situations where a payment is attributable to a Dutch PE of an LTJ and the LTJ is subject to the Dutch foreign corporate income tax rules).

2.2.6 Formal aspects

If no, or insufficient, withholding tax is paid, the tax inspector has the option of imposing an additional tax assessment on the withholding agent or the taxpayer. This is aimed at limiting the collection risk for the DTA. If the tax inspector decides to impose the additional assessment on the taxpayer, the tax inspector is not required to argue convincingly that insufficient or no withholding has been paid due to the fact that the taxpayer has provided the withholding agent with incorrect or incomplete information.

In addition, a new disclosure obligation is being introduced for withholding agents. Based on this obligation, a withholding agent is obliged to provide, on its own initiative and within two weeks, accurate and complete information to the DTA, if the withholding agent becomes aware that incorrect or incomplete information has been provided. The two-week period starts at the moment the withholding agent becomes aware that no information was provided, or the information provided was inaccurate or incomplete.

20 Article 15b CITA.

21 Article 2 paragraph 4 CITA.

22 Article 1 paragraph 3 DWTA 1965.

Non-compliance may result in a penalty of up to 100% of the withholding tax payable.

As part of the prohibitive character of the WTA 2021, article 36a of the Collection of State Taxes Act (**CSTA**) *(in Dutch: Invorderingswet*) introduces a new and stricter (collective) directors' liability. Based on this provision, directors of the withholding agent and the taxpayer (and the taxable entity itself) are jointly and severally liable for the underpaid withholding tax. The directors' liability under article 36a CSTA is more burdensome than the 'regular' liability, since the tax inspector is not required to argue convincingly that improper management (*in Dutch: kennelijk onbehoorlijk bestuur*) occurred. An exception applies to the extent the director(s) can argue convincingly that the director(s) cannot be reproached for the underpayment of withholding tax. Based on the parliamentary history of the WTA 2021, this may be demonstrated, for example, if reliable tax advice was obtained in advance based on which no withholding tax should be payable and such advice was based on correct and complete information.[23]

2.3 Practical conclusions and recommendations

As from 1 January 2021, IR Payments by a Dutch entity or PE may be subject to withholding tax. Due to the broad scope of the WTA 2021, withholding tax may also be payable in less clear-cut cases. In practice, the following elements are of particular importance:

- If direct IR Payments are made to entities or PEs in an LTJ, there is no possibility of rebuttal, even if genuine economic activities are being performed in the LTJ.
- Withholding tax is also applicable to IR Payments made by entities incorporated under Dutch law whose place of effective management has been relocated abroad (irrespective of the moment when the relocation was effected).
- Investors with only a marginal interest may also fall within scope of the WTA 2021 if they, together with other investors, qualify as a 'collaborating group'. Since there is no general definition of this term, this will have to be assessed on a case-by-case basis.
- IR Payments to hybrid entities may also be subject to withholding tax without the involvement of an entity in an LTJ. In addition, the involvement of Dutch participants in a 'regular' hybrid entity requires particular attention, as the exception will not apply in those situations.
- Despite the presence of abuse, the levy of withholding tax may in some cases still be (partly) limited by a Dutch tax treaty, provided the MLI has not yet entered into force for withholding taxes with respect to that tax treaty, or the treaty has not been reported by the Netherlands and this treaty does not (yet) contain a PPT.
- The WTA 2021 contains (very) strict formal provisions, including wide-ranging options for the tax inspector to impose additional tax assessments, an extensive disclosure obligation for withholding agents and far-reaching directors' liability. Directors of both the withholding agent and the taxpayer are jointly and severally liable, if insufficient or no withholding tax has been paid. Moreover, this directors' liability exceeds the 'regular' directors' liability, as the tax inspector is not required to argue convincingly that improper management took place.
- The withholding tax payable must be transferred to the DTA within a month following the end of the calendar year in which the IR Payments were made. This deadline is particularly important if the entity has a financial year that is different to the calendar year.

3 Consultation on the bill for the Withholding Tax Act 2024

3.1 Introduction

On 29 May 2020 the State Secretary of Finance announced that as of 1 January 2024 the WTA 2021 will be complemented with a conditional withholding tax on dividend distributions to LTJs.[24]

Contrary to the WTA 2021, a draft legislative proposal for the intended conditional withholding tax on dividend distributions to LTJs was presented for internet consultation on 25 September 2020 (the **Draft Bill)**. The final legislative bill is expected to be presented to the Dutch House of Representatives in the spring of 2021.

3.2 Background

According to the State Secretary, the current dividend withholding tax (**DWT**) requires complementation due to the substantial flow of dividend distributions from the Netherlands to LTJs that are currently not subject to DWT.

23 Parliamentary Papers II, 35 305, no. 3, Explanatory Memorandum, p. 52.

24 Letter from the State Secretary of Finance dated 29 May 2020, no. 2020-0000091888, p.7.

The essence of the Draft Bill remains the same as the WTA 2020 and similar to the WTA 2021, the background of the Draft Bill is clear: the Netherlands no longer wants to be involved in payments to LTJs.

In the paragraphs below we will elaborate on certain relevant items of the Draft Bill and discuss the differences of the Draft Bill compared / in comparison to the conditional withholding tax on dividends as proposed on Dutch Budget Day 2019 (the WTA 2020, see paragraph 2.1), the WTA 2021 and the DWTA 1965.

3.3 Methodology

The Draft Bill will be integrated in the WTA 2021. Accordingly, the legal methodology as regards to taxpayers, affiliation, abuse, hybrid entities, rates and formal aspects as discussed in the previous chapter, will also apply to dividend distributions as of 2024. The State Secretary of Finance indicated that an integration of the WTA 2021 (including the Draft Bill) and the DWTA 1965 will be reviewed in due course.[25]

3.3.1 Withholding agents

The Draft Bill identifies a more limited group of withholding agents compared to the WTA 2021. Mutual insurance corporations, associations, foundations, special-purpose funds and comparable foreign entities (if they are established in the Netherlands, or in case they are present in the form of a PE in the Netherlands) are not subject to the conditional withholding tax on dividends.

However, compared to the DWTA 1965, the Draft Bill contains a broader application with respect to withholding agents. Despite cooperatives and mutual funds having a familiar status as companies with share capital, the Draft Bill does not provide an exception for non-holding cooperatives.[26] The Draft Bill, deliberately, does not assign any value to 'relevant substance' in the Netherlands. As a result, cooperatives with 'genuine activities' established in the Netherlands may also be subject to conditional withholding tax on dividends as of 1 January 2024.

3.3.2 Tax base and rates

With a few exceptions, the Draft Bill adopts the tax base definition of the DWTA 1965.[27] However, contrary to that DWTA 1965, the Draft Bill does not include an exception for purchases for temporary investments and neither for a tax neutral return from a private limited company (*in Dutch: de geruisloze terugkeer uit een bv*), as the withholding tax is only relevant within a group of companies.[28]

Although the legislator initially indicated that not taxing a repayment of capital, partially or otherwise, would not be appropriate given the prohibitive character of the withholding tax,[29] the Draft Bill has nevertheless chosen to treat a repayment of capital in the same way as the DWTA 1965. Consequently, by following the 'formal route' of reducing the nominal share capital, a partial repayment of capital can be made to an LTJ shareholder without being subject to the conditional withholding tax.[30]

In respect of the conditional withholding tax as proposed earlier, it is relevant to note that in the Draft Bill the proposed levy regarding the direct or indirect disposal of Dutch companies has been eliminated from the tax base. This is an important and welcome easing of the measures compared to the previous proposal.

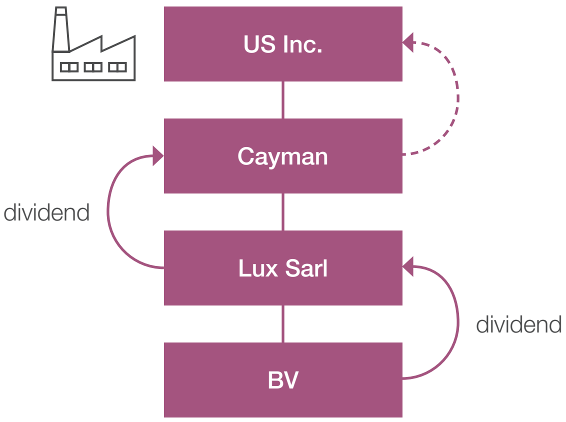
The Draft Bill also contains a specific provision focusing on the determination of the paid-up capital in the event of share exchanges, legal mergers and demergers.[31] Upon request of a taxpayer, the average paid-up capital on shares can be determined by way of a decision issued by the DTA. Such decision may concern both the paid-up capital at a particular moment in time, as well as after a specific event.

25 Parliamentary Papers II, 2019-2020, 35 305, no. 6, p. 35.
26 Article 1.2, paragraph 3 of the Draft Bill.
27 See Article 3 of the DWTA 1965 and Article 3.4a of the Draft Bill.
28 Draft of article-by-article explanation p. 5-6.
29 Parliamentary Papers II, 2018-19, 35 028, no. 2, p.4.
30 Based on the DWTA 1965, a partial repayment of paid up capital on shares – also to the extent pure profit exists – is not considered part of the tax base, if a resolution has been adopted beforehand by the general meeting of shareholders and the nominal value of the issued shares has been reduced by an equivalent amount by amendment of the articles of association. This tax neutral repayment of paid up capital also applies to the Draft Bill on the basis of Article 3.4a, paragraph 2, sub c.
31 Article 3.4b of the Draft Bill; this provision corresponds for the most part to the similar provision in Article 3a of the DWTA 1965.

Similar to the WTA 2021, the highest corporate income tax rate applies to the conditional withholding tax on dividends (2021: 25%).

3.3.3 Abuse

The Draft Bill does not contain a separate anti-abuse provision, but follows the WTA 2021 in this regard.[32] The text of this anti-abuse provision is identical to the anti-abuse provision as included in the current DWTA 1965, yet it is applied differently. The difference can be described using the same structure as included in the example of paragraph 2.2.3 and depicted below.



Based on the 'subjective test' in the DWTA 1965 one 'stops' with the look-through approach at the first shareholder that carries on a business enterprise, in the example: US Inc. If the dividend would be distributed by BV to US Inc. directly, the DWT exemption would have applied. As such, in this example, the subjective test is met and therefore no assumption of abuse is considered present for DWTA 1965 purposes.

According to the explanation of the look-through approach in the WTA 2021 and therefore relevant for the Draft Bill as well, the subjective test is not met in the example depicted above, as a result of which the assumption of abuse would be considered present (see paragraph 2.2.3).

A genuine presence will only be relevant for dividend distributions in case of intermediary entities established in non-LTJs.

3.3.4 Manner and timing of the levy

The Draft Bill provides for a possibility to reduce the conditional withholding tax, if the dividend is also subject to DWT pursuant to the DWTA 1965.[33] The prevention of the potential cumulation of corporation income tax and withholding tax has not been proposed. The impossibility to offset the withholding tax could as such lead to a high effective Dutch tax burden in situations where a technical substantial interest is involved (article 17, paragraph 3, sub b CITA).

To determine the moment when the dividend is paid, it is proposed to follow the moment at which the dividend is made available.[34] This is similar to the definition of the taxation date in the DWTA 1965.[35]

Contrary to the payment of the dividend tax withheld (i.e. payment to the DTA no later than one month after the moment of distribution), the conditional withholding tax withheld must be paid to the DTA within one month following the end of the calendar year in which the dividend becomes available, or is deemed to have been made payable.

3.3.5 Introduction date – transitory law

The proposed date of introduction is 1 January 2024 (i.e. three years after the WTA 2021 enters into force). No provision has been made in terms of transitory law.

3.4 Practical conclusions and recommendations

All direct shareholders established in an LTJ with a qualifying interest in a Dutch taxpayer will be affected by the Draft Bill. This also applies to the entities with genuine activities and also if a treaty country is involved. In case of a direct dividend distribution to an LTJ with which the Netherlands has concluded a tax treaty, it may be possible to limit the amount of withholding tax levied, even if a PPT is included in the tax treaty (this will have to be assessed on a case-by-case basis). In situations where abuse is considered present, application of the tax treaty should generally be restricted pursuant to the PPT.

32 Article 2.1, paragraph 1, sub c of the WTA 2021 and Article 4, paragraph 3, sub c of the DWTA 1965.
33 Article 5.2 of the Draft Bill.
34 Article 3.5, paragraph 4 of the Draft Bill.
35 Article 7, paragraph 3 of the DWTA 1965.

4 Proposal for a Dutch Exit Tax for certain cross-border reorganizations

4.1 Background and context

On 10 July 2020, member of parliament Snels (*GroenLinks*) published the Emergency Act on the Conditional Final Settlement of Dividend Withholding Tax (‘*Spoedwet conditionele eindafrekening dividendbelasting*’). This private member’s bill seeks to introduce a conditional exit taxation (**Exit Tax**) in the DWTA 1965. The aim of the proposed legislation is on the one hand to retain the Netherlands’s right, according to the initiator, to levy tax and on the other hand to tackle supposed dividend tax avoidance. At present the DWTA 1965 contains no provisions for outbound, cross-border reorganisations. Dutch dividend tax is in principle a tax on shareholders, withheld and paid by the withholding company at the moment that profits are made available for distribution. The DWTA 1965 has traditionally not put a claim on undistributed profit reserves of the company.

The private member’s bill can be viewed in the context of announcements on the intention of international companies to move their head offices out of the Netherlands.

After some amendments had been announced earlier on 18 September 2020, on 5 October 2020 an amended bill was sent to the House of Representatives with further amendments. The initiator also published on that date the opinion of the Council of State on the proposal.[36] The Council of State has serious objections to the private member’s bill and advises parliament not to debate the proposal. The Council of State regards it as a radical change to the dividend tax regime, which in its proposed form does not meet the requirements of thoroughness, legal certainty and legal soundness in the context of international and Union law.

4.2 Exit Tax

The Exit Tax is activated when a company established in the Netherlands relocates from the Netherlands to a ‘qualifying state’ by means of a cross-border reorganisation. This includes legal mergers, divisions, share mergers and the transfer of the place of effective management to jurisdictions that do not have withholding tax regimes comparable to the Dutch dividend tax regime, or which upon entry into the jurisdiction grant a ‘step-up’ for existing profit reserves.

From a technical and legal point of view, the company is deemed to have distributed the (deferred) profit reserves, or the ‘clear profit’, immediately prior to the cross-border reorganisation in so far as this is more than € 50 million. The dividend tax on the deemed profit distribution is levied by way of a ‘protective additional tax assessment’ that is imposed on the company, for which a deferment is granted automatically, interest-free and unconditionally. The collection of this protective additional tax assessment is only made at the moment the receiving, acquiring or relocated company actually pays out dividend after the cross-border reorganisation.

The clear profit (*in Dutch: zuivere winst*), a familiar term in the Dutch DWT context, comprises the entire equity of the company including the deferred profits in the assets and liabilities, in so far as this exceeds the capital paid up on the shares. Based on the current system of the DWTA 1965 the origin of the profit reserves (either domestic or foreign source) and the period in which these have been accrued (whether or not during Dutch residency) is irrelevant for the Exit Tax. In connection with the proposed Exit Tax, the private member’s bill proposes extending the Dutch scheme for incoming reorganisations. At present the DWTA 1965 already provides for a step-up scheme for share mergers and divisions in which a Dutch company issues shares.[37] On the basis of the private member’s bill, this scheme would be extended to include cross-border relocations of place of effective management to the Netherlands.

In principle, the private member’s bill is universally applicable in the case of cross-border reorganisations to qualifying states. There is explicitly no exemption on the basis of which business-motivated cross-border reorganisations to qualifying states can be excluded from the scope of the Exit Tax. It is important to note, however, that in many cases the Exit Tax will not have any consequences. The DWT exemption for shareholders established in the EU/EEA or in treaty states as laid down in Article 4 of the DWTA 1965 is in principle applicable in full to the deemed profit distribution. In this way, cross-border reorganisations of regional holding companies to

36 Room documents numbered 35 523

37 Article 3a of the DWTA 1965.

qualifying states will for instance generally not be affected by the Exit Tax, provided that the shareholders are actually entitled to the DWT exemption. The proposal in its current form affects mainly (listed) top holding companies with portfolio shareholders and other shareholders with respect to whom the DWT exemption cannot apply.

Furthermore, the private member's bill also contains an anti-abuse provision that combats the avoidance of the Exit Tax. The initiator notes that it should be invoked in arrangements that aim to avoid the Exit Tax, by first moving to a non-qualifying state (an intermediary step) before moving on to a qualifying state.

4.3 Retroactive effect

The private member's bill currently provides for a formal retroactive effect to noon on 18 September 2020, being the day a review of the proposal was first announced. All cross-border reorganisations to qualifying states made after that date will be affected by the Exit Tax, with no exception being made for reorganisations that were set in motion before that date. The amended proposal was published on 5 October 2020. According to the initiator, the amendments contained therein are not such that the retroactive effect needs to be shortened. Such retroactive effect is however only justified if there are special circumstances concerning the bill (such as foreseeable announcement effects) and the intended amendment is sufficiently known to the relevant taxpayers that are affected by it. In light of these requirements, the Council of State concluded in its opinion that the proposed retroactive effect is not justified in this case and its implementation would be irresponsible.

4.4 Qualifying states

As discussed, the Exit Tax will only be activated by cross-border reorganisations to jurisdictions that do not levy tax on (deferred) profit reserves that have been transferred to that jurisdiction. In other words, the proposed Exit Tax is aimed at cross-border reorganisations whereby the Dutch DWT claim would be lost, without it being replaced by a foreign DWT claim. For the application of the Exit Tax, a state is a qualifying state if:

(a) at the time of the cross-border reorganisation that state does not impose a withholding tax on dividend distributions comparable to the Dutch DWT; or
(b) for the purpose of levying a comparable withholding tax, that state provides for a 'step-up' by allowing that (deferred) profit reserves or the fair market value of the Dutch entity's equity are recognized as paid-up capital in that other state upon the reorganisation.

Another state is considered to have a comparable withholding tax regime if withholding tax is levied on cash dividends by top holding companies and has a generic scope, not limited to distributions to tax haven shareholders. The withholding tax rate is irrelevant, although a zero rate or almost-zero rate cannot be regarded as a comparable withholding tax. No detailed comparison needs to be made with the Dutch system as regards the subject of the withholding tax. It is sufficient, for example, that the foreign withholding tax pertains only to cash profit distributions. In addition, a state is not required to impose a withholding tax on all distributions in which a profit element can be identified, such as share buy-backs and hidden profit distributions, and a state is not required to have its own conditional exit tax.

In view of the context in which the private member's bill has been published, as regards qualifying states, first and foremost the United Kingdom comes to mind as a state that does not levy withholding tax on dividends. It should be noted that the scope of the proposed Exit Tax is not limited to countries outside the European Union or the European Economic Area, so that EU Member States could also qualify within the context of the Exit Tax.

4.5 Collection

As already noted, a 'protective additional tax assessment' will be imposed with the Exit Tax. The DWT liability will then be recovered if and to the extent profits are distributed on the shares issued in the context of the share merger or division, or the existing shares if the company has moved by relocating its place of effective management.

The initiator means to prevent that the DWT in respect of the Exit Tax ends up being a tax on the company. The private member's bill therefore provides for a right of recourse vis-à-vis the shareholders. This right of recourse should offer the company the assurance that it can actually recover the dividend tax from the shareholders at the time of later distributions. The company can then offset the DWT collected against the dividend to be paid out, so that the dividend can be paid out net of DWT. As such, the DWT liability will in fact follow the shares even if transferred to a new shareholder.

4.6 Preventing double taxation

Usually there is the option for portfolio shareholders to credit dividend tax withheld against domestic corporate income tax or income tax due as an advance levy. For shareholders resident in the Netherlands, the bill provides that the DWT liability collected (later) with respect to the Exit Tax can indeed also be against the income tax or corporate income tax due.

For foreign portfolio shareholders, dividend tax withheld on profit distributions is a final levy from a Dutch point of view. Usually, however, on the grounds of a tax treaty concluded with the Netherlands, the dividend tax rate will be reduced, and relief of double taxation is provided by requiring the state of residence of the shareholder to allow a credit or exemption of the income. The assumption of the bill is that the country of the shareholder's residence must allow for a credit if the DWT liability with respect to the Exit Tax is recovered by the company and paid to the DTA.

The proposed implementation of the Exit Tax can however lead to practical complications, and even to double (economic) taxation. It is uncertain how this actual payment – by a company then no longer established in the Netherlands – must be qualified under tax treaties. It is also uncertain whether the payment of the dividend tax liability by the company for treaty purposes can indeed be regarded as a levy of dividend tax. Consequently, at the moment that the dividend tax is recovered by means of setoff against a later distribution of profit reserves, portfolio shareholders could be confronted with the risk that the amount withheld cannot be regarded as a paid withholding tax, and as a result cannot lead to a credit for the domestic (corporate) income taxation abroad.

For legal entities not subject to corporate income tax, such as pension funds and fiscal investment institutions within the meaning of Article 28 CITA, the right to a refund or rebate of DWT has been extended to the DWT liability with respect to the proposed Exit Tax.

4.7 Compatibility with EU law

The original private member's bill limited the scope of the Exit Tax to companies that formed part of a group with a consolidated net turnover of at least € 750 million. Due to the risk of State aid, this exception was later removed by the initiator in the Memorandum of Amendment of 18 September 2020. This, and other amendments made, do not remove entirely any potential conflict with European Union law. In its opinion, the Council of State also referred to a potential conflict with rules of a higher order, such as those in international treaties or Union law.

In principle, the Exit Tax forms an obstruction to the freedom of establishment and the free movement of capital, as the initiator also acknowledged. After all, a merger of a Dutch company with one in the United Kingdom leads to an Exit Tax, while a similar merger to one in France, for example, would not be affected. It is debatable whether this obstruction can be justified by a balanced distribution of taxing rights between the EU Member States, as is argued by the initiator.

In addition, the Exit Tax, on the basis of its design and substantiation, may also fall within the scope of existing European legislation, including the EU Merger Directive[38] and the Anti-Tax Avoidance Directive (ATAD)[39]. In that case, implementation of this Exit Tax must be in accordance with the frameworks laid down therein.

4.8 Practical conclusions and recommendations

The proposed Exit Tax for cross-border reorganisations to qualifying states can have major consequences for intended reorganisations or negotiations in that context, particularly for listed companies. In view of the many objections from academics, and in particular from the Council of State, it is still uncertain whether the private member's bill will actually be adopted by parliament. If the proposal is adopted and implemented, the following points in particular should be considered.

- Since the private member's bill provides for retroactive effect to 18 September 2020, the Exit Tax may play a role in current negotiations or reorganisations. Cross-border share mergers, divisions or relocations of head offices that have already been completed before the stated date no longer fall within the scope of the Exit Tax.

38 Council Directive 2009/133/EC of 19 October on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States.

39 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

- In some cases, uncertainty may arise as to whether a state qualifies within the meaning of the Exit Tax. For example, uncertain is whether a state so qualifies if it grants a step-up only in specific cases, but does not have a generic scheme for this. On the basis of the explanation to the proposal, it is not always possible to rule out whether the state is a qualifying state. Taking account of the purpose of the Exit Tax – namely to prevent companies from leaving the Netherlands without a withholding tax being levied on the accrued (deferred) profits – it is plausible that the question whether a state qualifies must be assessed on a case-by-case basis.
- The private member’s bill does not initially focus on regional head offices of international groups of companies. These companies, however, are not exempted from the application of the Exit Tax and therefore must rely on the DWT exemption to avoid this levy. Whether the DWT exemption can indeed be claimed in these cases will depend on the facts and circumstances.
- The collection of the DWT liability with respect to the Exit Tax will only take place in so far as later profits are distributed after the cross-border reorganisation. In that context, the private member’s bill does offer companies a legal right of recourse to prevent the DWT liability passing to the company. On that basis, the DWT liability can be recovered by withholding it from the later distribution of profit reserves. Since this Dutch statutory right of recourse may lack extraterritorial effect, it is important to assess whether the right of recourse can be legally regulated in the company’s articles of association. One solution suggested by the initiator is the creation of classes of shares, where the right of recourse is linked only to a particular class.
- On the grounds of the private member’s bill, the company must make it known ‘in an appropriate manner’ that the DWT filing in respect of the Exit Tax has been made as a consequence of a cross-border reorganisation to a qualifying state. The initiator has stated in this regard that publication on the company’s website would be an appropriate method to inform shareholders of the Exit Tax filing.

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