PROPOSALS ON COOPERATIVES AND DIVIDEND WITHHOLDING TAX 2018

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The Netherlands proposes legislation to abolish dividend withholding tax in treaty situations and to amend dividend withholding tax position for cooperatives as from 1 January 2018.

On the third Tuesday of September 2017 (traditionally Budget Day in the Netherlands), the Ministry of Finance has proposed changes to the Dutch Dividend Withholding Tax Act and the foreign taxpayer rules in the Corporate Income Tax Act ("CITA"). The draft legislation was already expected, since The Dutch Ministry of Finance published a preliminary tax proposal for consultation on 16 May 2017 with proposed changes to the Dutch Dividend Withholding Tax Act. To further improve the investment climate of the Netherlands, in the same proposal the Dutch government proposes to abolish, under conditions, the current dividend withholding tax obligation on dividends distributed to certain corporate shareholders.

SUMMARY DRAFT LEGISLATION

The changes proposed are the following:
Dividend distributions by a holding cooperative will become subject to dividend withholding tax to the extent it concerns distributions to a qualifying member (5% threshold requirement).

i. Exemption of dividend withholding tax for dividend distributions by Dutch entities (including holding cooperatives) to companies resident in tax treaty countries.
ii. Introduction of an anti-abuse test when applying the new and existing dividend withholding tax exemption. Moreover, additional substance requirements will be included in the anti-abuse test.
iii. Amendment of the scope of the foreign corporate income tax payer rules.

INTRODUCTION: GOVERNMENT'S POLICY

In light of the ongoing international tax developments, the Dutch government has indicated to combat abusive structures that are mainly driven by tax avoidance motives and lack economic substance.

On the other hand, the Dutch government is willing to improve the investment climate for active business structures with sufficient economic substance. The proposed legislation is in line with these intentions.

HOLDING COOPERATIVES BECOME SUBJECT TO DUTCH DIVIDEND WITHHOLDING TAX

Currently, as a general rule, distributions by a cooperative are not subject dividend withholding tax. For that reason, Dutch cooperatives have been frequently used in international structures; they are typically involved with the holding of participations, asset investment and the financing of related entities. Holding cooperatives often have a limited number of members.

Pursuant to the draft legislation, profit distributions made by a cooperative will in principle become subject to dividend withholding tax if:

- the cooperative qualifies as *holding cooperative*; and
- the holding cooperative distributes a dividend to a *qualifying member*.

Repayments of the member contributions to the members of (holding) cooperatives are not subject to dividend withholding tax.

Holding cooperative

A 'holding cooperative' is defined as a cooperative which activities usually consist for more than 70% of holding participations or group financing activities. Whether a cooperative is considered a holding cooperative has to be tested during the year prior to the dividend distribution and at a stand-alone basis.

Various factors are relevant to determine whether the cooperative should be qualified as a holding cooperative (e.g. balance sheet, turnover, activities of the employees, etc.).

According to the legislation a 'top holding' which assets consists for 70% or more of participations should not be considered a holding cooperative in case it actively manages its participations, has employees, an office and carries out headquarter functions (relevant for private equity). It is not yet entirely clear if the cooperative has to employ qualified staff itself or that it may hire external staff.

Qualifying member

The dividend withholding tax obligation only applies to qualifying membership rights in a holding cooperative. This concerns an entitlement to at least 5% of the annual profit (liquidation proceeds or voting rights) of the cooperative. This implies that dividend distributions by a holding cooperative to members owning (alone or together with related persons or a collaborating group) less than 5% in the holding cooperative are not subject to withholding tax.

For distributions to qualifying members in a holding cooperative, the cooperative will be treated as a company with a share capital by equating the membership rights with shares. This in combination with the proposed changes to the withholding exemption (see below) means that private limited liability companies (BV) and public limited companies (NV) on the one hand, and holding cooperatives on the other, would be treated the same for dividend withholding tax purposes.

Grandfathering regime

No grandfathering regime will be introduced for existing cooperatives that are currently exempt from Dutch dividend withholding tax. Current tax rulings will be no longer valid as from 1 January 2018 and new tax rulings will only be granted as from 1 January 2018.

So called top holding cooperatives are granted an additional three months to comply with the two newly introduced substance conditions on wage tax costs and own office space (see 3.2).

EXTENSION OF THE DUTCH DIVIDEND WITHHOLDING TAX EXEMPTION TO TREATY SITUATIONS

For a long time, the Netherlands advocates the exemption of dividend withholding tax on dividends distributed to corporate shareholders owning 5% or more ("participation dividend"). In that light the government considers that it would be appropriate to extend the current withholding exemption for participation dividends under the EU Parent-Subsidiary Directive (i.e. for parent companies within the EU/EEA with an interest of 5% or more) to parent companies established in countries with which the Netherlands has concluded a double tax treaty.

Dividend withholding tax exemption for corporate substantial interest holders

As from 1 January 2018, the dividend withholding tax exemption from Dutch dividend withholding tax applies to distributions, if the shareholder/member:

1. Would be entitled to the Dutch participation exemption or participation credit had it been resident in the Netherlands (in short: a corporate entity with an interest of at least 5% in another entity);
2. Is resident (also based on tax treaties of its jurisdiction of residence with third countries) in the EU, EEA or a jurisdiction with which the Netherlands has concluded a tax treaty that covers dividends. Please note that the treaty does not have to provide for a full exemption. However, treaties without an article on dividends, such as information exchange treaties, do not qualify;
3. Does not have a function similar to a Dutch exempt investment institution or a fiscal investment institution as defined in the Dutch CIT Act;
4. Would not be denied a reduction of dividend withholding tax under the tax treaty between the Netherlands and its country of residence based on an anti-abuse provision in that tax treaty (attention should be paid to the introduction of the Principal Purpose Test ("PPT") in many Dutch tax treaties following the ratification of the Multilateral Instrument ("MLI")); and
5. Does not hold an interest in the distributing entity with the main purpose, or one of the main purposes, to avoid Dutch dividend withholding tax (subjective test), or the arrangement or series of arrangements is not considered to be artificial whereby an arrangement can consist of various steps or components. An arrangement or series of arrangements is considered to be artificial to the extent that it is not put in place for valid business reasons that reflect economic reality (objective test).

Introduction anti-abuse rule for dividend withholding tax exemption

Subjective test

This test is whether the direct holder of the shares/membership in the Dutch entity has been interposed to avoid Dutch dividend withholding tax. It should first be determined whether without interposing the holder of the shares in the Dutch entity, dividend withholding tax would be due on the dividend distribution. The subjective test is applied at the first level of shareholding above the Netherlands with an active business. This would, for example, be the case if the parent company of the shareholder (having an active business) is resident in a jurisdiction with which the Netherlands did not conclude a tax treaty.

If Dutch dividend withholding tax would not have been levied (for example, based on a tax treaty) had the direct holder not been interposed, the anti-abuse provision does not apply if dividend withholding tax would be due if the shareholder had not been interposed, the main purpose or one of the main purposes of holding the interest is deemed to be the avoidance of dividend withholding tax. In that case, it must be established whether there is an artificial arrangement or series of arrangements (the objective test).

Objective test
An arrangement is deemed artificial if it is not based on business reasons that reflect economic reality. Business reasons are reflected in the substance of the direct holder of the shares/membership in the Dutch dividend distributing entity. This is for example the case where the immediate shareholder/member of the entity distributing the dividends carries on an active business itself and the interest in the distributing entity is part of that business. This means that the shareholding/membership is in line with the business activities and is not a passive investment. Even if the shareholder/member does not carry on a business, there may still be business reasons if the intermediary holding has a linking function between the business activities or head office activities of the top holding and the subsidiary and it meets the Dutch substance requirements.

The substance requirements are:

1. at least half of the statutory board members with power to decide are resident in the country where the entity is resident (hereinafter: residence country);
2. the resident board members have sufficient knowledge and the capacity to perform their tasks, which, at least, include making decisions on transactions and managing the completion of transactions;
3. board decisions are actually made in the residence country;
4. the entity has qualified staff to manage and register the transactions. This qualified staff may be hired, for example, from a corporate service provider;
5. the most important bank accounts are held in the residence country;
6. the bookkeeping is actually done in the residence country;
7. as far as the entity is aware, it is not deemed to be a resident in another country;
8. the entity must incur wage costs as a remuneration for the activities regarding the linking function in an amount that would be equivalent to at least EUR 100,000 in the Netherlands. The activities must be performed in the residence country; and
9. the entity must have an office in the residence country for at least 24 months that is suitable and actually used for the activities regarding the linking function and holding activities.

The requirements under 8. and 9. will only apply as of 1 April 2018, whereas the other requirements will apply as of 1 January 2018.

If a dividend distribution is subject to withholding tax, the applicable rate of 15% can, in general, be reduced if a double tax treaty is in place. However, it is important to note that after the Netherlands has ratified the MLI and the PPT becomes part of certain Dutch tax treaties, application of the Dutch anti-abuse provision will probably also mean that the PPT will not be met and that the tax treaty will not prevent the Netherlands from taxing the dividend.

Hybrid entities
The holders of an interest in a hybrid entity which is deemed to be non-transparent from a Dutch tax perspective, but transparent from the perspective of the other jurisdiction, may be deemed to be the shareholder on which the subjective and objective tests should be applied.

The Dutch dividend withholding tax exemption applies in such case if they meet all requirements and if they are deemed to be the beneficial owner of the dividend distribution by their jurisdiction of residence.
Similarly, if the entity is deemed transparent by the Netherlands, but non-transparent by the other jurisdiction, the exemption may be applied on distributions to the entity if it is deemed to be non-transparent in that country and the dividend distribution is regarded as a part of the income or profit of that entity.

Obligation to inform the Dutch tax authorities
Whether there is enough substance must be determined on a case-by-case basis. A Dutch company distributing dividends to shareholders outside the Netherlands and which applies the dividend withholding tax exemption must inform the tax administration within a month after the dividend distribution that all requirements to apply the exemption, including the substance test, have been met. If this information is not provided on time, a fine of at most EUR 5,278 can be imposed.

TO CONCLUDE

We recommend that companies with a tax ruling that deals with their tax position regarding the Dividend Withholding Tax Act and/or the substantial interest provisions in the CITA, to check whether their ruling will be affected by the changes in the Dividend Withholding Tax Act and the CITA. As almost all rulings include a provision that the ruling is no longer valid in case of a change of law, the changes as of 2018 might have a serious impact on these rulings. This must be established on a case-by-case basis.

The extension of the dividend withholding tax exemption is beneficial for non-EU active business enterprises investing in the Netherlands by holding a qualifying participation of at least 5% in a Dutch company since in many cases Dutch dividend withholding tax will no longer be withheld. This is especially beneficial if the tax treaty only provides for a partial reduction of Dutch dividend withholding tax. For example, the exemption from dividend withholding tax will be extended to e.g., the US, Canada, China, India, Japan and Brazil.

Members of a cooperative with an interest of at least 5% who are resident in the Netherlands, the EU, the EEA or a third country with which the Netherlands has concluded a tax treaty, will not be affected by the broadening of the withholding obligations for holding cooperatives as long as they meet the requirements for the dividend withholding tax exemption. This is relevant for members of holding cooperatives that are part of a multinational enterprise or an active investment structure.

Passive investment structures using a cooperative with minimal substance might be negatively affected. This is, for example, the case for distributions to members resident in jurisdictions with which the Netherlands does not have a tax treaty, such as the British Virgin Islands and the Cayman Islands. Also, after the introduction of the PPT in tax treaties to which the Netherlands is a party, some existing structures with EU and EEA countries might be negatively affected. It is, therefore, important to review these and other passive structures both in relation to the domestic legislation and the PPT included in the MLI, and, if necessary, make changes before the inclusion of the PPT in the applicable tax treaty.

AMENDMENT OF THE SCOPE OF THE NON-RESIDENT CORPORATE INCOME TAX RULES

Currently, the non-resident corporate income tax rules for substantial shareholding apply if the substantial interest is held with (one of) the main intention(s) of avoiding Dutch personal income tax or dividend withholding tax.

To avoid overlap with the anti-abuse provisions in the Dividend Withholding Tax Act the reference to the "dividend withholding tax" is taken out from the subjective test.

As from 1 January 2018, the non-resident corporate income tax rules will be limited to substantial interests (i.e. an interest of at least 5%) in a company that is a resident of the Netherlands:

1. which are held with (one of) the main intentions to avoid Dutch personal income tax of another party (<u>subjective test</u>); and
2. the arrangement or series of arrangements is not considered to be artificial whereby an arrangement can consist of various steps or components. An arrangement or series of arrangements is considered to be artificial to the extent that it is not put in place for valid commercial reasons that reflect economic reality (<u>objective test</u>).

Both the subjective and objective test are discussed above under 3.2. If both of the above conditions are met, dividend and capital gains from such a substantial interest are in principle subject to Dutch CIT, however the application of the EU Parent-Subsidiary Directive, the EU Interest-Royalty Directive and/or the relevant tax treaty may yet prevent the Netherlands from levying CIT. Please note that the new Dutch anti-abuse rule is based on the PPT introduced by the OECD in the MLI. Therefore, it is likely that if the Dutch anti-abuse rule applies, the PPT in the treaty may also apply allowing the Netherlands to tax these capital gains.