taxnotes®
international
Volume 88, Number 10 ■ December 4, 2017

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Reprinted from *Tax Notes Int'l*, December 4, 2017, p. 975

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In this article, the authors analyze the proposed changes to the Dutch Dividend Withholding Tax Act and examine how the new rules may affect a range of entities.

On the third Tuesday of September — by tradition, Budget Day in the Netherlands — the Ministry of Finance proposed changes to the Dutch Dividend Withholding Tax Act (effective January 1, 2018). This proposed legislation is in line with a preliminary consultation draft published earlier this year. During the upcoming parliamentary proceedings, further clarification on specific topics is expected.[1]

This article analyzes the proposed changes.

I. Introduction: Dutch Tax Policy

In light of ongoing international tax developments, the Dutch government continues to state the policy goal of combatting abusive structures that are primarily driven by tax avoidance motives and that lack economic substance. Yet the government also wants to improve the investment climate in the Netherlands for active businesses and corporate structures that have sufficient economic substance. The proposed legislation is in line with both policy objectives.

II. Taxing Holding Cooperatives' Dividends

Dutch cooperatives (*coöperatie*) are special legal entities with roots in the 19th-century agricultural sector. The financial sector rediscovered them in the 21st century. Today, cooperatives are typically used for holding subsidiaries, making asset investments, and financing related entities. They often have a limited number of members.

Currently, a Dutch cooperative's distributions are not subject to dividend withholding tax,[2] while dividend distributions by Dutch limited liability companies are. For this reason, Dutch cooperatives are frequently used in international structures. To level the playing field between LLCs (such as a *besloten vennootschap* (BV) or *naamloze vennootschap* (NV)) and cooperatives, the legislation proposes treating holding cooperatives as equivalent to LLCs.

The proposal includes a provision that would make a cooperative's profit distributions subject to dividend withholding tax if:

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

Repayments of member contributions of a (holding) cooperative, however, would not be subject to dividend withholding tax.

[1] On October 10, the four political parties negotiating the coalition agreement for the new Dutch government announced their intention to abolish the Dutch dividend withholding tax (except for in abusive situations and for distributions to low-tax jurisdictions). Although the coalition agreement itself does not state when this proposal will take effect, the underlying documents suggest that the new rules are expected to take effect in 2020. The agreement does not contain the text of the proposed legislation or any additional explanatory remarks. Therefore, the exact scope and impact of the measures remain unclear. We expect that both the changes proposed for January and those proposed for 2020 will remain relevant since, based on the draft legislation, abusive structures will be excluded from both regimes.

[2] Since January 1, 2012, a Dutch cooperative's distributions can be subject to Dutch dividend withholding tax if the structure triggers specific antiabuse rules.

A. Holding Cooperative

A cooperative qualifies as a holding cooperative if, on average, more than 70 percent of its activities consist of holding subsidiaries or group financing activities. This test must be applied on a stand-alone basis for the year before the dividend distribution. Various evidence is used to determine whether the cooperative meets this test (such as the balance sheet, turnover, and employee activities).

An exemption applies to holding companies that actively manage their subsidiaries, have employees and an office, and carry out headquarters functions. This exemption from the definition of a holding cooperative is relevant for private equity.

B. Qualifying Member

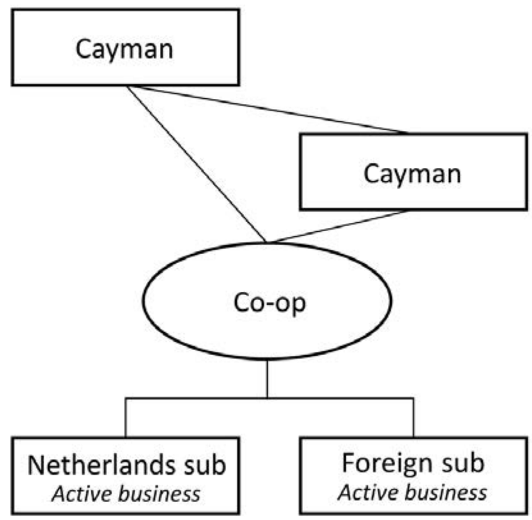
The dividend withholding tax obligation only applies to distributions to parties with qualifying membership rights in a holding cooperative. A qualifying member is a member entitled to at least 5 percent of the cooperative's annual profits, 5 percent of its liquidation proceeds, or 5 percent of the voting rights. Related persons and collaborating groups will have their holdings combined for purposes of this calculation. A holding cooperative's dividend distributions to members owning less than 5 percent will continue not to be subject to withholding tax. (See Figure 1.)

For distributions to qualifying members in a holding cooperative, the cooperative will be treated the same way a company with share capital is treated by equating the membership rights with shares. As a result, LLCs and holding cooperatives will be treated the same for purposes of dividend withholding tax. Therefore, the proposed extension of the withholding exemption (discussed below) is also relevant for holding cooperatives.

C. Grandfathering Regime

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

Figure 1. An Example of a Cooperative Used as a Holding Vehicle in an International Structure That Becomes Subject to the Dutch Dividend Withholding Tax



III. Extending Withholding Tax Exemptions

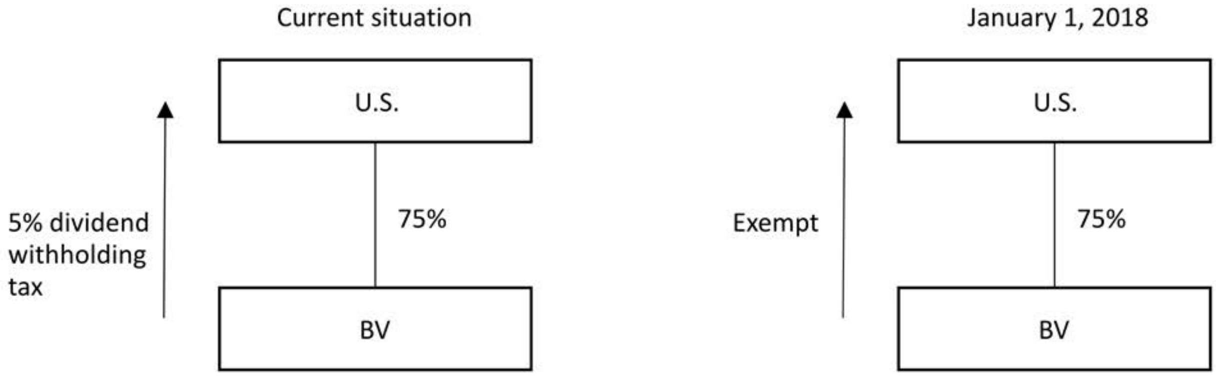
For many years, the Netherlands has exempted from dividend withholding tax dividends distributed to EU corporate shareholders that own 5 percent or more of a corporation (participation dividend). The Dutch government now believes that it is appropriate to extend the existing withholding exemption under the EU parent-subsidiary directive to parent companies established in countries with which the Netherlands has concluded a tax treaty that includes a dividend provision. (See Figure 2.) A general antiabuse rule will also be introduced.

A. General Requirements for Exemption

As of January 1, 2018, the exemption from the Dutch dividend withholding tax will apply to distributions when the shareholder or member:

- Would have been entitled to the Dutch participation exemption or participation credit had it been resident in the Netherlands (such as a corporate entity with an interest of at least 5 percent in another entity).
- Is resident in the EU, European Economic Area, or a jurisdiction with which the

Figure 2. The Effect of the Dutch Dividend Withholding Tax Exemption's Extension



Netherlands has concluded a tax treaty that covers dividends. (Determination of residence includes consideration of tax treaties of its jurisdiction of residence with third countries). The relevant treaty does not have to provide a full exemption, but treaties without an article on dividends, such as information exchange treaties, do not suffice.

- Is not denied a reduction of dividend withholding tax under the tax treaty between the Netherlands and its country of residence based on an antiabuse provision in that tax treaty. Note that the operation of the principal purpose test (PPT), introduced into many Dutch tax treaties following the ratification of the multilateral instrument, requires particular attention.
- Does not hold an interest in the distributing entity, with the main purpose — or one of the main purposes — being avoidance of Dutch dividend withholding tax (subjective test). Likewise, the exemption is denied if the arrangement or series of arrangements is considered artificial (for these purposes, an arrangement can consist of various steps or components). The exemption is also denied when an arrangement or series of arrangements is considered artificial to the extent that it was not put in place for valid business reasons that reflect economic reality (objective test).

B. Antiabuse Rule

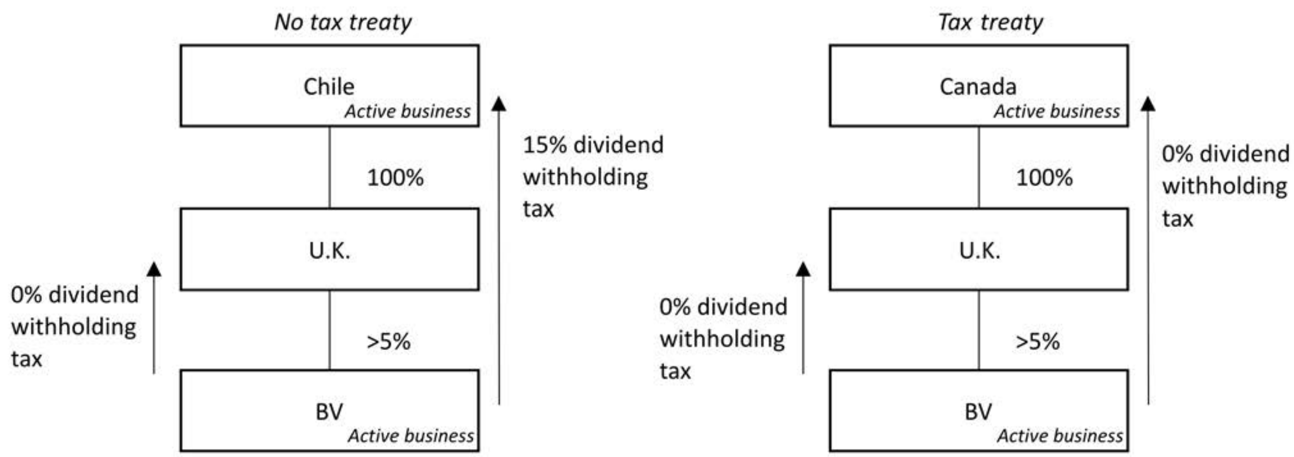
1. Subjective Test

Applying the subjective test requires determining whether the direct shareholder in the Dutch entity is a holding company that has been interposed for the main purpose of (or with one of the main purposes being) avoiding Dutch dividend withholding tax. This subjective criterion is tested objectively: It requires verifying what the dividend tax position would have been if the Dutch entity distributed a dividend directly to the (indirect) shareholder that has an active business. If dividend tax would have been due (for example, if no tax treaty exists), then the main purpose of holding the interest is deemed to be the avoidance of dividend withholding tax. The analysis then proceeds to the second step, which requires establishing whether there is an artificial arrangement or series of arrangements (the objective test, detailed in the following subsection). If no Dutch dividend withholding tax would have been levied had the direct shareholder not been interposed, then the antiabuse provision does not apply and the exemption of dividend withholding tax can apply.

Figure 3 illustrates how the subjective test would apply to two examples involving an active business in Chile and in Canada with an intermediary holding company in the U.K. The question is whether the U.K. intermediary holding company is interposed with the intention of avoiding the Dutch dividend withholding tax.

The Netherlands and Chile have not concluded a double tax treaty nor would a

Figure 3. The Subjective Test



Chilean company benefit from the exemption in EU situations. A dividend from the Netherlands directly to the Chilean parent company would be subject to 15 percent dividend withholding tax. Hence, there is a (deemed) intention to avoid Dutch dividend withholding tax and the subjective test is fulfilled. However, the exemption may still apply depending on the outcome of the objective test.

In the case of a Canadian parent entity, the result of the subjective test is different because the Canada-Netherlands double tax treaty covers dividends. If the Canadian entity owned the shares in the Dutch company directly, the dividend exemption would apply. Thus, there is no intention to avoid Dutch dividend withholding tax, and so the subjective test in the antiabuse rule is not fulfilled and there is no need to apply the objective test. The dividend distribution to the U.K. intermediary holding company is exempt from withholding tax.

2. Objective Test

If the subjective test reveals that the holding company is interposed to avoid Dutch dividend withholding tax, then the objective test must be applied — the dividend tax exemption is only rejected if it concerns an artificial arrangement. An arrangement is deemed artificial if it is not based on business reasons that reflect economic reality. Business reasons are identified by examining the substance of the direct shareholder in the Dutch dividend distributing entity.

Consider a situation in which the Dutch entity's direct shareholder carries on an active business itself and the share interest in the Dutch entity is part of that business. The shareholding in the Dutch entity is in line with the business activities and is not a passive investment.

If the shareholder does not carry on an active business, there may still be business reasons for the arrangement if:

- the intermediary holding company fulfills a linking function between the business activities above and below the intermediary; and
- the intermediary holding company meets the Dutch substance requirements.

The substance requirements for the intermediary are:

1) At least half of the statutory board members with the power to make decisions are resident in the country where the entity is resident (the residence country).

2) The resident board members have sufficient knowledge and capacity to perform their roles. At a minimum, these roles include making decisions about transactions and managing the completion of transactions.

3) Board decisions are made in the residence country.

4) The entity has staff qualified 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) Bookkeeping is done in the residence country.

7) As far as the entity is aware, it is not deemed to be a resident of another country.

8) The entity must incur annual wage costs for this linking function of at least €100,000. These activities must be performed in the residence country.

9) The entity must have had an office in the residence country that is both suitable and actually used for the activities involved in the linking function and holding activities for at least 24 months.

Requirements under 8) and 9) were recently introduced and will only apply as of April 1, 2018. The other requirements will apply starting January 1, 2018. (See Figure 4.)

Figure 4. An Example of an Intermediary Holding Company With Linking Function That Should Meet the Substance Requirements

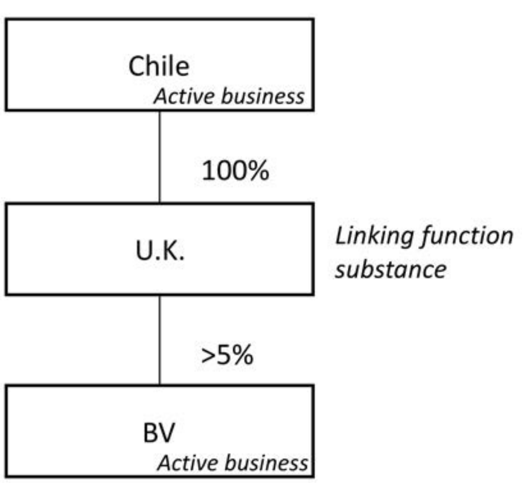
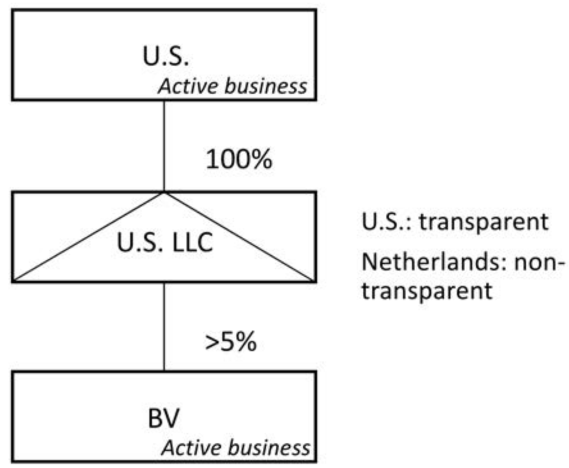


Figure 5. BV Could Apply the Dividend Withholding Tax Exemption Despite the U.S. LLC Not Being Considered as a Tax Resident of the U.S. for Treaty Purposes



C. Hybrid Entities

A hybrid entity — an entity that is nontransparent from a Dutch tax perspective and transparent from the other jurisdiction's perspective — may also benefit from the withholding tax exemption. To qualify, the interest holders in the hybrid entity must meet all the foregoing requirements, including the subjective and objective tests, and must be deemed to be the beneficial owners of the dividend distribution by their jurisdiction of residence.

Figure 5 illustrates the point. In the structure above, BV could apply the dividend withholding tax exemption despite the U.S. LLC not being considered tax resident in the U.S. for treaty purposes.

Similarly, if the entity is deemed transparent by the Netherlands but nontransparent by the other jurisdiction, the exemption may be applied on distributions to the hybrid entity provided that the dividend distribution is included in the tax base of that entity.

D. Obligation to Inform Dutch Tax Authorities

A Dutch company distributing dividends to nonresident shareholders that qualify for the dividend withholding tax exemption must inform the Dutch tax administration within a month after the distribution that all conditions for the exemption, including the substance requirement (if relevant for the case at hand), have been met.

If this information is not provided in a timely manner, a fine of up to €5,278 can be imposed.

IV. Breadth of the Impact of the Changes

A. Existing Tax Rulings on Dividend Withholding

We recommend that Dutch companies that have received tax rulings dealing with their Dutch dividend withholding tax positions check whether the changes to the regime affect their rulings. Because almost all rulings include a provision that the ruling is no longer valid if there is a change of law, the proposals could seriously affect existing rulings. This effect can only be established on a case-by-case basis.

B. Active Business Enterprises Outside the EU

The extension of the dividend withholding tax exemption benefits non-EU active business enterprises investing in or via the Netherlands since, in many cases, Dutch dividend withholding tax will no longer be withheld. This change is particularly beneficial if the tax treaty only provides a partial reduction of Dutch dividend withholding tax (such as the treaties with the United States, Canada, China, India, Japan, and Brazil).

C. Members of a Holding Cooperative

Members of a cooperative holding an interest of at least 5 percent therein and that 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 if 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 may be negatively affected by the proposed rules. This applies, for example, to distributions by a holding cooperative 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.

D. Other Structures Using Dutch Cooperatives

The Dutch cooperative may be an interesting pooling vehicle for investment structures with a large number of investors if no qualifying members (that is, members holding 5 percent or more of the cooperative) participate. These investors benefit from the dividend tax exemption and do not need to apply the antiabuse rule.

Also, the cooperative may be useful for non-holding and financing activities (that is, real estate investments) or mixed activities if the structure does not qualify as a holding cooperative — in other words, if 70 percent or less of the cooperative's activities consist of holding subsidiaries or group financing activities.

However, depending on the type of investors, the foreign taxation rules must be observed.

E. Effect of the MLI

When the PPT (included in the MLI) is introduced into tax treaties to which the Netherlands is a party, some existing structures falling within the antiabuse rule might be negatively affected (it is possible there is no reduction under the tax treaty). It is important to review these structures to consider the effect of domestic legislation.

V. Conclusion

Under the proposed legislation, a holding cooperative's distributions to qualifying members will become subject to Dutch dividend withholding tax. Thus, BVs, NVs, and holding cooperatives will be treated alike for dividend withholding tax purposes. Holding cooperatives, like BVs and NVs, could apply the extended withholding exemption for participation dividends under the EU parent-subsidiary directive (that is, for parent companies within the EU or EEA with an interest of 5 percent or more) to parent companies established in countries with which the Netherlands has concluded a double tax treaty.

Before applying the withholding tax exemption, Dutch companies must verify whether the antiabuse provisions successfully become law. Active business structures with sufficient economic substance headed by a direct or indirect parent company located in a non-EU treaty country will benefit from the proposed changes. Passive investment structures will not be eligible to apply the dividend withholding tax exemption.

If the dividend exemption does not apply because of the antiabuse rule, then the applicable domestic rate of 15 percent could, in principle, be reduced if a double tax treaty provides for a reduction. However, it is important to note that after the Netherlands ratifies the MLI, the PPT becomes part of some Dutch tax treaties. If the Dutch antiabuse provision applies, it may mean that the PPT would not be satisfied and thus no rate reduction would be provided under the double tax treaty.

Overall, the Dutch government is working to improve the investment climate. Active business structures with sufficient economic substance will benefit from the extended withholding exemption for participation dividends from January 1, 2018. ■