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Introduction Withholding Tax Act 2020

On Budget Day 2018, the Dutch government released its much debated proposal to abolish the dividend withholding tax of 15% as of 2020. Instead of the current provisions, a new specific withholding tax will be introduced for abusive situations. Proposal is to the levy, as of 2020, a withholding tax of 23.9% on dividend distributions to corporate entities that have a decisive control over the distributing entity and are residing in a jurisdiction with a statutory CIT rate of less than 7% or in countries on the EU list of non-cooperative jurisdictions.

The Dutch government is convinced that these measures will further strengthen the business climate in the Netherlands and will attract headquarter functions. Beside this, the new provisions should combat tax evasion and tax avoidance schemes, one of the drivers of the current government.
Below we will summarize the new Withholding Tax Act 2020 ("WHTA")

Framework

Under the new WHTA a withholding tax ("WHT") of 23.9% will be levied on distributions by Dutch resident corporate entities to qualifying recipients. In brief this is the case if the shareholder is:

1. a corporate shareholder that;
2. is a related entity (e.g. a group entity); and
3. is residing in a low-tax jurisdiction or in a jurisdiction of the EU blacklist.

The WHT rate of 23.9% is equal to the proposed corporate income tax rate for 2020 and will decrease to 22.25% in 2021.
Under the new provisions, there is no difference in treatment anymore between cooperatives on the one hand and BVs/NVs on the other hand.

Corporate shareholder

The new provisions only apply to corporate shareholders. Dividend distributions to individual shareholders are therefore not

subject to the new WHT.[1]

Related entity

The WHT will only be levied in case of *related entities*. The rationale is that tax avoidance is more likely in case of control. An entity is related if it has a 'qualifying participation' in the distributing entity. A participation is a qualifying if the shareholder can, directly or indirect, control the activities of the distributing entity. This will in any event be the case if the participation in the Dutch entity represents more than 50% of the statutory voting rights.

The recipient will also be related if a third party has a qualifying participation in the distributing entity *and* in the recipient entity. The recipient entity also has a qualifying participation if the recipient entity belongs to a 'cooperating group' that together holds a cooperating participation.

Residing in a low-tax jurisdiction or in jurisdiction of the EU blacklist

The new provisions only apply in case the shareholder resides in (i) a jurisdiction with a statutory CIT rate of less than 7% or (ii) a jurisdiction that is on the EU-list of non-cooperative jurisdictions. Jurisdictions that meet these requirements will be listed in a specific Decree issued by the Ministry of Finance. Jurisdictions with which the Netherlands has concluded a double tax treaty and have a statutory rate of less than 7% will not be considered a low-tax jurisdiction during the first three years after the WHTA has become effective.

Permanent establishments and hybrids

Contrary to the current practice, also distributions that are attributable to a Dutch permanent establishment of a foreign shareholder will be subject to WHT.

[1] Although such distributions could still be subject to personal income tax if the individual shareholder holds 5% or more of the shares or a class of shares in the distributing entity.

Depending on the circumstances, a typical 'CV-Cooperative' structures may no longer work as of 2020.

Further, distributions to a qualifying shareholder not residing in a low-tax jurisdiction which are attributable to a permanent establishment in a low-tax jurisdiction will be subject to the WHT.
Also distributions to hybrid entities could be in scope of the new provisions if the hybrid is located in a low-tax jurisdiction or not in any jurisdiction at all.

Anti-abuse rule

To avoid the artificial interposition of an intermediary holding company in a regular taxed jurisdiction, certain anti-abuse rules will be introduced.

Under the anti-abuse rule, WHT will still be levied if:

- The recipient entity holds the participation with the main purposes or one of the main purposes to avoid taxation for someone else (*subjective test*); and
- It concerns a wholly artificial arrangement or transaction or series of arrangements (*objective test*), whereby:
    1. an arrangement or transaction can consist of multiple arrangements;
    2. an arrangement, transaction or series thereof will be considered artificial if it is not based on valid business reasons that reflect economic reality.

<u>Subjective test</u>

To assess whether one of the main purposes is to avoid WHT, a comparison needs to be made

between the WHT due in a structure with an intermediary holding company and the scenario whereby the participants would hold their interest in the Dutch entity directly ('look through approach'). The intermediary holding company should be considered artificial if it does not pass the objective test. In the event the WHT in the look through approach is higher, an avoidance motive will be deemed to be present. In case there is no *related entity* in the structure that is residing in *a low-tax jurisdiction* there will not be an avoidance motive and the anti-abuse rule does not apply.

In case there are more intermediary holding companies in the ownership structure, one should look through each 'wholly artificial shareholder' that is not residing in a low-tax jurisdiction.

Counter evidence – EU Holding

With reference to the judgement of the EU Court of Justice in the Deister Holding case, the provisions include the possibility of counter evidence. The WHT should not apply if one of the intermediary holding companies (residing in a low-tax jurisdiction) can demonstrate that the structure has other valid business reasons that reflect economic reality. This counter evidence is, however, only possible in case the intermediary holding company is residing in the EU/EER.

The presence of valid business reasons can be demonstrated with business activities conducted by intermediary holding company. The activities should be 'real' and 'relevant'. The mere holding of shares and exercising shareholder rights is not sufficient. Also mere supportive and administrative activities do not qualify.

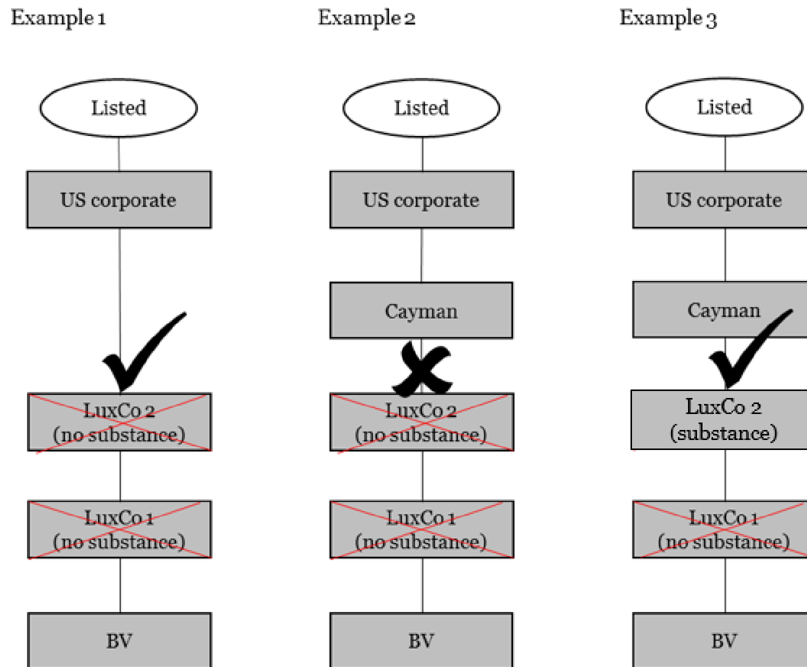
<u>Objective test</u>

The objective test should be assessed based on the relevant substance of the shareholder. Relevant substance will be present if the following criteria are met (cumulative):

a) At least half of the statutory board members of the company are resident in the jurisdiction where the intermediary holding is residing.
b) The board members residing in the country of residence have the required professional qualifications to adequately fulfil their tasks, which at least include taking decisions – on the basis of the company's own responsibility and within the scope of normal group management – on the transactions (to be) entered into by the company, and executing those transactions.
c) The company has qualified personnel for the adequate execution and registration of the transactions (to be) entered into by the company.
d) The management decisions are taken in the jurisdiction where the intermediary holding is residing.
e) The company's main bank accounts is kept in the jurisdiction where the intermediary holding is residing.
f) The company's bookkeeping is done in the jurisdiction where the intermediary holding is residing.
g) The company has to incur the Dutch equivalent of at least EUR 100,000 in *relevant* salary expenses annually in relation to its intermediary holding activities.
h) The company must have and use its own office space, which is appropriate for its activities, for at least 24 months.

<u>Examples</u>

Below are some examples on how the objective test and subjective test would work out.



In Example 1 there is no avoidance motive. Reason for this is that if one would ignore both LuxCo 1 and LuxCo 2, dividend distributions by BV directly to US corporate would not be subject to Dutch dividend withholding tax.

In Example 2 LuxCo 1 and LuxCo 2 are ignored and the look through stops at the level of Cayman. There is an avoidance motive as dividend distributions by BV directly to Cayman would be subject to Dutch dividend withholding tax. So unless the counter evidence applies, the distribution would be subject to WHT.

In Example 3 the look through stops at LuxCo 2 and there is no avoidance motive in the structure since dividend distributions by BV directly to LuxCo 2 would not be subject to Dutch dividend withholding tax.

Taxable transactions

The taxable transactions in the WHTA are comparable to those under the current Dividend Withholding Tax Act 1965. Therefore (deemed) dividend distributions, the repurchase of own shares, liquidation distributions and interest on profit participating loans remain taxable transactions.[2]

A couple of *new* transactions are added to the taxable base:

- Repayment of nominal share capital is subject to WHT to the extent there are profit reserves;
- Capital gains on the disposal of shares in the Dutch entity, provided that the amount is related to the profit reserves of that entity (including anticipated profits and hidden reserves). The same applies in case of an *indirect* disposal of the shares in the Dutch entity (sale at a higher tier).

Particularly interesting is that the proceeds from a direct or indirect sale of the shares in a Dutch entity also fall within the scope of the WHTA. Currently, the Netherlands does not levy any withholding tax on these type of transactions.

[2] A repurchase of shares or a liquidation distributions is only subject to WHT to the extent that the distribution exceeds the paid up capital.

Interest and royalties

Besides the introduction of the conditional withholding tax on dividends, the Dutch government also proposed to apply this WHT on interest and royalty payments as of 2021.

Concluding

Although this new WHTA is somehow similar to the current Dividend Withholding Tax Act 1965, this is in fact a new tax at source which may apply to intragroup dividends to corporate shareholders in low-tax jurisdictions. It is highly advisable to analyse the impact of the WHTA on your ownership structure and/or on contemplated transactions.